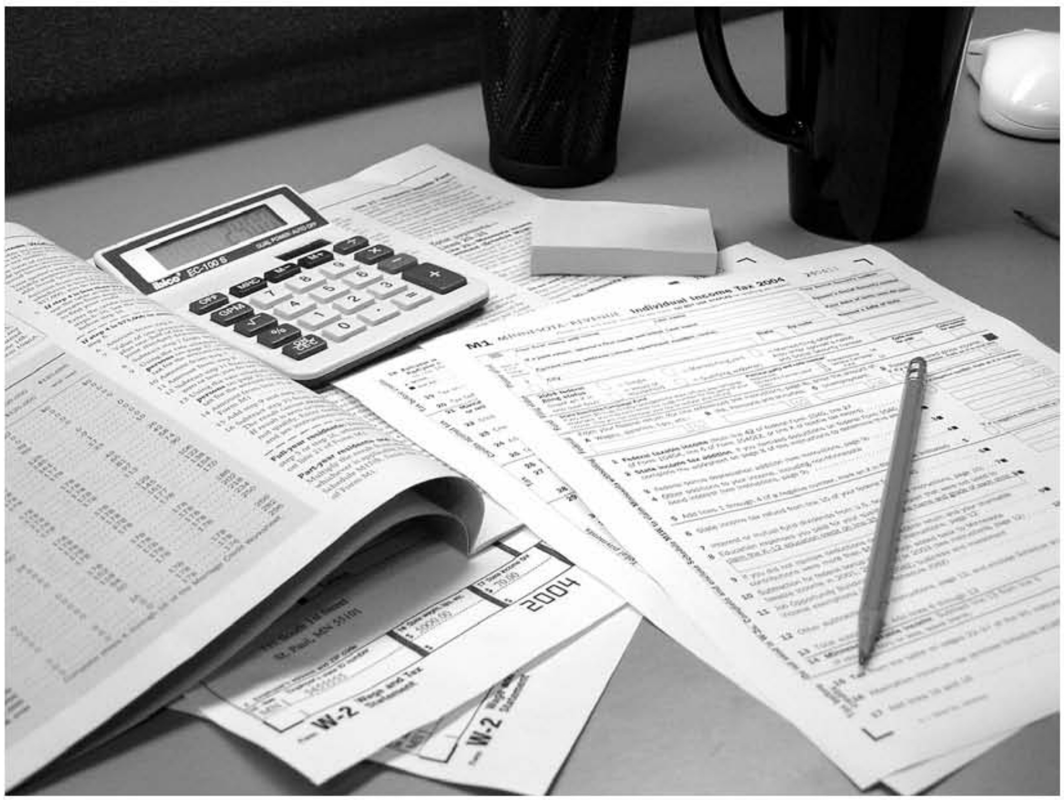
OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

EVALUATION REPORT

Tax Compliance



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OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

March 2006

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Minnesota's tax system depends on voluntary compliance. Nevertheless, the Department of Revenue has an important role in facilitating compliance and ensuring that citizens and businesses pay the correct amount of tax. In April 2005, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate how well the department is performing these responsibilities.

We found significant compliance problems with the state's two largest taxes—the individual income tax and the sales and use tax. While the department is using appropriate taxpayer assistance and enforcement strategies, we found numerous ways the department could make better use of its resources to detect errors and collect taxes due.

This report was researched and written by Deborah Parker Junod (project manager) and Dan Jacobson. The Department of Revenue cooperated fully with our evaluation.

Sincerely,

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Minnesota has significant tax compliance problems, and the state needs to strengthen its ability to detect and deter noncompliance.

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- In addressing the income tax gap, the Minnesota Department of Revenue has made significant progress targeting nonfilers but not underreported self-employment income (pp. 18-27).

- The department is not effectively using some important information that would help identify noncompliance (pp. 21-24, 53-54).

- On average, income and sales and use tax audits yielded $5 to $7 per dollar spent in fiscal year 2005, not counting revenue gains that may occur later because of better voluntary compliance (pp. 24, 54).

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- The Department of Revenue should improve its tools for identifying noncompliant taxpayers. To help, the Legislature should require employers to file wage reports in a common electronic format (pp. 41-42).

- The department should (1) make better use of performance data to evaluate audit projects and (2) modify or reduce resources in those that are unproductive (pp. 43, 66).

- The department should simplify the steps involved in pursuing debt collection cases and put more emphasis on collecting high-dollar debts (p. 83).

- The department should improve the quality of assistance provided to taxpayers who call or write with tax compliance questions (pp. 44-45, 68-69).

The Department of Revenue has had limited success targeting individuals who underreport their income and businesses that underreport their use tax liabilities.

Report Summary

The Minnesota Department of Revenue administers the state's system of income, sales, and other taxes. The individual income tax and the sales and use tax accounted for about 72 percent of state tax revenues (after refunds) in fiscal year 2005. The use tax is like the state sales tax, but it generally applies to purchases made from out-of-state businesses.

The department uses several strategies to boost tax compliance. This evaluation focused on the individual income tax and the sales and use tax, particularly the department's efforts to (1) help taxpayers comply voluntarily through assistance and education and (2) use audits to detect and correct errors in reported tax liability. We also evaluated efforts to collect tax liabilities that are assessed but not paid on time.

Taxpayers Are Underreporting Their Tax Liabilities By An Estimated $1 Billion Annually

A "tax gap" is the difference between the amount of taxes owed and the amount taxpayers voluntarily report on their tax returns. The Department of Revenue estimated that, annually, the income tax gap is about $604 million (based on 1999 returns) and the sales and use tax gap is about $451 million (based on 2000 returns). For each tax, the tax gap is roughly 10 percent of the taxes owed.

The Department Has Had Mixed Success Targeting Major Contributors To The Tax Gap

For the income tax, the primary contributors to the tax gap are (1) self-employed individuals who underreport their income and (2) taxpayers who do not file at all (nonfilers). The department has made limited progress in addressing underreported self-employment income—largely because of staff turnover among field auditors needed to do the complex audits required to detect it. However, the department has significantly increased its auditing of nonfilers.

Much of the sales and use tax gap is from unreported use tax, primarily by businesses that purchase taxable goods from out-of-state vendors. The department has targeted its audits at industries with high sales and use tax noncompliance, but has not made much progress in reducing the use tax gap overall. It audits a relatively small proportion of businesses, and it does little to enforce individual filers' compliance with the use tax because it does not consider it cost effective. A multi-state initiative to collect tax on Internet purchases holds promise for addressing use tax noncompliance, but its impact remains uncertain.

The Department Lacks Some Tools That Would Help Identify Noncompliant Taxpayers

The department effectively uses a variety of tools to identify noncompliant taxpayers. However, it is not using some information that would help identify other types of noncompliance.

For the income tax, the department does not adequately match state tax returns with the W-2 Wage and Tax Statements that employers file. It does not participate in the Internal Revenue Service's "Fed-State" tax return processing program, which would allow it to more effectively identify certain types of noncompliance. The department has a backlog of federal field audit reports that can be used to determine whether taxpayers owe additional state taxes, though recent changes will enable the department to reduce this backlog. Until January 2006, the department's income tax data systems lacked drivers' license, motor vehicle registration, and hunting and fishing license data that would particularly help identify unreported self-employment income.

Increased audit activity has been productive, but the department could further increase revenues by modifying some types of audits.

The department has fewer sources of information available to it that would help identify sales and use tax noncompliance. But some data are available, such as sales figures reported on federal tax returns, and these need to be integrated into the department's data systems.

Overall, Audit Productivity Has Improved, But Some Types Of Audits Find Little Noncompliance

Audit productivity—the revenue collected per dollar spent on audits and collection—has improved in recent years. For audits completed in fiscal year 2005, we estimate that the department will collect, on average, about $6.70 per dollar invested in income tax audits and $5.40 per dollar invested in sales and use tax audits.

The department generally groups audits into projects aimed at specific groups of taxpayers or compliance issues. Although overall productivity has improved, these averages mask variation in results among projects. For example, two large sales and use tax audit projects have been less than one-third as productive as the average for each of the past three years. Similarly, some income tax field audit projects have found little noncompliance.

In part, unproductive audit projects persist because the department has only recently begun to use audit performance data to assess and improve them. The department has focused on restructuring and increasing the number of audits it does. Now it needs to do more to fine tune its audit programs.

Collection of overdue tax payments has been increasing, but poor data and inefficient processes impede efforts to more effectively pursue delinquent taxpayers.

Collection Of Past Due Taxes Has Been Increasing, But Over $450 Million Is Still Owed To The State

If taxpayers report a balance due on their tax returns or are assessed additional tax after an audit, they must pay by certain deadlines. If timely payment is not made, the taxpayers' accounts become delinquent and are referred to the department's Collection Division. At the end of fiscal year 2005, these tax debts totaled over $450 million. About 63 percent of debts were for individual income tax liabilities.

The department received additional funding to increase debt collection, and as intended, collections increased from about $164 million in fiscal year 2002 to $191 million in fiscal year 2005. Still, the pace of debt collection has not met the department's goal to collect most debts within a year of becoming delinquent. As of late 2005, 60 percent of debts had been delinquent for more than a year.

Some Collection Practices Are Inefficient, And Collection Resources Could Be Used More Strategically

Cumbersome case routing and inconsistent collection procedures have contributed to inefficient debt collection. Collection work is divided among work groups that each function independently. Combined with a lack of standardized collection procedures, this led to inconsistent treatment of debtors. Also, collection cases are handed off numerous times, adding to case processing time. The department has recently acted to improve its performance management system, standardize application of collection procedures across work groups, and identify problems in case routing. However, these changes have not been in place long enough to assess their impact.

The department needs to improve access to taxpayer assistance, particularly for taxpayers with limited English proficiency.

The department does not do enough to test the accuracy of the assistance it provides by telephone and e-mail.

The collection process also lacks strategic focus. Less than 10 percent of cases account for over 70 percent of total tax debt, yet the department does not allocate a greater share of resources to these cases. Moving forward, the division needs to invest in developing and analyzing better data on debts, debtors, and collection results in order to make greater gains in efficiency and effectiveness.

The Department Relies Heavily On Its Website For Taxpayer Education

Education services are intended to help taxpayers understand and voluntarily meet their tax obligations, reducing state and taxpayer compliance burdens. In recent years, the Department has emphasized self-service through the department website, although it still provides direct services, such as taxpayer training, support for volunteer return-preparation programs that help low-income filers, and direct outreach to certain groups of taxpayers.

However, education efforts targeted at taxpayers with limited English proficiency could be improved. The department has translated some documents into other languages, but its telephone assistance is not well structured for bilingual service.

Taxpayers Who Call With Questions Often Do Not Receive Prompt Assistance

Answering taxpayers' questions is another strategy to improve tax compliance. But in 2005, many callers had a hard time getting through to assistance representatives, particularly around return filing deadlines.

From February through April 2005, department staff were able to answer 64 to 70 percent of income tax assistance calls. One problem is that many taxpayers are not using automated options for learning the status of their refunds. These callers are a drain on telephone assistance resources, limiting the department's ability to assist callers with more complex questions. Access to help with sales and use tax questions is even more difficult. Around the annual sales tax filing deadline in January and February 2005, representatives answered only about half of incoming calls.

The department needs to seek staffing, call routing, and automated solutions to improve the level of service provided.

The Department Does Not Adequately Ensure That Taxpayers Get Correct Answers To Their Questions

Some calls to the income tax assistance line are recorded and later evaluated for accuracy and adherence to department procedures. For fiscal year 2005, the department evaluated about 300 calls and noted a problem in about 30 percent of them. Among the most common problems were failure to verify the caller's identity and inaccurate answers. But not all calls were thoroughly evaluated, and only about one-fifth of the monitored calls involved technical tax questions, for which incorrect answers pose the highest risk to the taxpayer.

The department does not have a systematic quality assessment process in place for sales and use tax assistance calls and needs to establish one. The department also should do more to test the accuracy of staff responses to e-mail inquiries.

Introduction

Two types of taxes account for most of Minnesota's state tax revenue. For example, in fiscal year 2005, the department collected \$15.5 billion in state revenue; about 41 percent from the individual income tax (\$6.4 billion) and about 31 percent from the sales and use tax (\$4.8 billion). However, according to Minnesota Department of Revenue studies of 1999 and 2000 tax returns, taxpayers annually owed, but did not report, an additional \$600 million in individual income tax and \$450 million in sales and use tax. This difference between taxes owed and tax liabilities reported is referred to as a "tax gap." In addition to revenue lost to the tax gap, many taxpayers who report the correct tax liability or are assessed additional taxes after an audit do not make their payments on time. At the close of fiscal year 2005, these late tax payments totaled yet another \$460 million.

In addition to processing millions of tax returns every year, the Department of Revenue is responsible for promoting compliance with state tax laws, closing the tax gap, and collecting late payments. The department uses many strategies to do so, including educating taxpayers so that they understand and voluntarily meet their tax obligations, auditing tax returns that potentially underreport taxes owed, and arranging payment plans so that taxpayers can eliminate their debts.

In April 2005, the Legislative Audit Commission directed the Office of the Legislative Auditor to evaluate the Department of Revenue's tax compliance programs. In this report, we address the following questions:

- **Does the Department of Revenue have an effective program to identify and audit taxpayers who may have underpaid their taxes?**

- **Does the Department of Revenue have effective education and assistance services to help taxpayers understand and meet their tax obligations?**

- **How successful is the Department of Revenue in collecting delinquent tax payments?**

For the first two questions on taxpayer assistance and auditing, we focused our work on the two taxes that account for most state tax revenue: the individual income tax and the sales and use tax. Regarding collection of delinquent payments, our work focused on the department's Collection Division. To answer these questions, we reviewed state laws, legislative reports, and Department of Revenue publications that describe the state tax system and compliance programs. In addition, we interviewed Department of Revenue staff, including the department's Taxpayer Rights Advocate, and analyzed available data on taxpayer assistance programs, audit selection and results, and debt collection.

To evaluate programs to identify and audit income tax and sales and use tax returns, we interviewed department staff about compliance plans, audit selection procedures, and audit results. We also examined tax gap studies and analyzed summary data on audit results and audit program expenditures. To assess the relative productivity of various types of audits, we also analyzed available case-level data for both income tax audits and sales and use tax audits.

To evaluate taxpayer assistance efforts, we interviewed taxpayer assistance staff and officials at a nonprofit organization that partners with the department in providing free income tax preparation assistance. In addition, we obtained and analyzed available department data on the purpose, nature, and results of taxpayer education programs. Also, to assess how promptly and accurately the department responds to taxpayers' inquiries, we analyzed department data on the number of inquiries received and responded to. We also evaluated department procedures to assess the quality of assistance provided.

To evaluate the department's ability to collect tax debts, we interviewed Collection Division employees about collection policies and procedures and reviewed the Collection Division manual. In addition, we obtained and analyzed division data on tax debts, collection actions, and amounts collected.

Because the evaluation was already broad in scope, we were not able to include several important aspects of tax compliance efforts. For example, we did not assess the department's criminal investigation function, analyze data on use of penalties, or assess the extent and results of taxpayer appeals. We did not evaluate tax processing, nor did we independently asses the quality of income or sales tax audits. In addition, we did not systematically assess how tax laws could be revised to improve taxpayers' ability to comply or the department's ability to enforce them.

The report is divided into four chapters. In Chapter 1, we provide an overview of Minnesota's income tax and sales and use tax, tax gap estimates, and Department of Revenue strategies to ensure tax compliance. In Chapter 2, we discuss income tax compliance, including how the department identifies and selects returns for audit, audit productivity, and efforts to help taxpayers comply voluntarily through education and assistance. In Chapter 3, we evaluate similar tax compliance programs relative to the sales and use tax. Chapter 4 describes the amount and nature of tax debts owed to the state and the effectiveness of department procedures for collecting these debts. By law, certain aspects of tax auditing and collection—particularly audit selection criteria—are protected, nonpublic data.[1] As a result, we do not report some of our evaluation results in detail.

[1] *Minnesota Statutes* 2004, 270B.01.

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Background

SUMMARY

The Minnesota Department of Revenue administers the state's system of income, sales, and other taxes. The individual income tax and sales and use tax are the state's biggest sources of revenue, generating about 72 percent of the $15.5 billion in taxes collected in fiscal year 2005. But, not all taxpayers pay the correct amount of tax. The department estimates that taxpayers have annually underpaid income taxes by about $600 million and sales and use taxes by another $450 million. The department uses a variety of techniques to improve tax compliance. These include (1) education and assistance to help taxpayers understand their obligations before they file their returns and (2) enforcement techniques to detect noncompliance, audit tax returns, and collect the correct amount of tax due.

The Minnesota Department of Revenue administers the state's system of income, sales, and other taxes.

State budget shortfalls over the past several years have raised many questions about Minnesota's spending priorities and tax policy. Budget shortfalls also heightened interest in ensuring that taxpayers pay the taxes they owe under current law. In addition to processing millions of tax returns every year, the Minnesota Department of Revenue is responsible for promoting compliance with state tax laws and making sure that taxpayers meet their obligations. Tax compliance has many elements aimed at helping taxpayers voluntarily pay the right amount of tax and pursuing taxpayers who intentionally underpay the taxes they owe.

The purpose of our evaluation was to assess how well the Department of Revenue helps ensure that individuals and businesses pay the correct amount of Minnesota tax. As background, this chapter addresses the following questions:

- **How is Minnesota's state tax system structured?**
- **To what extent are individuals and businesses paying the correct amount of tax?**
- **What is the Department of Revenue's general approach to ensuring tax compliance?**

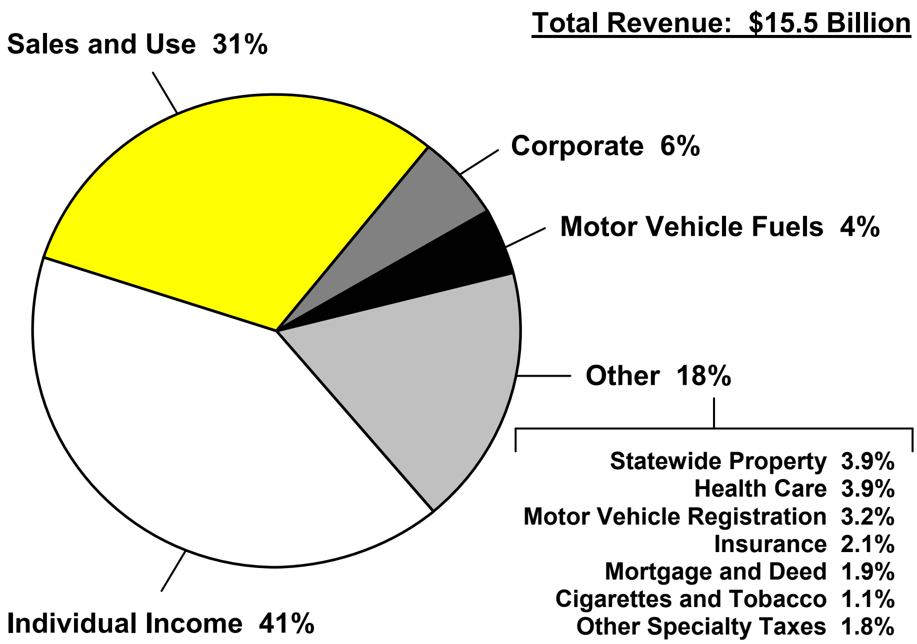
To answer these questions, we reviewed state laws, legislative reports, and Department of Revenue publications that describe the state tax system and compliance programs. In addition, we analyzed available data on the number of returns filed and revenues collected, and we interviewed Department of Revenue officials regarding the agency's approach to tax compliance.

MINNESOTA STATE TAXES

The Minnesota Department of Revenue administers Minnesota's system of income, sales, and other taxes.[1] As shown in Figure 1.1, the individual income tax and sales and use tax accounted for about 72 percent of state tax revenues in fiscal year 2005 (after refunds). The next largest revenue source is the corporate franchise tax, which accounted for about 6 percent of revenues in fiscal year 2005. Our evaluation focused on compliance with the individual income tax and sales and use tax because they account for the majority of state tax revenue.

The individual income tax and sales and use tax are Minnesota's largest sources of tax revenue.

Figure 1.1: Revenue by Tax Type, Fiscal Year 2005



NOTES: Percentages are based on tax revenue after refunds. The Sales and Use category includes the Motor Vehicle Sales Tax. "Other Specialty Taxes" includes, among others, taxes on estates, gambling, waste, and alcoholic beverages.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue data.

Individual Income Tax

Minnesota's income tax is linked to the federal income tax.

Minnesota's income tax is linked to the federal income tax. Calculation of Minnesota income tax liability starts with taxable income as reported on the federal tax return. Minnesota taxpayers then calculate various additions and subtractions to income to determine state taxable income. The taxpayer's tax

[1] For a more detailed discussion of Minnesota state taxes, see Nina Manzi, Joel Michael, Pat Dalton, and Paul Wilson, *Overview of Income, Corporate Franchise, Sales, and Other State Taxes* (St. Paul: Minnesota House of Representatives Research Department, 2005); http://www.house.leg.state.mn.us/hrd/issinfo/incpresent0105.pdf; accessed May 5, 2005.

liability depends on the tax bracket and eligibility for state tax credits.[2] Minnesota's individual income tax return is called the "M1." The state also has a series of related returns, such as the "M1NR" for part-year residents or nonresidents and the "M1PR" for homeowners and renters claiming a property tax refund.[3]

Nearly two-thirds of income tax returns are filed electronically.

As with the federal income tax, the filing deadline for Minnesota's income tax is April 15.[4] To achieve improved efficiency and accuracy, the Department of Revenue encourages taxpayers to file their returns electronically. As shown in Table 1.1, although the number of income tax returns filed has stayed relatively stable, the percentage of taxpayers filing electronically has been increasing. About 63 percent of income tax returns were filed electronically in 2005 compared to 26 percent in 2000. Beginning in the 1998 filing season, some taxpayers with simple returns could file using touch-tone telephones (an electronic filing method called "telefile"); however, Minnesota discontinued this option in 2005.

Table 1.1: Individual Income Tax Returns Filed, 2000-05

	2000	2001	2002	2003	2004	2005[a]
Paper	1,768,766	1,558,585	1,362,410	1,179,207	927,334	907,322
Electronic	627,545	882,745	1,052,629	1,236,990	1,488,229	1,523,301
Total	2,396,311	2,441,330	2,415,039	2,416,197	2,415,563	2,430,623
Percentage Filed Electronically	26.2%	36.2%	43.6%	51.2%	61.6%	62.7%

NOTE: Data are for calendar years. Returns filed during one calendar year report income from the prior year. For example, returns filed in 2005 are for income earned in 2004.

[a] Data are as of December 3, 2005.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue data.

At least half of all individual income tax returns are prepared for a fee by someone other than the taxpayer. In 2005, about 57 percent of returns were filed with a paid preparer's signature. According to department officials, however, this percentage likely understates the prevalence of commercially prepared returns because not all paid preparers identify themselves as required on the returns they complete. While the taxpayers themselves are liable for the accuracy of their returns, the Department of Revenue has a strong interest in the

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[2] Minnesota has three income brackets with a different rate for each. State tax credits include the Minnesota Working Family Credit and the K-12 Education Credit. For more detail, see: Nina Manzi, *Minnesota's Individual Income Tax* (St. Paul: Minnesota House of Representatives Research Department, 2004).

[3] Eligibility for a property tax refund is based on household income and the property tax paid on the taxpayer's principal place of residence. Property tax refund returns are due by August 15 each year but can be filed for up to a year after the due date.

[4] The Department of Revenue will automatically extend the income tax filing deadline to October 15. If April 15th falls on a weekend, the filing deadline is the following Monday. In 2006, the filing deadline is April 17.

quality of tax preparation services in the state. Paid preparers range from licensed professionals, such as certified public accountants, attorneys, and enrolled agents (who are certified to represent their clients before the Internal Revenue Service) to those with little or no training.

Most income tax revenue is collected through employer withholding.

Most state income tax revenue is collected through employer withholding. For most employees, businesses are required to withhold various federal taxes and state income tax from their wages. Employers must remit state income tax withheld to the Department of Revenue either quarterly or annually. Also, at the end of each calendar year, employers are required to prepare a federal Form W-2 Wage and Tax Statement for every employee paid wages. In addition to federal tax information, this form includes the amount of wages earned in Minnesota and the amount of state income tax withheld. Employers are required to give W-2s to their employees by January 31 of the following year and to the state and federal governments by February 28. In fiscal year 2005, about $5.2 billion (82 percent) of the $6.4 billion in state income tax paid was collected through employer withholding.

Sales and Use Tax

Minnesota has a 6.5 percent general sales tax that applies to most retail sales and some services.[5] Distinguishing taxable sales from those that are exempt is complicated, and the Department of Revenue has issued many publications delineating the goods and services that are taxable.[6] But in general, the sales tax applies to most tangible goods purchased for personal use unless specifically exempted. Sales tax generally does not apply to services except when specifically included by statute. Taxable sales include such things as building materials, cable TV service, over-the-counter medication, admission fees, computers, and motor vehicles. Taxable services include such things as laundry and cleaning services, pet grooming, and parking services. Some goods and services are taxable at special rates, including liquor, car rentals, and certain waste management services. Overall, about 40 percent of sales taxes are paid by businesses.[7]

The sales and use tax applies to most tangible goods and some services.

Sales tax exemptions may be different for individuals and businesses. Most food and clothing are exempt purchases for individuals. Businesses do not have to pay sales tax on goods used directly in the production of taxable goods and services, nor must they pay sales tax on capital equipment used in manufacturing, farming, or mining. In the case of capital equipment purchases, however, businesses must pay tax at the time of purchase, then claim a sales tax refund from the Department of Revenue.

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[5] Some local governments impose a local sales tax, which would increase the total sales tax rate within certain communities. For some localities, businesses remit local sales tax collected to the Department of Revenue along with state sales tax. The department then forwards the local tax revenue to the appropriate local government.

[6] See Department of Revenue sales and use tax publications on its website: http://www.taxes.state.mn.us/taxes/sales/index.shtml.

[7] Pat Dalton, *The Minnesota Sales Tax Base* (St. Paul: Minnesota House of Representatives Research Department, 2002), 1.

The sales tax is a "trust tax," meaning that businesses collect tax from purchasers on behalf of the state. Thus, sales tax collected is not part of the business's income. All businesses that provide taxable sales and services must register with the Department of Revenue for a permit to conduct taxable sales. Businesses are then required to file sales tax returns and remit the sales tax collected to the department. The frequency of filing—either monthly, quarterly, or annually—depends on the business's volume of taxable sales. At the end of 2005, the department had about 264,000 registered sales tax accounts. Of these, about 183,000 file annually, 40,000 file quarterly, and 41,000 file monthly.

Use tax applies to taxable items or services purchased out of state for use in Minnesota.

Use tax is comparable to the state sales tax. The use tax rate is 6.5 percent, and it applies to the same set of taxable goods and services as the sales tax. The use tax applies to taxable items bought out of state for use in Minnesota or bought from a seller who did not collect Minnesota sales tax. The use tax is most commonly associated with purchases made over the Internet, from catalogs, or through television sales. The use tax applies to purchases made in other countries as well as other states.

There are some differences in how the use tax applies to businesses and individuals. Individuals are exempt from the use tax if their eligible purchases are for personal use and are less than $770 per year. If an individual's purchases exceed that amount, the use tax is due for the entire amount, not just the portion exceeding $770. Individuals can either report use tax on a paper return or set up an electronic use tax account at the Department of Revenue.[8] The state does not have an exemption threshold for business purchases subject to the use tax. Businesses are to report and remit use tax on their own purchases when they report and remit sales taxes collected from their customers.

Since 2002, nearly all businesses are required to file sales and use tax returns electronically using the Department of Revenue's "e-File Minnesota" system, which allows filing over the Internet or by touch-tone telephone. As shown in Table 1.2, over 96 percent of returns were filed electronically in 2005, and the department receives over 650,000 returns each year. Not all registered

Table 1.2: Sales and Use Tax Returns Filed, 2000-05

	2000	2001	2002	2003	2004	2005[a]
Paper	711,921	503,584	50,288	36,684	32,820	25,400
Electronic	1,574	193,256	625,619	678,130	638,149	648,923
Total	713,495	696,840	675,907	714,814	670,969	674,323
Percentage Filed Electronically	0.2%	27.7%	92.6%	94.9%	95.1%	96.2%

[a] Data are as of December 12, 2005.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue data.

[8] For more information, see Minnesota Department of Revenue, *Fact Sheet 156: Use Tax for Individuals* (St. Paul, 2002).

businesses submit returns. For example, the department received about 675,000 returns in 2005 rather than the 840,000 sales and use tax returns it would have received had each registered account holder submitted returns per its required filing schedule (monthly, quarterly, or annually). In some cases, businesses should have filed a return but did not; in other cases, the account holders may not have been required to file because they did not make taxable sales or purchases subject to the use tax.

MINNESOTA'S TAX GAP

Minnesota taxpayers owed but did not report over $1 billion in income and sales and use taxes.

A "tax gap" is the difference between the amount of taxes owed and the amount taxpayers voluntarily report on their tax returns. A tax gap includes unpaid taxes by (1) filers who underreport the amount of tax due by understating income or overstating credits and deductions and (2) those who do not file tax returns at all (these taxpayers are called "nonfilers").

The Department of Revenue has estimated the tax gap for Minnesota's two largest revenue sources—the individual income tax and the sales and use tax. As shown in Table 1.3, these studies estimated that the income tax gap is about $604 million (based on 1999 returns) and the sales and use tax gap is about $451 million (based on 2000 returns). For each tax, the tax gap was roughly 10 percent of the taxes owed.[9]

Table 1.3: Minnesota Tax Gap Estimates

	Taxes Owed (in millions)	Taxes Paid (in millions)	Tax Gap (in millions)	Compliance Rate
Income Tax	$5,736	$5,132[a]	$604	89%
Sales and Use Tax				
Sales Tax	3,685	3,505	180	95
Use Tax	577	305	272	53
Subtotal	$4,261	$3,810	$451	89%

NOTE: Estimates for the income tax gap are based on returns for 1999; sales and use tax estimates are based on returns for 2000. Amounts may not add to subtotals due to rounding.

[a] Amount of taxes paid does not include additional revenue collected as a result of income tax audits. It also does not include tax balances due that taxpayers report on their tax returns, even if the balance due is not remitted on time.

SOURCES: Minnesota Department of Revenue, *Individual Income Tax Gap, Tax Year 1999* (St. Paul, 2004); American Economics Group, Inc., *Minnesota Sales and Use Tax Gap Project: Final Report* (St. Paul: Minnesota Department of Revenue, 2002); and Minnesota Department of Revenue data on sales and use tax paid.

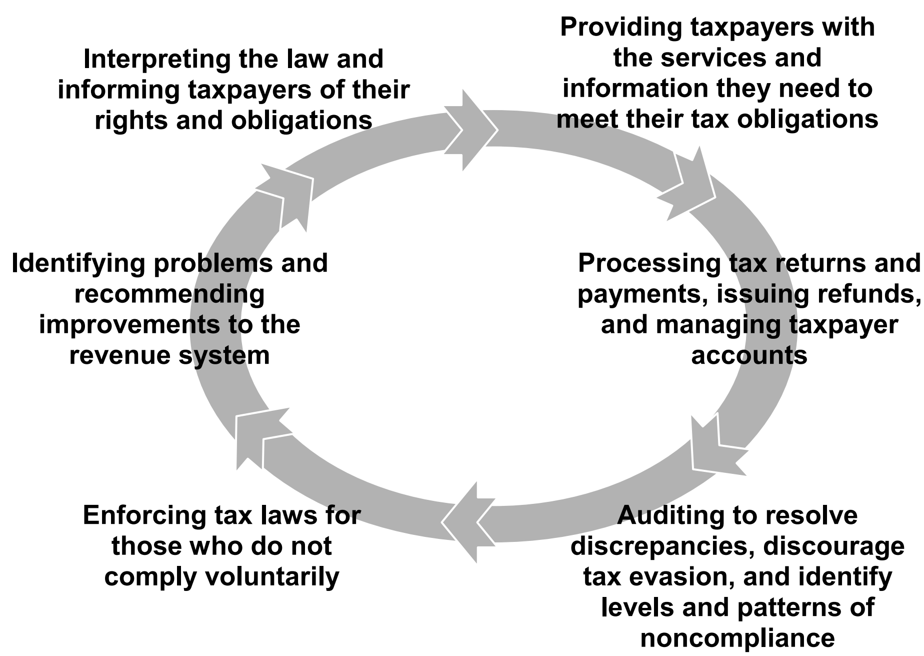
[9] Minnesota Department of Revenue, *Individual Income Tax Gap, Tax Year 1999* (St. Paul, 2004); and American Economics Group, Inc., *Minnesota Sales and Use Tax Gap Project: Final Report* (St. Paul: Minnesota Department of Revenue, 2002). Audit results are used in the methodology to estimate the tax gap. Because audits for a given tax year can take place several years after the return is filed, tax gap estimates also can be published several years after the filing year.

TAX COMPLIANCE

The Department of Revenue uses a variety of strategies to address noncompliance.

The Department of Revenue uses a variety of strategies to boost tax compliance. As shown in Figure 1.2, the department approaches tax compliance as a cycle involving taxpayer assistance and education, enforcement, and improvements to the tax system itself that simplify compliance. Our evaluation focused on efforts to (1) help taxpayers comply voluntarily through assistance and education, (2) detect and correct errors in reported tax liability, and (3) collect tax liabilities that are reported or assessed after audits but not paid on time.

Figure 1.2: Tax Compliance Cycle



SOURCE: Minnesota Department of Revenue, *Strategic Plan* (St. Paul, 2004), 2.

Organizationally, responsibility for tax compliance and collection is divided among several Department of Revenue divisions. Income tax compliance is primarily the responsibility of the Individual Income Tax Division, which has a staff of field auditors, office auditors, and taxpayer assistance representatives. The Tax Operations Division, which handles the processing of tax returns, also plays a role in income tax compliance by screening returns for problems as they are filed. Sales and use tax compliance is the responsibility of the Corporate and Sales Tax Division, which also administers the state's corporate franchise tax. And finally, the department's Collection Division manages the process for collecting tax payments that are past due. All four divisions are based in the St. Paul headquarters, but compliance staff are located in field offices statewide.

Taxpayer Assistance

Tax education and assistance are important ways to help taxpayers understand their obligations and voluntarily comply.

According to the Department of Revenue, an essential element of tax compliance is helping taxpayers understand their tax obligations and promoting voluntary, accurate reporting of tax liabilities. Avoiding problems from the start benefits both the taxpayer and the department. Thus, the department's taxpayer assistance efforts have several elements, including: (1) issuing understandable forms and publications; (2) providing an array of education and outreach programs targeted at those who want to comply and groups at risk of noncompliance through lack of understanding; and (3) promptly and accurately answering taxpayers' questions.

Over the past several years, the department has purposefully shifted to a self-service model of taxpayer assistance. In part a response to budget reductions, the department has expanded and revamped its website to provide written materials on tax requirements and filing procedures. It has also increased its reliance on automated self-service, such as internet registration for business tax identification numbers and refund status information available via the department's website and automated telephone service.

Auditing

Auditing involves identifying taxpayers who may be noncompliant and then detecting and correcting errors.

Whether intentionally or unintentionally, not all taxpayers file timely returns or pay the correct amount of tax due. The tax auditing process involves using available information to identify taxpayers who may be noncompliant. That information includes such things as federal tax return data, information reports from financial institutions, employer wage statements, and other Minnesota tax return data. Then, depending on the type of tax and nature of the error the department is trying to detect, it uses a variety of audit techniques to find and correct errors in a taxpayer's reported tax liability.

Income tax audits range from a fully automated process to more extensive, face-to-face audits, as shown in Table 1.4. Enforcement begins during the processing of tax returns, when department computers screen all incoming returns for calculation errors, fraud schemes, and questionable deductions and credits. The department screens returns during processing because it is harder to collect taxes owed after the refund is issued. If the computer screening identifies one or more possible errors, the return is subject to an early audit. To avoid delaying valid refunds, these early audits are usually quick and use information available at the time of processing. A year or two after processing, the department's computers check returns for inconsistencies with other data, primarily information obtained from the Internal Revenue Service. The computers can correct many of these discrepancies and notify taxpayers of any additional taxes that are due (called automated audits). Other discrepancies are more complex and require auditors to review the case and contact the taxpayer for additional information (called office audits). The department also uses third-party income data to identify people who likely owe taxes but did not file a return at all (called nonfiler audits). Finally, when issues are more complex, such as those involving underreported self-employment income, the department typically conducts field audits face-to-face with taxpayers. Audits can result in additional assessments of tax, penalties and interest, or in some cases, a refund to the taxpayer.

Income tax audits range from a fully automated process to more extensive, face-to-face audits.

Table 1.4: Types of Income Tax Audits

Early Audit	Audits conducted during the processing of tax returns. The department's computers screen all income tax and property tax refund returns for math errors, questionable credits and deductions, and various other factors. Early audit staff review returns that are flagged by the computer. The Tax Operations Division conducts most early audits. The Income Tax Division handles early audits that may involve fraud and a few other issues.
Fraud Audit	A type of early audit in which fraud unit staff in the Income Tax Division review refund returns flagged by fraud criteria when tax returns are processed. The fraud unit also reviews returns based on tips from the Internal Revenue Service and other states.
Automated Audit	Straightforward audits conducted by computer without review by auditors. Computers detect discrepancies between the return and information from the Internal Revenue Service, correct the return, and send out a notice notifying the taxpayer of taxes due or an additional refund.
Office Audit	Moderate in complexity, office audits typically involve a single issue that cannot be reliably handled by computer but does not require a comprehensive audit. Typically, the auditor reviews the case and may write the taxpayer for additional information.
Nonfiler Audit	A special type of office audit in which computers identify individuals who appear to have taxable income but did not file a return. If taxpayers do not file a return after being notified, the department generates and files a return based on the information they have and issues an order for any taxes due.
Field Audit	Comprehensive audits typically conducted in person with the taxpayer. They often involve complex issues such as self-employment income.

SOURCE: Office of the Legislative Auditor.

Sales and use tax enforcement is similar to income tax enforcement in that the department checks for calculation errors as it processes tax returns and follows up with various types of audits after processing is completed. After processing, sales tax enforcement relies on field audits to a greater extent than income tax enforcement because the department does not have as much third-party information to match with the sales tax returns. As shown in Table 1.5, the department uses several types of field audits. In addition to field audits, it also conducts (1) managed audits, in which businesses with good compliance records conduct self audits under the supervision of department auditors, and (2) self reviews, in which the department sends letters to all businesses in a selected industry asking them to review a particular issue and make appropriate changes to the sales or use taxes they owe. The department also does office audits for select issues that do not need to be examined at the business site.

For the sales and use tax, the department relies primarily on field audits conducted in the business' offices.

Table 1.5: Types of Sales and Use Tax Audits

Field Audit	Comprehensive audits of businesses conducted in the business' offices. Most sales tax audit time is spent on field audits.
Research and Development Audit	Field audits of a sample of businesses from selected industries to find out the size and nature of compliance problems in the industry.
Special Enforcement Audit	These hard-to-conduct field audits are targeted at businesses with a high percentage of cash transactions or whose books are kept by the owner.
Managed Audit	Audits conducted by the business under the supervision of an auditor from the Department of Revenue. The department lets a business conduct a managed audit based on whether it has good records, is in good standing with the department, and understands the audit issues.
Self-Review Audit	Department support staff send letters to all businesses in a selected industry asking them to review a particular issue and make any appropriate changes to the sales or use taxes they owe. The support staff help process amended returns, handle questions from businesses, and send reminder notices to businesses that do not respond.
Office Audit	Audits of specific issues that can be conducted via correspondence, such as audits of customs declarations.
Refund Claim Audit	Reviews of claims for sales tax refunds for tax paid on capital equipment purchases. These audits are a special type of office audit.
Nexus Audit	Reviews to determine whether an out-of-state business has a physical presence in Minnesota and should therefore collect sales tax on behalf of the state.

SOURCE: Office of the Legislative Auditor.

Auditing has both short- and long-term compliance benefits.

Enforcement activities have both short- and long-term benefits. In the short term, audits bring in additional revenue for the state by denying refunds or collecting additional tax, penalty, and interest owed. These benefits are relatively easy to measure and are often used to justify audit expenditures. In the long run, enforcement actions—or the perceived likelihood of enforcement actions—should also result in improved voluntary compliance. While long-run benefits are harder to measure, one national study found that field audits may have a greater long-run impact on voluntary compliance than on short-term revenue yield. This study estimated that person-to-person field audits increased voluntary tax compliance by over $11 for every dollar assessed in the audit.[10]

Collection of Past Due Payments

For all tax types, some taxpayers do not make full payment of taxes due at the time of filing or after an audit. Taxpayers that do not pay on time are referred to

[10] Alan H. Plumley, *The Determinants of Individual Income Tax Compliance, Estimating the Impacts of Tax Policy, Enforcement, and IRS Responsiveness*, *Publication 1916 (Rev. 11-96)* (Washington, DC: Internal Revenue Service, 1996), 35.

the department's Collection Division, which attempts to collect these delinquent tax payments.[11] In 2005, this inventory of delinquent tax payments exceeded $450 million.[12] The collection process begins with a notice stating the amount of delinquent payment and the taxpayer's rights during the collection process. The taxpayer has 30 days to respond to this notice, called the "billing" notice, before

Table 1.6: Enforcement Actions Used to Collect Delinquent Tax Payments

Lien	A lien is a claim or an encumbrance on property for payment of a debt. A lien gives the Department of Revenue a priority position against a debtor's property and extends the statute of limitations for collection to ten years from the date the lien is recorded. Once filed, a lien may be renewed indefinitely.
Levy	A levy is the act of taking property to pay a debt. The department can levy against wages, bank accounts, investment accounts, cash, rents, and other sources of income or property.
Seizure	A property seizure is a specific type of levy in which the state physically takes possession of a debtor's real property, such as a boat or car. The Department of Revenue must obtain district court approval to seize property, and the value of the seized property cannot exceed the tax debt.
Tax Refund Offset	The federal offset program allows the state to intercept federal tax refunds as payment for state individual income tax debts. Similarly, the state can claim individuals' Minnesota income tax refunds to satisfy tax debts.
Vendor Offset	The Department of Revenue may intercept payments being made to individuals and businesses who provide goods and services to the State of Minnesota.
Liquor Posting	If a business with a state license to sell liquor, beer, or wine files a late return or fails to make a tax payment on time, the business is put on the Department of Public Safety's "Delinquent Taxpayers List" published monthly. No wholesaler, manufacturer, or brewer may sell or deliver any product to a liquor retailer whose name appears on the posted list. State law requires the Department of Revenue to use liquor posting in all relevant cases and prohibits businesses subject to liquor posting from paying tax debts through installment payments.
Sales Tax Permit Revocation	Businesses that make sales or perform services subject to the state sales tax are required to have a permit to do so. The Department of Revenue can revoke the sales tax permit of a business that owes sales tax.
License Revocation	For certain individuals or businesses with state tax debts or unfilled returns, the Department of Revenue can direct city, county, and state licensing authorities to deny or revoke professional or business licenses, such as those for building contractors, concession operators, or physicians.

SOURCE: Minnesota Department of Revenue, *Collection Manual* (St. Paul, 2004).

[11] For tax returns filed with a balance due, payments must be made by the filing deadline. For audit assessments, the taxpayer has 60 days from the date of the assessment to pay.

[12] In general, the states' inventory of delinquent tax payments is not included in tax gap estimates.

the division takes other direct collection actions. As illustrated in Table 1.6, the division uses a number of tools to collect debts, from collecting money directly from bank accounts (levying) to revoking professional licenses until back taxes are paid. The division refers some cases to outside collection agencies that are paid based on the amount of debt they collect on the state's behalf.

TAX COMPLIANCE RESOURCES

For several years, the department has received additional funding to increase audit and collection efforts.

Over the past several biennia, the Legislature has appropriated additional funds to the Department of Revenue to boost audit and collection activities. Compliance initiative funding, which was allocated primarily to tax audit programs and collection of past-due payments, totaled $10 million for fiscal years 2002-03 and $12.8 million for fiscal years 2004-05. The department received an additional $17.8 million for the current biennium covering fiscal years 2006-07.

At the same time, nonenforcement programs at the department faced budget reductions. As shown in Table 1.7, comparing expenditures for the 2000-01 biennium to the 2004-05 biennium, the department's tax compliance and collection expenditures increased by about 40 percent. All other spending declined by about 30 percent.[13] Overall, in the 2000-01 biennium, compliance and collection activities accounted for 43 percent of the department's expenditures. In the 2004-05 biennium, these activities accounted for about 60 percent of department expenditures, reflecting the Legislature and department's increased focus on tax law enforcement. We describe the results of these investments in the remainder of the report.

Table 1.7: Expenditures and Staffing by Biennium, Fiscal Years 2000-05

Expenditures in thousands

	FY 2000-01		FY 2002-03		FY 2004-05[a]		Percentage Change 2000-01 to 2004-05	
	Expenditures	FTE	Expenditures	FTE	Expenditures	FTE	Expenditures	FTE
Compliance	$60,994	440	$66,965	460	$ 84,929	523	39.2%	18.9%
Collection	21,931	184	25,357	197	29,889	217	36.3	17.8
Subtotal	$82,925	624	$92,322	657	$114,818	740	38.5%	18.6%
All Other[b]	109,607	518	104,946	485	76,890	428	-29.8	-17.4
Total	$192,532	1,142	$197,268	1,142	$191,708	1,168	-0.4%	2.2%

NOTE: FTE is a "full time equivalent" measure of staffing. The FTE counts shown are for the second year of each biennium.

[a] Beginning in fiscal year 2004, rent expenditures were allocated to each program activity, including compliance and collection, based on the number of FTEs in each activity.

[b] The Department of Revenue's other budget categories include: Administrative Support; Appeals and Legal Services; Property Tax Administration and State Aid; Tax Payment and Return Processing; and Technology Development, Operations, and Support. Rent expenditures are included in an administrative budget category through fiscal year 2003.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue Finance Division data.

[13] Beginning in the 2004-05 biennium, rent is allocated to all budget categories based on staffing complements. In prior years, it was included in a centralized, administrative budget category.

2 Individual Income Tax

SUMMARY

The Minnesota Department of Revenue uses a variety of compliance strategies to address an estimated $600 million individual income tax gap. Compliance initiative funding has helped increase the percentage of income tax returns audited, and overall, these audits have yielded $6 to $7 per dollar invested. However, some types of audits have been less productive than others, and the department has made limited progress in addressing one of the biggest contributors to the tax gap—underreporting of self-employment income. To improve audit productivity, the division needs to better use available data for identifying noncompliance, address staff turnover problems, and make better use of audit data to monitor its performance. Income Tax Division education services are intended to help taxpayers understand and voluntarily meet their tax obligations, but the department needs to do more to evaluate the impact of these programs. Answering taxpayers' questions is another strategy to improve voluntary compliance; but in 2005, many callers had a hard time getting through to assistance representatives. In addition, income tax telephone assistance is not well structured to help taxpayers with limited English proficiency, and the department needs to do more to ensure that taxpayers are getting correct answers to their questions.

Minnesota relies on the individual income tax as a major source of state revenue, and for many Minnesotans, annual filing of an income tax return is their most visible interaction with state government. With over two million individual income tax filers, ensuring that taxpayers file accurate returns can have a big impact on state revenues. And, with taxpayers underreporting their tax liabilities by about $600 million a year, the Department of Revenue knows that it faces a significant compliance problem.

Minnesota has over two million income tax filers.

Two of the department's divisions focus on individual income tax compliance—the Tax Operations Division, in charge of certain compliance actions as incoming returns are processed, and the Individual Income Tax Division, charged more generally with taxpayer assistance and auditing. In this chapter, we address the following questions:

- **How effectively does the Department of Revenue (1) identify individuals who may have underpaid their income taxes and (2) audit their tax returns?**

- **How effectively do the department's education and assistance services help taxpayers understand and meet their income tax obligations?**

To answer these questions, we interviewed Department of Revenue officials and reviewed department policies, procedures, and other documents, including the Income Tax Division compliance plan. To assess the effectiveness of income tax auditing, we examined tax gap studies by the Internal Revenue Service (IRS) and the Department of Revenue and analyzed summary data on audit results and expenditures for audit programs. We also analyzed available case-level data for audits completed after mid-December 2002. To evaluate taxpayer assistance efforts, we obtained and analyzed available department data on taxpayer education programs, interviewed officials at a nonprofit organization that partners with the department in providing free tax preparation assistance, and analyzed call volume and performance data and call quality assessment reports for the income tax telephone assistance center.

AUDITING

Our evaluation focused on five key phases of the audit process.

The primary purpose of auditing taxpayers is to improve overall compliance with tax laws. The audit process has many phases, from measuring the tax gap, to choosing an appropriate audit technique, to monitoring the effectiveness of audit programs. To assess the department's tax auditing, we used criteria based on the five audit phases that are listed in Table 2.1. In the following sections, we evaluate the department's audit efforts against each of these criteria.

Table 2.1: Criteria for Evaluating Audit Programs

The extent to which the Department of Revenue:

1. Identifies the size and nature of the tax gap,
2. Establishes an audit presence that creates an incentive for taxpayers to comply voluntarily,
3. Develops tools to effectively identify taxpayers who do not pay their taxes,
4. Conducts productive tax audits, and
5. Monitors the effectiveness of audit programs.

SOURCE: Office of the Legislative Auditor.

Measuring the Tax Gap

Tax gap studies help identify areas with large compliance problems.

Identifying the size and nature of the tax gap (the difference between taxes owed and taxes voluntarily reported) helps policymakers and the Department of Revenue know the amount of income tax noncompliance. By identifying areas with large compliance problems, tax gap studies help the department target its resources. Monitoring changes in the tax gap over time helps policy makers assess progress in improving tax compliance. We reviewed the department's tax gap estimates and found that:

- **The Department of Revenue used a reasonable approach to identify the size and nature of the income tax gap.**

In 2004, the department estimated that the income tax gap for tax year 1999 was about $604 million. Underreporting of nonwage income—such as self-employment income—was responsible for most of the income tax gap, as shown in Table 2.2.[1] Nonfilers, including those with wage income and nonwage income, were also responsible for a large portion ($124 million). The study also found that families and individuals with incomes over $100,000 were responsible for nearly half of the tax gap ($289 million), although they represent only about 7 percent of taxpayers.[2]

Underreported self-employment income is a major contributor to the income tax gap.

Table 2.2: Minnesota Income Tax Gap Estimates, Tax Year 1999

Type of Noncompliance	Amount of Unreported Tax (in millions): Wage Income	Nonwage Income	Total
Underreported Income	$ 2	$477	$479
Nonfiler	65	59	124
Total	$68	$536	$604

NOTE: Wage income includes hourly wages, salaries, tips, and commissions. Nonwage income includes income earned outside of the traditional employer-employee relationship, such as self-employment income, taxable interest and dividends, taxable pensions, gambling income, and net capital gains. Amounts may not add to total due to rounding.

SOURCE: Minnesota Department of Revenue, *Individual Income Tax Gap, Tax Year 1999* (St. Paul, 2004), 4.

Minnesota's approach to estimating the tax gap is reasonable, but the tax gap estimates should be viewed as rough approximations because of data limitations. Minnesota's tax gap estimate was based in large part on census data. Differences between income reported on census forms and Minnesota taxable income make it difficult to accurately estimate taxes owed. For example, the census data on interest income does not distinguish between taxable and nontaxable interest.

Nonfilers – those who do not file a tax return at all – are another major source of noncompliance.

The IRS's recent study of the federal income tax gap generally parallels findings in the Minnesota tax gap study, adding credence to Minnesota's findings. The IRS recently estimated that the federal tax gap attributable to underreporting of the individual income tax is $197 billion.[3] Both the IRS and Minnesota studies found that most of this income tax gap is due to underreporting of nonwage income. In fact, the IRS study found that roughly half of the federal income tax gap is due to underreporting of self-employment and other business income.[4] Overstated deductions and credits were responsible for about 16 percent of

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[1] Wage income includes hourly wages, salaries, tips, commissions, and other compensation paid by an employer. Nonwage income includes income earned outside of the traditional employer-employee relationship, such as self-employment income, taxable interest and dividends, taxable pensions and annuities, unemployment compensation, net capital gains, and gambling income.

[2] The income categories were based on federal adjusted gross income for 1999.

[3] Internal Revenue Service, *IRS Updates Tax Gap Estimates, IR-2006-28* (Washington, DC, 2006). To estimate the tax gap, the IRS thoroughly audited 46,000 individual income tax returns. The IRS has also estimated that, among all tax types, the nonfiling tax gap is $27 billion and the "underpayment gap" of taxes reported but not paid on time is another $33 billion.

[4] Business income includes net income from proprietorships, partnerships, S-corporations, rent, royalties, estates, trusts, and farms.

underreported tax liabilities. This latter finding is particularly useful to the Department of Revenue because the Minnesota study did not examine the extent to which taxpayers overstated their deductions and credits. The department can use results of the IRS study to help target its audits because Minnesota taxes are based in large part on the federal income tax return.

The department is doing a second tax gap study to track changes in noncompliance.

The Department of Revenue plans to conduct periodic tax gap studies that will allow it to track changes in the size and nature of the income tax gap in Minnesota. The department plans to have tax gap results for tax year 2002 in 2006, including estimates of the amounts attributable to nonfilers and income underreporting. These studies should help the department assess how much progress it is making toward reducing the tax gap.

While the department did not track how much of the gap it eventually recovered through its enforcement programs, past audit data suggest that the department ultimately collected about $40 million of the $604 million tax gap for 1999. The tax gap figures reflect taxes owed prior to any audit or collection activities, so the net tax gap was about $564 million.

Establishing Audit Presence

Establishing audit presence means doing enough audits among the various segments of the individual income taxpayer population to make taxpayers aware that they have a realistic chance of being audited. Tax auditing programs are based on the assumption that voluntary compliance tends to improve as the percentage of returns audited increases. In fact, Minnesota's tax gap study provides some evidence for this assumption. Wage income, nearly all of which is verified with third-party income matches, has a much higher compliance rate than self-employment income, which is much harder to verify. The tax gap study found that 98 percent of taxes attributable to wage income were voluntarily reported, compared with 76 percent for nonwage income.[5]

For audit programs to have an impact on voluntary compliance, taxpayers need to believe they have a realistic chance of being audited.

It is important to establish an audit presence for all major sources of income, especially when noncompliance is high. The Department of Revenue does this by conducting various types of audits ranging from simple checks of taxpayers' math calculations to thorough examinations of taxpayers' books and records in their homes. (See Table 1.4 for a description of each type of income tax audit.) For Minnesota, audits conducted by either the federal or state government may affect voluntary compliance because the Minnesota income tax return is closely tied to the federal tax return.

In evaluating audit presence among Minnesota individual income taxpayers, we found that:

- **The Department of Revenue has improved its overall audit presence during the past seven years.**

[5] Minnesota Department of Revenue, *Individual Income Tax Gap, Tax Year 1999* (St. Paul, 2004), 6-7.

As shown in Table 2.3, between fiscal years 1998 and 2005, the Department of Revenue has increased the percentage of returns audited in each category of post-processing audits, including field, office, automated, and nonfiler audits. As a percentage of income tax returns filed, post-processing audit rates increased from about 0.8 percent in fiscal year 1998 to 2.1 percent in 2005. Field audits, the most comprehensive type of audit, had a six-fold increase, going from 0.03 percent of returns to 0.2 percent.

Table 2.3: Minnesota Income Tax Returns Audited, Fiscal Years 1998 and 2005

	Number of Returns Audited		Returns Audited as a Percentage of Returns Filed		
	FY 1998	FY 2005	FY 1998	FY 2005	Percentage Point Change
Early Audits	123,288	99,482	5.5%	4.1%	-1.4%
Post-Processing Audits					
Field	641	4,512	0.03	0.2	0.2
Office	9,072	17,322	0.4	0.7	0.3
Nonfiler	3,970	10,308	0.2	0.4	0.2
Automated	4,488	18,055	0.2	0.7	0.5
Subtotal	18,171	50,197	0.8%	2.1%	1.3%

NOTE: Typically, computers scan all returns during processing, but the early audit figures include only those returns flagged for review that resulted in an adjustment to the tax due or refund amount. In contrast, post-processing audits include returns audited regardless of whether they resulted in a tax adjustment. Early audit figures for the Tax Operations Division are based on calendar years.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue data.

The percentage of returns subject to early audits declined between 1998 and 2005, but this does not reflect a decline in audit presence. The department did not reduce the number of returns screened during processing nor did it cut the number of screening criteria. Instead, according to the department, the number of early audits declined because taxpayers are making fewer mistakes that trigger them. This is likely due to increased electronic filing of tax returns.

The department plans to make more use of a less-expensive alternative to audits, namely an "education letter." The department may send education letters to a group of taxpayers that appears to be out of compliance on a particular issue, such as the education credit. The department sends to these taxpayers computer-generated letters that identify the issue in question, describe the rules they should follow, and ask them to review their returns. If the return is incorrect, the letter asks the taxpayers to file an amended return and/or file correctly on future returns. In 2005, the department sent seven different education letters to a total of about 16,000 taxpayers.

The department has appropriately tried to target audits at areas with large tax gaps.

While overall audit coverage is important in establishing audit presence, it is also important to ensure sufficient audit coverage in areas with large tax gaps. The department has appropriately tried to target audits at two areas responsible for a large share of the estimated $604 million income tax gap—nonfilers and underreporting of nonwage income by people who do file tax returns. Nonfilers include individuals who have wage income and those who have self-employment or other types of nonwage income. As shown in Table 2.2, about half of the nonfiler tax gap involved wage income.

In assessing how well the department targets audits at major contributors to the tax gap, we found that:

- **Of the two major tax gap components, the Department of Revenue has improved audit presence among nonfilers, but it has made limited progress in achieving audit presence among self-employed individuals.**

Since 2000, the department has doubled the number of nonfiler audits undertaken each year.

The Department of Revenue has substantially improved its presence among nonfilers by more than doubling the number of nonfiler audits undertaken each year, from about 4,000 per year during fiscal years 1998 through 2000 to over 10,000 per year beginning in fiscal year 2002. Income tax assessments resulting from nonfiler audits have also increased—from $13 to $17 million per year prior to fiscal year 2002 to an annual average of $28 million in fiscal years 2002 through 2005.

In contrast, the department's efforts to establish audit presence for self-employment income has been hampered by staffing issues, the decline in federal field audits, and data limitations in the department's computer systems. High employee turnover has limited the department's ability to target audits at noncompliance by self-employed individuals. Self-employment audits are much more complex than audits of wage income, and they generally require field audit techniques rather than simpler office or automated audits. They also require auditors with considerable training and experience.[6]

The department has made limited progress addressing noncompliance by the self-employed.

With compliance initiative funding, the Income Tax Division has been hiring many new auditors. But turnover among these new hires has been high, particularly among Twin-Cities area field auditors who have four-year accounting degrees. For example, in 2005, the income tax regional office that covers most of the Twin Cities area had 50 percent turnover. As a result, most field auditors lack the skills and experience necessary to effectively audit self-employed taxpayers. In fiscal year 2005, about half of all field audits were conducted by auditors with less than two years of experience, and the types of audits assigned to them were generally not related to self-employment income. In addition, the senior auditors most qualified to conduct self-employment audits have had less audit time because they have been training new employees. Consequently, the department has completed far fewer audits targeting self-employment income than it would like.

The department attributes the high turnover among recently hired auditors to high demand for accountants in the private sector, especially after the federal government enacted new accounting and auditing requirements for publicly traded corporations in 2002.[7] In fact, the departmentwide turnover rate for entry-

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[6] According to the Income Tax Division director, these complex audits generally require auditors with a minimum of a four-year accounting degree and three years of experience.

[7] The new requirements were enacted under what is commonly called the Sarbanes-Oxley Act of 2002, *Public Law* 107-204.

level revenue tax specialists—the employee class used for tax auditors just out of school—increased from about 2 percent in fiscal year 2002 to about 16 percent in fiscal years 2004 and 2005. According to the department, exit interviews and focus group discussions with current employees showed that dissatisfaction with low salaries is the main reason auditors left the department.

High turnover among new auditors has hampered efforts to do more audits aimed at detecting underreported self-employment income.

A second factor that has likely weakened audit presence for self-employment income is the decade-long decline in federal field audit coverage. As we noted above, field audits are important tools to get at self-employment income and other complex issues that cannot be handled through an office audit. Federal field audits are as important as state field audits because the state taxes are closely linked to income reported on the federal tax return. Nationally, federal field audit coverage declined from 0.7 percent of returns to 0.2 percent between 1995 and 2004. While these are nationwide figures, state officials said that federal audit rates also declined in Minnesota. Although the Department of Revenue has increased its field audit coverage, the percentage point increase in department audits was less than half of the decline in federal field audit coverage since 1995. If federal audit rates declined in Minnesota as much as they did in the entire nation, the combined federal and state field audit rate in Minnesota would have declined from over 0.7 percent to about 0.4 percent during this ten-year period.

A third factor that has hampered the department's efforts to reduce noncompliance by self-employed individuals is that its computer systems have lacked certain data that would help it identify people who underreport their income. We describe this problem in the next section.

Identifying Noncompliant Taxpayers

Accurately identifying returns that are likely to be noncompliant helps ensure that the department's limited resources are effectively targeted at compliance problems. For taxpayers who file returns, there are a variety of tools that can be used to identify potential underreporting of income and overstated deductions and credits. These tools also can help identify individuals who appear to have taxable income but did not file a state return. In assessing the resources the department has available to identify noncompliance, we found that:

Third-party information from the IRS and employers are important tools for identifying noncompliant taxpayers.

- **The Department of Revenue has effectively used many, but not all, available tools to identify taxpayers who may have underreported their tax liabilities.**

As shown in Table 2.4, the department obtains a variety of data to identify noncompliant taxpayers. These data sources include federal tax return information, W-2 reports of wage income and taxes withheld by employers, Form-1099 information reports on nonwage income, federal audit reports, federal tax return adjustments, and fraud reports from the IRS and other states.

Generally, the Department of Revenue has effectively used data matching from these information sources to instigate audits that result in additional tax assessments. Some discrepancies identified from these sources lead to automated audits, under which computers send out notices of the discrepancies and the

Table 2.4: Information Used to Detect Taxpayer Noncompliance

IRS Audit Reports	The Internal Revenue Service regularly reports to the Revenue Department the results of completed audits involving Minnesota residents.
Federal Tax Return Adjustments	For each tax year, the IRS sends a series of six computer files indicating all adjustments it made to federal returns of Minnesota residents, except for changes due to federal field or correspondence audits (which are included in IRS audit reports, above). The files include changes to income, deductions, and credits. For tax year 2002, for example, the IRS sent Revenue adjustments for 22,000 returns to the Department of Revenue. Most of these adjustments were reported in a file sent to Minnesota in 2005.
Information as Reported on Federal Tax Return	The IRS provides electronic files containing federal income tax return data as reported by Minnesota residents. The data can be used to verify income reported on the Minnesota tax return, including the federal adjusted gross income, adjustments made to determine Minnesota income, household status, and number of dependents. Data are also used to check information reported on the property tax refund returns.
W-2 Forms	W-2s contain information from employers, including wages earned and taxes withheld. Employers submit over 4 million W-2s per year for Minnesota wage earners.
1099 Forms	1099 reports are third-party information reports sent by banks and other institutions to the IRS showing nonwage income, such as interest, dividends, and capital gains. The IRS sends to the Department of Revenue electronic files with 1099 information for Minnesota residents.
Fraud Reports	The federal government and states, including Minnesota, exchange information on fraud cases and schemes.

SOURCE: Office of the Legislative Auditor.

The department is effectively using data-matching techniques to identify potential noncompliance.

amount of taxes due. Unless the assessments are appealed by the taxpayers, auditors are not involved. Other discrepancies require hands-on investigations by office or field auditors. Overall, the department has generated much revenue from these data matches. For example, the department's office and automated audits of taxpayers whose returns were adjusted by the IRS produced about $10.5 million in additional state assessments during fiscal year 2005.

On the other hand, the department had other data that it did not use effectively. For example, the department has a backlog of federal audit reports that can be used to determine whether taxpayers owe additional state taxes. The IRS regularly reports federal audit results for Minnesota taxpayers to the Department of Revenue. Department staff review these reports to see whether (1) the taxpayer also owes additional state taxes and (2) the taxpayer has already filed an amended Minnesota tax return to report the additional tax liability. Until recently, the IRS submitted summaries of these audit reports in paper format. Over the last two years, the IRS has increasingly submitted these reports in electronic form.

The department does not participate in an IRS program that would allow it to identify certain noncompliance taxpayers.

The Department of Revenue has continued to use the paper audit reports to check Minnesota tax returns, but it did not use the reports submitted in electronic form until early 2006. When the IRS first started providing the reports in electronic format, the department decided to develop a new data system to handle them; it also decided not to use these electronically submitted reports until the new system was completed. However, development of the new system did not proceed as expected, and delays in completing it led to a backlog of unused federal audit reports. As a result, the number of audits based on these reports declined from 1,892 audits in fiscal year 2004 to 631 in fiscal year 2005. The amount of assessments made from these reports also declined from $5.0 million to $1.8 million. Although the department can still use these federal audit reports, department officials said that delays typically make it harder to collect the taxes owed.

Minnesota is one of only four states with an income tax that does not participate in the IRS' "Fed-State" tax processing program. Under this program, the IRS processes electronically filed state and federal returns together. This means that when the IRS rejects a federal return because of certain errors or missing data, the associated state return is rejected as well. If Minnesota were to participate in this program, it would allow Minnesota to take advantage of certain checks that the IRS routinely performs during processing. However, Minnesota faces some barriers to joining the Fed-State program. First, Minnesota must work out a way for the federal government to handle property tax refund returns submitted with the income tax return. Second, participation could delay processing Minnesota tax returns by up to 2 days while the state returns go through the IRS filing checks then get sent to the department. Third, the department estimates that it would cost roughly $50,000 to make the computer programming changes necessary to participate in the program.

The department is not efficiently matching employers' W-2 wage reports with Minnesota income tax returns.

The department's ability to efficiently match tax returns with information on W-2 Wage and Tax Statements is hampered because approximately one million W-2s (about one-fourth of the total) are submitted to the state on paper. In addition, some employers do not submit W-2s at all, and other employers submit W-2s in a variety of electronic formats. The department is currently undertaking a project to hand-enter W-2 data submitted in paper form and seek W-2s from employers who failed to file them. Hand-entry of W-2 information is inefficient, and it prevents the department from making timely matches between W-2s and income tax returns.[8]

Until early 2006, the Department of Revenue's data warehouse lacked other data that could help identify possible income tax noncompliance. For example, the department wants to use data on drivers' licenses, motor vehicle registrations, and fishing and hunting licenses to identify nonfilers and establish underreporting of income by self-employed individuals. These data could be used to establish residency and identify residents whose lifestyles are inconsistent with their reported income. While the department has had the authority to access these data, the data were not previously linked together, and auditors had to look up information one case at a time. By placing these data in a computerized database

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[8] Employers are required to submit W-2 information forms to the IRS and the Department of Revenue by February 28. As a result, many returns may be submitted too early for the department to use this information to check returns as they are processed.

with the appropriate links, the department will be able to more efficiently identify potential noncompliance, particularly for self-employed workers. The department started obtaining these data and testing their use in January 2006.

In another case, the department has not used information it receives to verify some key items reported on the state income tax return. We do not describe this situation in detail to avoid providing a blueprint for tax evasion. To determine how much noncompliance it could identify if it were to routinely use this information, the department plans to match the data to state returns in 2006.

Audit Productivity

Not all taxes assessed because of an audit are collected.

The department does not audit every return that is potentially noncompliant. To productively use its limited resources, the department needs to weigh various factors when selecting returns to audit, such as potential audit yield and the potential to establish audit presence among certain types of taxpayers. In this section, we measure audit productivity in terms of the amount of revenue raised per dollar spent. It is important to recognize that this measure does not include audits' impact on voluntary compliance, which though very important, we cannot quantify. Nevertheless, audit productivity expressed as revenue per dollar spent relates to the audit's impact on voluntary compliance because audits that do not effectively discover understated tax liability are less likely to bring about improvements in voluntary compliance.

Overall Audit Productivity

Our overall productivity measure is based on estimates of the amount of audit assessments collected from fiscal year 2005 audits divided by audit-related spending during that year. Audit assessments include refunds denied, additional taxes, penalties, and interest.[9] Audit spending includes spending related to planning, conducting, and supervising income tax audits and collecting assessments made in those audits.[10] In our review of income tax audit productivity, we found that:

- **Department of Revenue income tax audits are generally effective at raising revenue, generating about $6 to $7 in revenue per dollar spent.**

[9]Assessments are net of (1) credits owed to the taxpayer that were found in audits, and (2) reductions made to the original assessment after appeals by the taxpayer. Assessments do not include additional interest charged after the audit was completed.

[10] Audit-related spending includes payroll, equipment, supply, and contract expenses related to income tax audits within the Income Tax Division, the Tax Operations Division, and the Collection Division. Some expenses, including administrative and computer support expenses, were allocated between audit and non-audit activities based on estimates by the Income Tax Division director. Audit-related spending also includes estimated Collection Division expenses for collecting debts related to the income tax audits. The Collection Division does not track collection expenses by type of debt. Thus, we used the overall average cost of 7.2 cents per dollar collected by the Collection Division for fiscal year 2005. Our spending estimates do not include the cost of space in state-owned buildings or the administrative support from other divisions within the Department of Revenue or other state agencies.

As shown in Table 2.5, through its income tax audits, the department assessed about $93 million in fiscal year 2005.[11] Early audits and fraud audits, usually performed during tax processing, resulted in assessments of $28 million. Most of the assessments for early and fraud audits are refund reductions, which means that they are immediately collected. The department assessed $64 million through field, office, nonfiler, and automated audits, all of which are conducted after tax processing.

The Department of Revenue does not actually collect the entire amount assessed as a result of its audits. Based on past collection trends, we estimate that the department will eventually collect about 67 percent, or $62 million, of the fiscal year 2005 assessments. These collection estimates are probably low because they are based on the percentage of assessments actually collected as of June 30, 2005, for income tax assessments made between December 2002 and June 2004. The department will likely collect even more of these assessments with time.

Table 2.5: Estimated Income Tax Audit Productivity by Type of Audit, Fiscal Year 2005

Type Of Audit	Assessments[a] (in millions)	Estimated Assessments Per Audit Dollar Spent	Estimated Audit and Collection Expenditures[b] (in thousands)	Estimated Collections (in millions)	Estimated Collections Per Dollar Spent
Audits During Processing					
Early Audits	$25.5	$16.18	$1,606	$22.4	$13.92
Fraud	2.8	16.60	177	2.2	12.35
Subtotal	$28.3	$16.22	$1,783	$24.5	$13.77
Post-Processing Audits					
Field	$22.7	$ 6.45	$3,854	$11.4	$2.97
Office	12.7	9.97	1,527	8.7	5.67
Nonfiler	22.8	32.30	1,421	12.3	8.65
Automated	6.1	10.76	684	5.2	7.65
Subtotal	$64.2	$10.60	$7,487	$37.6	$5.02
Total	$92.5	$11.86	$9,270	$62.2	$6.71

NOTE: The assessments per audit dollar spent are based on the cost of audits only; they do not include expenditures by the Collection Division used to collect the assessments. In contrast, the collections per dollar spent reflect both the cost of audits and the cost of collection.

[a] Assessments include refunds denied, additional taxes, penalties, and interest due to audits. Assessments are net of (1) credits owed to the taxpayer that were found in audits, and (2) reductions made to the original assessment after appeals by the taxpayer. Assessments do not include additional interest charged after the audit was completed. Early audit assessments made by the Tax Operations Division are based on calendar year 2005.

[b] Expenditures include audit dollars—Income Tax Division and Tax Operating Division expenditures attributable to the audit activity—and Collection Division expenditures based on the reported average cost of 7.2 cents per dollar collected.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue audit and expenditure data.

[11] The assessment figures in this chapter do not include assessments made by the Corporate and Sales Tax Division's partnership unit. This unit made income-tax related assessments of $1.6 million in fiscal year 2004 and $13.8 million in fiscal year 2005.

Productivity estimates do not include the impact audits have on voluntary compliance.

Estimates of the amount of tax ultimately collected as a result of audits may also be low because they do not take into account indirect effects on voluntary compliance. The impact of audits on voluntary compliance has not been measured in Minnesota, but as discussed above, the impact could be substantial. For example, in fiscal year 2004, the department's income tax fraud unit assessed several million dollars for returns claiming working family credits and dependent deductions to which the families were not entitled. The fraud unit believes that the number of similar fraudulent refund claims greatly diminished during the 2005 filing season because widespread publicity led to a change in taxpayer behavior. Such reductions in fraudulent behavior are not counted in the audit productivity results.

Productivity of Audit Projects

In fiscal year 2005, the Income Tax Division conducted about 55,000 audits that were grouped into approximately 100 projects. Each project is defined by the reason tax returns were selected for audit, such as an income discrepancy between the federal return and the state property tax refund return. Some projects may involve more than one type of audit. In the above example, some simple discrepancies can be handled with an automated audit, while other more complex discrepancies require an office audit. In addition to an overall evaluation of audit productivity, we also assessed the value of specific audit projects.[12] We found that:

- **While overall productivity is good, some income tax audit projects are not very productive.**

Field audits are an important tool for addressing the tax gap, but their productivity could be improved.

As shown in Table 2.5, field audit projects, in particular, had relatively low productivity, yielding about $3 in additional revenue per dollar spent. We estimate that other types of income tax audits will generate between $5 and $14 in additional revenue per dollar spent. Two common types of field audit projects—involving self-employment income and a certain type of deduction—had productivity that was less than one-third of the average field audit.[13] This suggests that these two types of projects may bring in less revenue than they cost. The department conducts many of these deduction audits because they are good training audits for inexperienced auditors.

One reason field audits have lower productivity than other audits is that their greater complexity makes them more resource intensive. For example, field audits of self-employed workers typically involve looking at evidence that the workers' lifestyles are inconsistent with their reported income. As we discussed above, a second reason that field audits have low productivity is high turnover among field auditors, causing experienced auditors to spend less time auditing in order to train new employees. Also, according to the Income Tax Division director, poor performance by some of its experienced field auditors reduces productivity.

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[12] For this comparison, we measured productivity in terms of assessments per audit hour.

[13] Selection criteria for audit projects are not public, so we do not describe project details in this report.

Another factor that reduces productivity is the high percentage of audits that did not find any noncompliance, suggesting that the department did not effectively select noncompliant returns. In fiscal year 2005, 34 percent of the department's income tax field audits resulted in no change to the taxes owed. This "no change" rate is more than twice as high as the 15 percent no change rate for IRS field audits in 2004.

Field audit projects, particularly self-employment audits, are designed to improve compliance by changing taxpayers' behavior in the long run. Thus, field audits should not be judged solely on the basis of short-term productivity. Nevertheless, productivity is important in its own right, and better productivity could enhance the audits' impact on voluntary compliance.

Audits by the fraud detection unit are highly productive.

Among the remaining audit categories, the fraud unit is highly productive, particularly after being expanded in fiscal year 2003. Typically, the fraud unit saves state revenue by denying all or a portion of taxpayer refund claims.[14] In fiscal year 2005, the fraud unit saved or brought in over $12 per dollar spent. After the department increased the income tax fraud unit staff from one to three, assessments increased from less than $1 million per year to an average of about $5 million per year during the last three years. Recently, the department expanded the fraud unit again. As of January 2006, the fraud unit has five permanent employees and plans to supplement their staff with temporary employees or other office audit staff during the filing season.

The cost and effectiveness of debt collection activities have a large effect on the productivity of certain types of audits. For example, nonfiler audits had the highest productivity based on assessments per dollar spent by the Income Tax Division, but its productivity was well below that of the fraud audits based on actual collections per dollar spent, including collection costs. This is because it is harder to collect nonfiler assessments than most other audit types. In contrast, ability to collect was not a major issue for fraud assessments because most fraud assessments were simply denied refunds.

Recent Trends in Audit Productivity

We also examined how productivity changed after the Department of Revenue started receiving additional funding for compliance initiatives. To assess whether these increases—or future increases—are worthwhile, it is important to monitor whether the department's audit productivity has reached a point of significant diminishing returns—that is, that additional compliance funding will result in little additional revenue. Our analysis of productivity trends for income tax audits shows that:

- **Investments in tax enforcement have not yet reached the point of diminishing returns.**

In fact, the Department of Revenue has increased its income tax audit productivity over the past seven years. Assessments per dollar spent on income

[14] For some tax returns, the fraud unit also examines returns submitted in previous years by the same individual. If it finds that the proper tax was not paid, it will assess the individual for taxes owed plus penalties and interest.

tax activities increased by 57 percent between fiscal years 1998 and 2005.[15] Assessments increased by 88 percent, while spending was up 20 percent. Part of the productivity increase is due to greater emphasis on direct compliance activities that generate revenue and less emphasis on taxpayer assistance and education. Also, part of this increase occurred because the greater use of electronic filing reduced the number of tax booklets that needed to be mailed to taxpayers.

Monitoring Audit Effectiveness

Monitoring the effectiveness of audit programs is important if the Department of Revenue is to maintain a productive income tax audit program. Monitoring can help the department redirect its audit resources as patterns of noncompliance change over time or audit projects fail to yield expected results. We found that:

- **The Department of Revenue improved its performance data, but it is not making the best use of these data to evaluate project performance.**

The department needs to do more to evaluate audit projects and modify them, as needed.

The Income Tax Division has work in progress to monitor major changes in tax compliance, but it does little to monitor how specific audit projects affect voluntary compliance. Through upcoming tax gap studies, the first of which is due in 2006, the department will be able to monitor how overall compliance has changed for nonfilers and nonwage income, two key components of the tax gap. However, the tax gap studies cannot be used to monitor changes in more specific taxpayer behavior, such as compliance with certain income deduction requirements.

In December 2002, the Income Tax Division established a new audit performance data system that tracks audit results. This system tracks audit hours, assessments, and the amount actually collected for each audit completed after mid-December 2002. The database also allows staff to analyze results for different projects, regional offices, and employees. But during the past few years, the division has focused on hiring new auditors and expanding its audit program. It has only recently begun to use the system to evaluate project performance.

The Income Tax Division has many audit projects that are targeted at improving voluntary compliance related to specific aspects of the tax return, but it has measured changes in voluntary compliance for only a few projects. For example, the division does not usually track the extent to which audited taxpayers who were found to be noncompliant became more compliant in the years following the audits. An example in which it did track behavior changes involves its "education letter" projects. Under one of these projects, the department sent

[15] To track changes in productivity over time, we used a productivity measure that differs from the measure we used elsewhere in this chapter. We divided assessments by total division expenditures, including audit expenditures and nonaudit expenditures because available data do not isolate audit-related expenditures prior to fiscal year 2005.

letters to taxpayers whose claim of the K-12 education tax credit was questionable. In the letters, the department explained the eligibility criteria and asked taxpayers to self-audit their claim for the credit and file an amended return, if needed. The department monitored the future use of K-12 education credits by taxpayers who received these letters. It found that these taxpayers used the education credit substantially less often after receiving the education letters. Similar follow-up studies could be performed for many of its audit projects.

The early audit unit in the Tax Operations Division has a system that reports results of its early audits, but it lacks several features that would be useful for monitoring the performance of its audit selection criteria. The early audit unit's reporting system tracks overall assessments made, but it does not usually track adjustments due to appeals or the amount ultimately collected.[16] The system tracks the number of returns flagged by each criterion, but it does not accurately track the assessments attributable to each criterion. Instead, it credits the entire assessment to all of the criteria that flagged the return, making it difficult to tell how important each criterion is in identifying noncompliance. For example, if a return is flagged by three criteria, such as a math error, a questionable deduction, and a questionable credit, the system would credit the total assessment to all three criteria. Another limitation of the department's early audit monitoring is that it does not systematically analyze whether thresholds are set at appropriate levels. For example, if returns are flagged because they exceed a certain threshold, the reporting system only records that the threshold was exceeded, not the amount by which it was exceeded. Thus, these reports do not indicate what the impact would be if the department were to raise or lower that threshold.

TAXPAYER ASSISTANCE

The Department of Revenue Individual Income Tax Division has primary responsibility for income tax assistance, and the division’s goal is to help taxpayers understand their tax obligations and file timely, accurate returns. As discussed in Chapter 1, taxpayer assistance includes several elements: making clear, understandable forms and publications readily available; educating taxpayers to help them understand tax laws and the filing process; and responding to taxpayers who call or write with questions about their individual circumstances. Our evaluation focused on educating taxpayers and responding to inquiries.

The department uses several strategies to help income taxpayers understand their obligations.

Educating Taxpayers

A group of seven staff in the Income Tax Division provides most education services. According to division managers and the division compliance plan, the division’s primary education strategies are to (1) support free income tax return preparation programs, (2) provide training for paid tax preparers, and (3) assist taxpayers for whom English is a second language. In addition, the division uses education letter projects that combine education on specific tax issues with

[16] The only time that it tracked how much of its assessments were actually collected was for audits funded by the recent compliance initiatives.

self-auditing. To be an effective strategy in closing the tax gap, education activities should be aligned with compliance priorities and their performance assessed against expected outcomes. In evaluating education services, we found that:

- **The Department of Revenue has expanded its income tax education efforts but could do more to evaluate the impact of these services.**

Return Preparation Programs

The department provides logistical support for volunteer organizations that help lower-income taxpayers prepare and file their returns for free.

The Income Tax Division partners with the IRS and nonprofit organizations to provide two tax return preparation programs that are free to qualifying taxpayers: Volunteer Income Tax Assistance and Tax Counseling for the Elderly. With state and federal support for the programs, various community groups organize tax preparation sites across the state and recruit volunteers who help lower-income taxpayers, seniors, and the disabled file their state and federal income tax returns.[17] The IRS provides some training materials and computer software that supports free electronic filing at the sites. The Department of Revenue coordinates the program statewide, providing training materials, training volunteers, and providing computer and software technical support. According to the division, the IRS has reduced its support for these programs over the last several years, but the Department of Revenue and the volunteer organizations have tried to fill in the gaps. One of the program's biggest challenges is obtaining a sufficient number of computers powerful enough to run the tax preparation software needed to support electronic filing. In the past two years, the Department of Revenue has provided over 200 surplus computers, plus monitors and printers, to volunteer tax preparation programs around the state.

Participation in volunteer tax preparation programs has been declining.

The Income Tax Division's stated performance goal for volunteer tax preparation assistance is to "continue to provide support" for Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs. Division officials said that they would like to increase the number of sites, volunteers, and taxpayers helped, but as shown in Table 2.6, program results have fluctuated. Compared to 2001, the free tax preparation program in 2005 had fewer volunteers, fewer sites, and assisted fewer taxpayers. Division staff are concerned about these trends because one purpose of the volunteer tax assistance programs is to draw lower-income taxpayers away from some for-profit tax preparers who target this population because they are often eligible for refundable tax credits.[18] With this in mind, the division's desire to expand volunteer tax preparation programs makes sense, but division staff could do more to articulate specific goals on where and how new sites can be facilitated. The division could also do more analysis related to the impact of these efforts, such as the proportion of tax returns with claims for refundable credits that are self-prepared, filed by paid preparers, and filed through volunteer programs.

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[17] Senior citizens, disabled citizens, and individuals with income of $25,000 or less ($35,000 or less for families) are eligible for assistance. Most volunteer tax preparation sites are open from February 1 through April 15.

[18] Many paid preparers offer high-cost "refund anticipation loans" at interest rates that significantly reduce the amount of refund going to the taxpayer. As a matter of tax policy, the department would prefer to see the entire refund going to the taxpayer, without a portion going to preparer fees or costs for refund anticipation loans.

Table 2.6: Results of Tax Preparation Assistance Programs, 2001-05

	2001	2002	2003	2004	2005
Assistance Sites	331	292	312	325	310
Volunteers	1,719	1,222	1,641	1,500[a]	1,500[a]
Taxpayers Assisted	101,313	84,869	115,372	84,066	86,961
Returns Filed					
Federal	35,817	39,388	41,201	41,604	40,373
State	56,001	60,983	63,962	62,793	71,856
Total	91,818	100,371	105,163	104,397	112,229

NOTE: Returns prepared in the calendar year shown are for income from the prior year. For example, tax return assistance in 2005 was for 2004 tax returns.

[a] Department of Revenue estimates.

SOURCE: Department of Revenue volunteer tax assistance program data.

Paid Preparer Education

Over half of the income returns filed each year are completed by paid tax preparers.

Providing formal training and information for paid tax preparers is another of the division's education objectives. As noted earlier, over half of the income tax returns filed are completed by paid tax preparers, so the division has a strong interest in contributing to their training.[19] With one staff person coordinating preparer training, the division publishes an annual newsletter to preparers before the start of each filing season. It also issues electronic newsletters several times a year to tax-preparer professional organizations, which then forward the newsletter to their members. In addition, the Income Tax Division coordinates classroom training for preparers who choose to participate.

According to the division, these organized training events and resources are probably not reaching the paid preparers that the department is most concerned about—those that have questionable expertise, charge high fees to lower-income taxpayers who receive tax refunds, or instigate fraud schemes. The impact of "problem" preparers is magnified because one preparer can complete thousands of returns. Many paid tax preparers are affiliated with professional organizations of attorneys, accountants, and IRS-enrolled agents, which provide training and support for their members.

The department offers preparer training, but has few other tools to deal with problem preparers.

Department officials said, and we agree, that tools other than training and education are needed to deal with problem preparers who are more likely to be unaffiliated with a professional organization and who are less likely to avail themselves of Department of Revenue training. The department can issue negligence penalties on preparers, but it has few other enforcement tools. Minnesota does not license paid preparers. In the 2005 legislative session, the department supported a bill that would allow it to publicize the names of paid

[19] Paid preparers are supposed to sign the returns they prepare, along with the taxpayer. The Department of Revenue is able to track the number of income tax returns that have a signature on the preparer line, but not all preparers follow the signature rule.

preparers convicted of tax crimes or issued civil penalties. The law that passed included publishing a list of tax preparers convicted of crimes but not those issued administrative penalties.[20] The department currently publishes a list of businesses that are delinquent in paying taxes due. Department officials believe that a similar list of penalized preparers would help educate taxpayers who are considering hiring a paid preparer.

Community Outreach

The department initiated an outreach program in 2000, but it needs to refine its goals for the program.

The division's third education priority is outreach to non-English speakers. In January 2000, the division initiated a community outreach program. The program's goal is to help people who may have cultural or language barriers that make it harder for them to understand the tax system and to comply with tax laws. Division managers decided to invest in community outreach in response to (1) demographic trends showing that Minnesota is becoming more diverse and (2) specific tax fraud schemes to which certain communities have been susceptible. Initially, the program focused on the Vietnamese, Hmong, and Latino communities but has since expanded to include Laotian, Cambodian, Somali, and Native American communities.

Division staff said that their primary strategy is to partner with existing community organizations and programs to disseminate information in native languages and to develop free tax preparation sites. Although the division is trying to broaden its impact by working with existing community networks, the four outreach staff, all of whom are bilingual, report spending a great deal of time responding to individual inquires from taxpayers who have limited English proficiency. As we discuss in more detail below, the outreach staff appear to be filling a gap in non-English speakers' access to telephone assistance. However, outreach staff are working in the field at least half the time and cannot always provide prompt assistance when taxpayers need it.

As with the other education strategies, the division could not articulate specific performance measures for outreach activities. The income tax compliance plan states that the division's goal is to "grow and support" outreach activities. Expanded outreach activities may be warranted, but they would benefit from a clear understanding of purpose, more detailed plans to achieve goals, and better articulated statements of expected outcomes linked to improved compliance. According to division managers, most of their evaluation of outreach programs is anecdotal, but they believe outreach activities are reaching taxpayers not otherwise served by department resources.

The department is experimenting with education letters targeting specific compliance problems.

Education Letters

While we discussed the Income Tax Division's education letter project as a way to increase audit presence, it is also a good example of targeting education efforts at specific compliance problems. As discussed, the division sent about 16,000 education letters to taxpayers in December 2005. Each contained detailed compliance instructions regarding the issue that was the subject of the letter.

[20] *Laws of Minnesota* 2005, chapter 151, art. 9, sec. 10. House File 1234 includes the provision as introduced in 2005.

While the taxpayers were encouraged to amend previous returns if they determined that they had made an error, the bigger impact of these letters may be on future filing compliance. The department will need to collect and analyze data from recipients' amended or future tax returns in order to evaluate the letters' impact.

Responding to Taxpayer Inquiries

Most often, taxpayers with questions call the department's assistance line, but use of e-mail is increasing.

Taxpayer education is aimed at broad groups of taxpayers, but responding to individual taxpayers who have questions is another important aspect of taxpayer assistance. As discussed in Chapter 1, the Department of Revenue as a whole has shifted to a self-service model of assistance by expanding the information available on the Department of Revenue website and providing automated self-service options. Still, some taxpayers want or need to speak with a department employee about their tax situations, filing procedures, or enforcement actions, such as audits, in which they might be involved. The department eliminated formal walk-in assistance at its regional offices and the St. Paul headquarters in 2004 as a budget-saving measure, which increased the importance of telephone assistance for taxpayers who want to speak directly with a department employee.[21] At the same time, the department also terminated its toll-free telephone assistance numbers, leaving taxpayers from outside the Twin Cities metropolitan area to pay the cost themselves.

In the Income Tax Division, taxpayers ask most questions by calling one of the division's telephone assistance numbers, but many send e-mail, as shown in Table 2.7. Since 2001, the number of calls has declined by over one-third, while the number of e-mails has more than doubled. But overall, the division has seen about a 35 percent drop in demand for assistance.

Table 2.7: Taxpayer Inquiries by Telephone and Correspondence, 2001-05

	2001	2002	2003	2004	2005[a]	Percentage Change 2001-05
Telephone Calls	1,112,930	1,034,394	666,334	652,704	717,275	-36%
Correspondence						
Paper	1,653	1,984	1,495	1,354	880	-47
E-Mail	4,335	16,617	12,828	10,400	12,164	181
Subtotal	5,988	18,601	14,323	11,754	13,044	118
Total Contacts	1,118,918	1,052,995	680,657	664,458	730,319	-35%

[a] As of December 9, 2005.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue taxpayer assistance data.

[21] Department of Revenue staff will provide walk-in assistance upon request, but the department no longer promotes or staffs it as a formal taxpayer service option.

In 2005, the division had 12 full-time employees responding to taxpayer inquiries. In January 2006, the division hired additional permanent and temporary staff, bringing staffing to 21 permanent, full-time taxpayer assistance representatives and 5 temporary employees to help during the income tax filing season. We evaluated the division's taxpayer assistance services along two general dimensions—access to services and quality (primarily accuracy) of assistance provided. In addition, we discussed with department staff the extent to which help is available to taxpayers with limited English proficiency.

Access to Taxpayer Assistance

Regarding access to Department of Revenue telephone assistance representatives, we found that:

- **The Income Tax Division does not have enough staff available to answer calls from taxpayers during the filing seasons for the income tax and property tax refunds.**

On average, the department answered 60 percent of incoming calls for income tax assistance in 2005.

The income tax assistance telephone system has several components.[22] The Department of Revenue publishes several phone numbers for income taxpayers to use. One is described as an "automated service" number that takes callers through a menu-driven list of self-service options, such as getting automated refund status information, ordering forms, or notifying the department of a change of address. A second phone number is publicized as being for account resolution questions, technical tax questions, and other general inquiries; like the automated service number, callers make menu choices about the type of question they have. For both of these incoming phone lines, there are various points at which callers can choose to have their calls directed to a representative. The third income tax phone number is given to taxpayers who have received a nonfiler audit notice, and these calls are routed directly to a representative who answers questions about nonfiler audits. All of the incoming calls from these three phone numbers get routed through the same computerized telephone system. The Department of Revenue's goal for calls routed to income tax representatives is to answer 70 percent of calls within two minutes.

Calls being routed to an income tax representative are placed in one of four queues related to the type of call, and depending on demand, some number of representatives will be assigned to take calls for each queue. The four call-type categories are: (1) refund status, (2) nonfiler audits, (3) account resolution, and (4) technical tax. Each call queue has a certain number of callers who can be on hold at any give time. If for a given queue, the hold positions are full and all of the queue's representatives are busy, then the caller gets a message saying the system is full (essentially, a busy signal).

In 2005, about 243,000 calls were directed to the Income Tax Division's telephone assistance representatives, as shown in Table 2.8. However, about 57,000 calls, or 24 percent, could not get through because available

[22] This telephone system, used across the department, was new as of December 2003. According to the Income Tax Division lead worker who works with the system, the department started getting reliable tracking data from the system in February 2004.

representatives were busy with other calls and the hold queues were full.[23] Another 38,000 callers hung up while waiting on hold. For the year, about 60 percent of calls routed to a representative were answered.

Table 2.8: Access to Income Tax Telephone Assistance Representatives, 2004-05

	2004	2005
Incoming Calls	210,126	243,238
Unable to Be Routed Because System is Busy	40,358	57,087
Abandoned by Caller While on Hold	26,446	38,476
Answered by a Representative	143,129	146,361
Percentage of Calls Answered	68.1%	60.2%

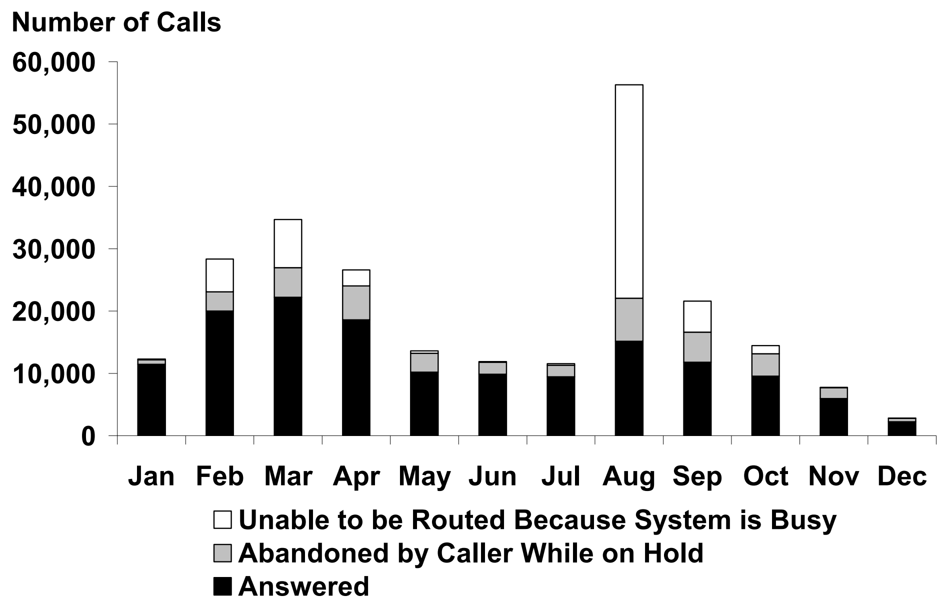
NOTE: Subgroup totals may not add to the reported number of incoming calls because of telephone system errors when counting calls.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue taxpayer assistance telephone system data.

Annual statistics, however, mask two major peaks in taxpayer assistance workloads—those surrounding the individual income tax filing season from January to April and the property tax refund filing season in August. As illustrated in Figure 2.1, during these filing seasons, demand outstrips available

Meeting the demand for assistance at the property tax filing deadline in August 2005 was a particular problem.

Figure 2.1: Access to Income Tax Telephone Assistance Representatives by Month, 2005



SOURCE: Office of the Legislative Auditor analysis of Department of Revenue telephone system data.

[23] The number of calls does not necessarily equate with the number of callers. It is quite possible that frustrated callers exacerbate overflow problems by hanging up and dialing again.

staff, resulting in more calls unable to be routed, longer hold times, and more callers hanging up while waiting. During the property tax refund season in August 2005, there was an unusually high spike in demand, and assistors answered less than 30 percent of incoming calls; over half of incoming calls were not routed at all because the system was busy. The data for August had a major impact on the statistics for the entire year. During the months of February through April 2005—the period of peak demand for the income tax filing season—representatives answered between 64 and 70 percent of calls.

The department should place a higher priority on providing prompt assistance for callers with technical tax questions.

During the income tax filing season, callers with technical tax questions have a particularly difficult time getting through to a representative. As discussed above, when callers indicate through a menu option that they have a technical tax question (for example, about their filing status or eligibility for a tax credit), the calls are routed to one call queue. As shown in Table 2.9, representatives answered about 58 percent of calls on the technical tax line in 2005.[24] Data for March 2005, the filing season's busiest month, show that about 53 percent of calls routed to the technical tax queue were answered by a representative. Some of the callers who could not get through at all or who hung up while on hold may have called back. But, the callers who are of the greatest concern are those who did not call back and were left with an unanswered question about an issue that may have affected their tax liability.

Table 2.9: Access to Income Tax Telephone Assistance Representatives by Type of Call, 2005

Type of Call	Incoming Calls	Calls Answered	Percentage of Calls Answered
Taxpayer Accounts	88,872	58,406	65.7%
Tax Compliance and Filing	76,354	44,343	58.1
Refund Status	65,904	32,459	49.3
Nonfiler Audit	12,108	11,153	92.1
Total	243,238	146,361	60.2%

NOTE: Data are as of December 9, 2005.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue taxpayer assistance telephone system data.

To manage demand for telephone assistance, we found that:

- **The department has had limited success diverting callers to automated service options.**

Inquiries regarding refund status are a drain on telephone assistance resources, and the department's efforts to redirect callers to automated means of checking their refund status have not been as effective as hoped. In 2005, about 25 percent

[24] Access to the refund call queue was even lower, but these callers are a lower risk to the department because they have less impact on taxpayer compliance.

of calls routed to representatives were refund inquiries—information that taxpayers can get on their own by using the department's automated "Where's My Refund?" service on the website and through the telephone assistance lines. The department already places a low priority on refund calls by assigning fewer representatives to answer these calls and by reducing the number of hold positions in the call queue, as reflected in the 49 percent answer rate for calls on the refund line shown in Table 2.9.

The department has had limited success diverting callers to automated sources of refund-status information.

If the department were able to redirect more of these callers to automated services for obtaining refund status information, representatives could devote more call time to those with technical tax questions or other questions that are a higher priority. Department managers have discussed removing the telephone system menu option that allows refund callers to choose to have their calls routed to a representative. However, taxpayer assistance staff said that these callers would be frustrated and would likely use other routes through the telephone menus to get to a representative, which would, in the end, make it more difficult to efficiently route and handle incoming calls of all types.

Because many taxpayers seem to prefer personal service to automated options, the department needs to maintain a mix of permanent and temporary staff sufficient to provide a reasonable level of service. We think that the 2005 level of performance—answering 60 percent of calls during the filing season (even lower on the technical tax line)—is inadequate. In January 2006, the Income Tax Division hired additional permanent and temporary taxpayer assistance representatives. It will be important to monitor the level of access that division can provide at this level of staffing.

Although most taxpayers call the department with questions, many submit their questions by e-mail. The department counts the number of incoming e-mails and letters, but we found that:

- **The department does not track performance statistics related to written correspondence, so we could not determine whether taxpayers are receiving timely responses to their inquiries.**

The division received over 12,000 e-mails and 800 letters in 2005, but it does not track the type of question asked or the response time. The division's goal is to answer e-mail within two days and letters within two weeks. Division staff said that they do not meet these turnaround times during times of peak demand, but absent data on response time, we could not determine the extent of any delays in responding to correspondence.

Quality of Assistance

The department has a process in place to assess the quality of its telephone assistance.

Providing accurate answers to questions is another key element of taxpayer assistance. In this regard, we found that:

- **The Income Tax Division's efforts to assess the quality of taxpayer assistance do not provide sufficient assurance that taxpayers are getting correct answers when they call or write with questions.**

To its credit, the Income Tax Division has a process in place to assess the quality of assistance provided to taxpayers who call with questions. The telephone system used since late 2003 allows calls to be taped for later review, and the division's protocol is to monitor six calls in a week, three times a year (18 calls per year) for each telephone assistance representative. The taxpayer assistance analyst who assesses call quality uses a check sheet of 20 performance elements related to customer service, accuracy of the information provided, and adherence to division procedures. The checklist, to which the analyst responds in a "yes/no/not applicable" format, includes such things as proper verification of the caller's identity, accuracy of the answer given, speaking clearly, and proper documentation of the call in the department's records. The performance expectation for representatives is an average score of 90 percent or better for all calls monitored in a year.

The department found a problem in about one-third of the calls it monitored.

As shown in Table 2.10, the taxpayer assistance supervisor evaluated 304 calls in fiscal year 2005 and noted at least one error in 95, or 31 percent of calls monitored. Although the average call quality score was 93 percent, 5 of 22 telephone assistance staff did not meet the division's performance goal of an average quality score of 90 percent or better. In addition, for 6 of 10 permanent employees who were on staff for all of fiscal year 2005, the supervisor did not monitor 18 to 20 of their calls per year, as is required by division policy.[25]

Table 2.10: Telephone Assistance Call Quality Reviews, Fiscal Year 2005

Type of Employee	Number of Employees	Calls Monitored	Calls with Quality Errors	Percentage of Calls with Errors	Average Review Score	Number of Employees with Average Score Below 90 Percent
Permanent[a]	16	247	84	34.0%	92.2%	4
Temporary	6	57	11	19.3	95.8	1
All Employees	22	304	95	31.3%	92.9%	5

[a] Included in "permanent staff" are six employees who worked for part of fiscal year 2005. Temporary staff work during the income tax filing season only.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue income tax assistance call monitoring data.

We reviewed the evaluation reports for the 95 calls with errors. As shown in Table 2.11, the most common were failure to properly document the call and failure to follow procedures for confirming the caller's identity. We noted during our review that many of the 20 quality elements on the checklist were marked as "not applicable." Among the 95 reports, at least 13 of the checklist items were not rated for 50 percent or more calls, including the item "assistance complete." As a result, the evaluations either individually or as a whole may not provide a complete picture of call quality.

[25] The procedure for monitoring call quality changed during fiscal year 2005 from ten calls per week twice a year to six calls per week three times a year.

Table 2.11: Errors Noted During Telephone Assistance Call Quality Reviews, Fiscal Year 2005

Error	Number of Times Error Noted	Percentage of 304 Calls Monitored
Did not properly document call after completing it	45	14.8%
Did not properly verify the caller's identity	40	13.2
Assistance not accurate	12	3.9
Assistance not complete	11	3.6
Did not ask relevant questions	2	0.7
Did not control the conversation	2	0.7
Did not research the question appropriately	1	0.3
Did not verify taxpayer's understanding	1	0.3
Did not close the call appropriately	1	0.3

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue income tax telephone assistance quality review documents.

Callers' technical tax questions provide an opportunity for telephone representatives to help taxpayers comply with tax laws; however, the distribution of calls by call type in our group of 95 did not align with the distribution of calls into the various telephone queues. Of the 95 quality reports we reviewed in detail, 18 percent involved callers with technical tax questions although about 30 percent of incoming calls are routed to the technical tax telephone assistance queue. About 40 percent of the quality reports we reviewed were for calls to obtain refund status information—those least risky in terms of tax compliance if the answers are not accurate.

Too few of the calls monitored involved technical tax questions—those that pose the highest risk to taxpayers if the answers provided are incorrect.

With few exceptions, the division does not routinely review outgoing e-mail and letters for quality. According to the division, supervisors do not have a quality review process in place for correspondence. The officials said, however, that a supervisor will review an e-mail or letter if the division receives a complaint about an inaccurate answer, which they said happens occasionally. As we said earlier, providing access to assistance is not enough; the department should review enough correspondence to be reasonably assured that the answers provided are correct.

In spite of these concerns, results of a 2005 survey show that most income tax filers' are satisfied with department services, and their use of the department's website has increased since the last survey in 2003.[26] Overall, almost all survey respondents who said they had used a department service of any kind were satisfied or very satisfied with the professionalism of staff, the usefulness of information provided, and the accuracy of information received. However, to the extent that taxpayers are not aware that they may have received inaccurate information, their satisfaction ratings are less meaningful. The survey also

[26] The Research Edge, *2005 Minnesota Department of Revenue: Taxpayer Satisfaction with the Filing Process* (St. Paul, 2005).

corroborates the department's view that there is potential for greater use of automated services. Compared to the 70 percent of respondents who were aware of the telephone assistance lines, only about half were aware of automated service options for getting refund status information. Among those aware of automated options, about 20 percent had actually used the telephone refund status line and 16 percent had used the web-based service.

Assistance for Taxpayers With Limited English Proficiency

As Minnesota has become home to a more diverse population, the Department of Revenue has taken steps to provide bilingual assistance. Most notable, the department's website has a number of publications available in translated form. However, we found that:

- **Income tax telephone assistance is not well structured to help taxpayers with limited English proficiency.**

For callers with limited English proficiency, the department's English-only telephone menus inhibit access to assistance.

The income tax telephone system menus are presented to callers only in English. The system contains no non-English referrals to other available resources, such as translated documents available on the website. The Department of Revenue has a contract for translation services during telephone calls. If a department employee receives a call from a taxpayer who does not speak English, the employee can call the contractor for translation assistance. But, according to the Department of Revenue's Taxpayer Rights Advocate, the service is rarely used, and employees said they were reluctant to use the service because of the associated cost. In response, the advocate allocated funds in 2005 from her department budget to cover the cost of the service and publicized this to department employees. The advocate reported, however, that during the 2005 income tax filing season, no employee requested translation assistance.

Taxpayer assistance staff report that they occasionally have difficulty answering calls because of language barriers; however, the taxpayer rights advocate and taxpayer assistance officials believe that taxpayers with limited English proficiency are probably not getting through to department representatives at all because navigating the telephone assistance system requires English language skills. These officials believe that language barriers are a growing problem, and the department will need to expand bilingual taxpayer services if it wants to support voluntary compliance among non-English speaking taxpayers. However, the department has not formally researched where the greatest needs are for bilingual services or the best means of delivering them.

The department is increasing the number of income tax forms and publications it translates into other languages.

In the past year, the department has increased efforts to provide translated income tax forms and publications, and the department has modified its website to make it easier to find these documents. But according to the taxpayer rights advocate, taxpayers with limited English proficiency are less likely to have Internet access, so putting documents on the website is not sufficient. This increases the importance of other means of obtaining assistance, namely telephone assistance, walk-in assistance, and access to hard-copy forms and publications. The division has taken some action by recently issuing a request for proposals for multi-lingual telephone menus. With multi-lingual services, the caller could choose a language option at the beginning of the call, and hear instructions thereafter in the chosen language.

CONCLUSIONS

The department has made productive use of increased compliance funding, but needs to fine-tune its efforts.

Income tax audit productivity has improved over the past seven years, and the Department of Revenue has had little difficulty finding productive uses for its compliance initiative funding. However, the department has not made much progress in targeting audits at Minnesota's largest compliance problem—the underreporting of self-employment income. High turnover among its field auditors has hampered the department's ability to conduct audits of self-employed taxpayers, and audits of self-employment income that have been completed have not effectively raised revenue. The department appears to be making more progress dealing with nonfilers—the second biggest portion of Minnesota's tax gap. It has stepped up its nonfiler audit program, resulting in increased assessments and the recovery of some back taxes owed by nonfilers. Now, the department needs to assess the impact of these audits on future filing behavior.

The department has shown a commitment to a balanced compliance program by investing in taxpayer education and assistance. But across all education and assistance programs, the department needs to better articulate the outcomes it wants to achieve and to measure the results. With better performance data in hand, we think the Income Tax Division will be better able to strategically allocate taxpayer assistance resources.

RECOMMENDATIONS

Enhance Audit Productivity

RECOMMENDATIONS

To improve audit productivity and address key contributors to the tax gap, the Department of Revenue should:

- ***Join the Internal Revenue Service's Fed-State tax return processing program;***
- ***Expedite development of the data system that will handle federal audit reports submitted in electronic format;***
- ***Expedite integration of data on drivers' licenses, motor vehicle registrations, and hunting and fishing licenses into the data warehouse; and***
- ***Continue working to reduce employee turnover among income tax field auditors, including taking measures to make pay more competitive.***

Joining the Fed-State program would take advantage of certain checks that the IRS can conduct more effectively during processing than the state. Although there are some barriers to joining this program, the potential benefits make it worthwhile.

Improving audit productivity also depends on obtaining and using the best information available to identify potential noncompliance. As of January 2006, the department had completed a data system for electronic federal audit reports, and it had obtained data on drivers' licenses, motor vehicle registrations, and hunting and fishing licenses for its data warehouse. However, we retained recommendations related to these efforts because neither system had been fully tested or integrated into routine compliance work.

Reducing turnover would not only enable the Income Tax Division to conduct more complex audits, it would save staff training time and allow the division to assign more audits based on their potential for improving compliance rather than training potential. The Department of Revenue has worked with the Minnesota Department of Employee Relations to improve entry-level pay for tax auditors. This helped to reduce employee turnover during the employees' first year, but turnover has remained high in the second and third year. Additional pay will be necessary to make the department more competitive with the private sector.

RECOMMENDATION

To further improve audit productivity, the Legislature should require employers to submit state withholding data in a common electronic format.

Beginning with a 1993 financial audit report, our office has recommended that the department improve its procedures for verifying the accuracy of the withholding data it receives from employers and individuals.[27] The department has improved how it verifies wage information by making use of data from the IRS and from the Minnesota Department of Employment and Economic Security; however, neither of these data sources includes the amount of state income tax withheld. Hence, to verify state tax withholding, the department needs to rely on withholding data that employers submit directly to the state. The department would be better able to identify noncompliance if these data were submitted in a common, electronic format.

The department has discussed this option internally, although it does not have a cost estimate for the information systems investment that would be required. Some businesses that currently submit wage reports in paper form may also incur additional costs to format and transmit these data electronically. However, most Minnesota businesses already electronically transmit information to the state through a common system. For example, all businesses that make taxable sales are required to electronically file sales and use tax returns through the department's e-File Minnesota system. In addition, as of July 2005, all Minnesota employers are required to electronically file their wage reports for the unemployment insurance program. The Minnesota Department of Employment and Economic Development offers two electronic filing options: an internet-based filing system and an option to file using a touch tone telephone.

[27] Minnesota Office of the Legislative Auditor, *Department of Revenue Financial Audit for the Year Ended June 30, 1992* (St. Paul, 2003), 3. Unresolved concerns are discussed in later financial audits for fiscal years 1993-98.

Improve Evaluation of Audit Projects

RECOMMENDATION

To better target audit resources, the Department of Revenue should improve its evaluation of income tax audit projects, including measuring their impact on voluntary compliance.

Evaluating and revising audit projects would help ensure that the department has a productive mix of audit projects. The nature of tax noncompliance may change from year to year. Monitoring the effectiveness of audit projects will help the department adjust its audit strategy to changes in noncompliance.

Including measures of how audits affect voluntary compliance would make project monitoring more useful. The Income Tax Division could track whether taxpayers who did not comply in the past have become more compliant in succeeding years. For example, it could monitor people who were assessed taxes for not filing to see whether they appropriately file. This would help the department determine whether additional action is required to bring these persons into compliance.

Improve Education Services

RECOMMENDATIONS

To bring more focus to education services and to help reduce the income tax gap, the Department of Revenue should create a performance plan that lays out specific objectives for taxpayer education and outreach, steps to meet those objectives, and measures for assessing progress.

To help taxpayers make educated decisions when choosing a tax preparer, the Legislature should amend state law to require the Department of Revenue to publish the names of tax preparers that have received certain civil penalties.

The Income Tax Division divides its resources among many education and outreach activities. While these activities, generally speaking, are logical in focus, division staff had little evidence to justify the resources devoted to one particular effort over another. It may make sense to expand or modify education programs, but as it does so, the division needs to do a better job evaluating whether these services are achieving expected outcomes.

In 2005, the legislature authorized the department to publish the names of tax preparers convicted of tax-related crimes.[28] To further assist the department in its

[28] *Laws of Minnesota* 2005, chapter 151, art. 9, sec. 10. The provision applies to tax preparers convicted of a crime under *Minnesota Statutes*, chapter 289A.63.

efforts to educate taxpayers, we think the department should also publish the names of tax preparers that have been assessed certain civil penalties. The original bill authorizing the list of problem preparers included those who have been issued civil penalties, but the provision was removed in a conference committee.[29] The dropped provision that we think the Legislature should reinstate required public disclosure of preparers penalized for violating state law regarding (1) standards of conduct, (2) disclosure of the terms of refund anticipation loans, and (3) itemized billing of clients.[30]

Increase Access to Telephone Assistance

RECOMMENDATIONS

To improve access to telephone assistance during periods of high demand, the Department of Revenue should:

- ***Establish reasonable service goals for the percentage of calls answered and use staffing, scheduling options, and call routing techniques to meet these goals;***
- ***To the extent possible, modify the automated telephone system to more strongly encourage callers to use the automated refund status options; and***
- ***Alter the call routing protocols as needed to place a high priority on technical tax calls.***

Taxpayers who are trying to file an accurate return should have a reasonable chance of getting through to an income tax representative when they have questions. In 2005, many callers did not. We recognize, though, that determining the correct number of staff can be tricky when demand varies by day of the week and month. The department faces an added degree of difficulty from taxpayers who prefer to speak with a representative even when automated options are available. Since the new, more sophisticated telephone routing system was implemented in 2003, the Income Tax Division has been experimenting with call routing rules and staffing levels to achieve better levels of service, but we think further modifications are warranted, especially to improve access to representatives for taxpayers with technical tax questions.

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[29] The provision was introduced in House File 1234 in February 2005. The language approved by the House and Senate was included in House File 2228, art. 9.

[30] These provisions are in *Minnesota Statutes* 2005, 270.30, subd. 3-5. *Minnesota Statutes* 2005, 270.30, subd. 6, authorizes the Department of Revenue to issue penalties of up to $1,000 per violation and to terminate a tax preparer's right to file electronic returns with the state.

Improve Service to Non-English Speakers

RECOMMENDATIONS

To better aid compliance among taxpayers with limited English proficiency, the Department of Revenue should:

- ***Assess the demand for more education materials and telephone assistance services in other languages; and***
- ***As warranted, translate more written materials and add automated phone menus in other languages.***

Given trends in state demographics and state government's interest in ensuring that all taxpayers pay the correct amount of tax, we agree with department officials who believe that the department should do more to assist taxpayers with limited English proficiency. It would be prudent, however, to invest in some research to determine where taxpayers would most benefit before investing in additional bilingual publications and services.

Better Assess the Quality of Assistance

RECOMMENDATIONS

To better assess the quality of assistance provided, the Department of Revenue should:

- ***Improve the checklist used for assessing telephone calls and monitor more calls involving technical tax questions; and***
- ***Develop performance goals and measures for responses to taxpayers' written inquiries and evaluate the accuracy of these responses.***

It is to the division's credit that the taxpayer assistance group has used technology available in the new phone system (the ability to tape calls for later review) to initiate a meaningful process for evaluating the quality of telephone assistance. To make the evaluations more useful, however, we think the division should monitor more of the calls where accuracy of answers has direct implications for tax compliance—those regarding payments taxpayers are required to make and technical tax questions relating to tax law and filing requirements. In addition, the assessment checklist should contain those items that the division thinks are most important, and to the fullest extent possible, each monitored call should be rated using all checklist items.

To date, the division has done little to assess the quality of responses provided by e-mail and letter. The accuracy of these responses is as important as those provided by telephone, and the division's quality assessment policy should be modified to include evaluation of a sample of correspondence. The department should use this data, as it does for the results of telephone quality assistance reviews, to evaluate individual and group performance.

3

Sales and Use Tax

SUMMARY

Taxpayers underreport their sales and use tax liabilities by an estimated $450 million annually. As with the income tax, the Department of Revenue takes a multi-pronged approach to sales and use tax compliance. With additional compliance funding, the department increased the number of sales tax audits completed, and overall, the revenue raised from these audits has risen to over $5 per dollar invested. However, some types of audits have been much less productive than average, and the department continues to have trouble containing use tax noncompliance. To improve audit productivity, the department needs to improve the database it uses to identify businesses likely to be noncompliant, reallocate audit resources away from poorly performing audit projects, and adopt the practices of regional offices that have demonstrated productive audit selection techniques. To help businesses comply voluntarily, the department relies primarily on posting informational materials on its website, and it offers a limited array of taxpayer training classes. Access to telephone assistance is a problem, particularly near filing deadlines. For those callers that do get through, the department does not monitor staff responses for accuracy or quality of service.

About 264,000 businesses are registered to collect sales tax in Minnesota.

Minnesota's sales and use tax revenues totaled $4.8 billion in fiscal year 2005, making it the second largest source of state tax revenue behind the income tax. About 264,000 businesses operating in Minnesota are required to collect sales taxes on most retail sales and some services. The use tax applies to taxable items bought out of state for use in Minnesota (such as items purchased over the Internet or from a catalog) or bought from a seller that did not collect Minnesota sales tax. The sales and use tax gap is substantial, with taxpayers understating their tax liabilities by an estimated $451 million annually.

Responsibility for administering the sales and use tax rests within the Department of Revenue's Corporate and Sales Tax Division, which also administers the corporate franchise tax. In this chapter, we address the following questions:

- **Does the Department of Revenue have an effective program to identify and audit taxpayers who may have underpaid sales and use tax?**

- **Does the Department of Revenue have effective education and assistance services to help taxpayers understand and meet their sales and use tax obligations?**

To answer these questions, we interviewed Department of Revenue officials and reviewed department policies, procedures, and other documents, including the business plan for the Sales and Use Tax Section. To assess the effectiveness of the department's audit programs, we analyzed case level data on completed audits for fiscal years 2002 through 2005. We also examined summary data on audit results and expenditures from fiscal years 1998 through 2005. We did not assess the accuracy or completeness of the audits themselves. To evaluate taxpayer assistance efforts, we obtained and analyzed available department data on education programs and the frequency, type, and quality of assistance provided to taxpayers who call or write with questions.

AUDITING

The department conducted about 13,000 sales and use tax audits in 2005.

In fiscal year 2005, the Corporate and Sales Tax Division conducted about 13,000 sales and use tax audits, as shown in Table 3.1.[1] Division staff spent most of their time on field audits, the most comprehensive type of audit, even though field audits represent just 27 percent of all audits completed. The division groups field audits into roughly 40 projects, generally targeting specific types of businesses or types of noncompliance.[2] Self reviews, which involve asking businesses to audit themselves regarding a particular issue, account for 31 percent of audits, but only 2 percent of auditors' time. Audits conducted from the auditor's office—reviews of refund claims, customs declarations, and nexus issues—make up 39 percent of audits, but just 11 percent of auditors' time.[3]

Table 3.1: Sales and Use Tax Audits Completed, Fiscal Year 2005

	Audit Hours		Audits Completed	
	Number	Percentage	Number	Percentage
Field Audits				
General	104,488	80%	3,516	27%
Research and Development	7,004	5	230	2
Special Enforcement	1,784	1	67	1
Nexus Audits	6,271	5	984	8
Refund Claim Audits	5,990	5	2,646	20
Self Review Audits	2,167	2	4,040	31
Office Audits	1,889	1	1,468	11
Managed Audits	1,657	1	70	1
Total	131,248	100%	13,022	100%

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue sales and use tax audit data.

Field audits account for most of the department's audit hours.

To evaluate how well department audit activities improve compliance with sales and use tax laws, we focused on the same five criteria used to evaluate income tax audits: (1) measuring the tax gap, (2) establishing audit presence, (3) identifying noncompliant taxpayers, (4) audit productivity, and (5) monitoring audit effectiveness.

[1] See Table 1.5 in Chapter 1 for a description of sales and use tax audit types.

[2] Selection criteria for many audit projects are not public, so we do not describe project details in this report.

[3] Businesses pay sales tax on capital equipment used in manufacturing, farming, and mining at the time of purchase, but they may later apply to the Department of Revenue for a refund of the sales tax paid. The purpose of nexus audits is to determine whether a multi-state business has a physical presence in Minnesota and should collect sales tax on Minnesota transactions.

Measuring the Tax Gap

Unreported use tax accounts for the largest share of the tax gap.

Knowing the size and nature of the sales and use tax gap—the sales and use tax owed but not voluntarily reported—helps the Department of Revenue determine the level of resources that should be devoted to compliance efforts and where to focus those resources. After examining the department's method for estimating the tax gap, we found that:

- **The department uses appropriate methods and data to measure the tax gap for the sales and use tax.**

In 2002, the department estimated that the sales and use tax gap for tax year 2000 was about $451 million, as shown in Table 3.2.[4] About 60 percent of the $451 million tax gap was due to unreported use tax. In fact, use tax compliance was much lower than sales tax compliance. In 2000, taxpayers paid only 53 percent of the use tax owed, compared with 95 percent of the sales tax owed. The fastest growing portion of the tax gap is for e-commerce, primarily use tax on Internet sales. The tax gap study estimated that the e-commerce tax gap would grow from $67 million in 2000 to $269 million by 2007. The department plans to conduct another sales tax gap study in 2006. This will allow it to track its progress toward containing sales and use tax noncompliance.

Table 3.2: Sales and Use Tax Gap Estimates, 2000

	Taxes Owed (in millions)	Taxes Paid (in millions)	Tax Gap (in millions)	Compliance Rate
Sales Tax	$3,685	$3,505	$180	95%
Use Tax	577	305	272	53
Total	$4,261	$3,810	$451	89%

NOTE: Amounts may not sum to totals due to rounding.

SOURCES: American Economics Group, Inc., *Minnesota Sales and Use Tax Gap Project: Final Report* (St. Paul: Minnesota Department of Revenue, 2002); and Department of Revenue data on sales and use taxes paid.

Businesses are responsible for all of the sales tax gap and nearly three-fourths of the use tax gap. The sales tax gap involves both businesses that do not charge the sales tax when they should and businesses that collect the tax but fail to remit it to the state. According to the study, the use tax gap included about $197 million for business purchases in 2000 and about $75 million for household purchases.

[4] American Economics Group, Inc., *Minnesota Sales and Use Tax Gap Project: Final Report* (St. Paul: Minnesota Department of Revenue, 2002).

Establishing Audit Presence

Audit presence, or the extent to which taxpayers believe that they might be audited, is an important factor in improving voluntary compliance, especially in areas with high noncompliance. The purpose of establishing audit presence is not just to make short-term revenue gains, but also to create a credible threat of audit that encourages taxpayers to voluntarily comply. The Department of Revenue establishes audit presence with a variety of audits, ranging from auditors reviewing refund requests in their offices to thoroughly examining taxpayer records in the businesses' offices. In this section, we analyze the adequacy of audit presence for the sales and use tax and examine another approach for improving voluntary compliance.

After reviewing the results of the department’s sales and use tax audit program, we found that:

- **The department targets audits at industries with high noncompliance rates, but weaknesses in audit presence for the sales and use tax may undermine voluntary compliance.**

The department targets audits at industries with the lowest compliance rates.

As shown in Table 3.3, during fiscal years 2004-05, the department targeted its audits at the three industry categories with the lowest compliance rates—construction, manufacturing and wholesale trade, and services. The construction industry had the lowest compliance rate, paying about 79 percent of the sales and use taxes owed, compared with an average compliance rate of 91 percent. The three industries with the lowest compliance rates comprise 39 percent of the state’s sales tax base, but the department spent 68 percent of its audit hours on these industries. In contrast, the department devoted a disproportionately small amount of resources on retail businesses, which had an above-average compliance rate (94 percent).

Table 3.3: Sales and Use Tax Audit Hours Compared with Compliance Rate and Sales Tax Base by Industry

Industry	Compliance Rate	Share of Tax Base	Share of Audit Hours
Construction	78.5%	1.7%	9.6%
Manufacturing and Wholesale Trade	86.4	19.3	27.0
Services	87.4	18.3	30.9
Agriculture	87.6	0.7	0.7
Finance, Insurance, and Real Estate	87.8	1.6	13.5
Mining	93.3	0.6	0.9
Retail	93.6	47.6	13.8
Transportation and Utilities	96.5	10.3	3.6
All Industries	91.0%	100.0%	100.0%

NOTE: The compliance rates and share of tax base figures are for tax year 2000. The share of audit hours figures are averages for fiscal years 2004 and 2005.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue data.

The department's audits address noncompliance by businesses for both the sales and use taxes. In fact, the department made more assessments for the use tax than the sales tax, consistent with the fact that the majority of the tax gap is unpaid use tax. In fiscal year 2005, use tax assessments totaled $61 million compared with $33 million in assessments for the sales tax.[5]

The department does little to enforce the use tax among individual households.

Even though the department targets its audits at industries with compliance problems, there are weaknesses in its audit presence. First, the department does little to enforce use tax payments by individual households. As mentioned earlier, the sales and use tax gap study estimated that households were responsible for about $75 million of the tax gap in 2000 and projected that it would rapidly grow. Department staff said that it is not cost effective to enforce use tax payments by households. Most household transactions subject to the use tax are small, and there is no comprehensive third-party source of sales transactions that the department can use to identify use tax liabilities.

Second, the department audits a small percentage of businesses. Minnesota relies primarily on field audits to establish audit presence among Minnesota businesses. According to the assistant director of the Corporate and Sales Tax Division, the number of field auditors is small relative to the number of businesses in the state. In fiscal year 2005, the department conducted field audits of about 4,000 businesses, or about 1.5 percent of the 264,000 businesses registered to collect sales tax in Minnesota. Typically, field audits cover returns for the past three years, which increases the chance that a sales and use tax return will eventually be audited. Unlike the income tax, the federal government does not audit sales and use tax returns. So, the federal government does not supplement the department's audit coverage in Minnesota. However, through the multi-state tax commission, the division does participate in joint, multi-state audits of large national companies that are located in many states.

The department audits a small percentage of businesses each year.

The division's reliance on time-intensive field audits means that the division can do fewer audits, thus reducing overall audit presence among businesses. Although office audits are less time consuming than field audits, auditors have a hard time identifying instances of noncompliance that might be suitable for office audits. Currently, office audits are limited to three narrowly focused issues—customs declarations, refunds for capital equipment purchases, and nexus determinations. As discussed in the next section on identifying noncompliant businesses, the department does not have a practical way to verify sales reports for all Minnesota businesses. So, compared with income tax auditing, computer data matching is a less viable means to identify issues suitable for office audits.

Results from the department's research and development audits provide evidence that the audit presence is not expansive enough to have much of an impact on voluntary compliance, especially for the use tax. Through its research and development audit program, the division audits a random sample of businesses in selected industries to determine the extent and nature of noncompliance in that industry. For seven of these industries, the department conducted follow-up audits about five years after the initial audits. Overall, use tax compliance did

[5] Assessment amounts do not reflect changes in favor of the taxpayer or penalties and interest. In fiscal year 2005, the department also denied $19 million in claims for sales tax refunds.

not significantly improve for the seven industries. It continued to be low for most of the industries examined, averaging only about 38 percent during the follow-up phase. Out of six industries with comparable data, the overall use tax compliance improved for three industries, remained the same for one industry, and declined for two industries.

The department's audits appear to have had little impact on use tax compliance.

Although these audits apparently did not have much of an effect on industrywide compliance, there is evidence that the specific businesses audited during the first phase improved their compliance during the follow-up period. For each of the seven industries covered by the follow-up audits, some of the businesses were also audited in the initial phase. On average, use tax compliance improved by 25 percentage points among all of the businesses that were audited twice. For example, among the 14 engineering and architectural firms that were audited twice, the use tax compliance rate increased from 9 percent to 62 percent. The results for sales tax compliance were less clear. Many of the businesses audited twice were already in full compliance during the period covered by the first audit. Overall, sales tax compliance rates improved for three industries, declined for one industry, and remained at 100 percent for three industries.

Several factors may have influenced businesses to change their compliance behavior. Some businesses may not have fully understood what transactions are subject to the use tax. It is possible that the audit process educated these businesses on their tax obligations, and businesses subsequently changed their behavior. Alternatively, the threat of future audits may have induced them to more fully report their tax obligations. In either case, the audits appear to have contributed to a change in behavior by the businesses that were audited.

The department is pursuing an alternate means of addressing noncompliance with the use tax.

As an alternative to enforcing use tax compliance, the department is trying to get more multi-state businesses to collect sales tax for transactions now covered by the use tax. Because of a Supreme Court decision, a state cannot require businesses that do not have a physical presence in the state to collect sales taxes on its behalf. The court decision was made in part because of the burden on businesses to comply with widely-divergent state sales tax laws. Instead, states have had to rely on the households and businesses that make these out-of-state purchases to voluntarily pay use tax. In response to the rapidly growing tax gap on these remote sales, Minnesota and many other states joined the Streamlined Sales Tax Project to have multi-state businesses collect and distribute sales taxes based on the purchaser's state of residence. In assessing the project's potential, we found that:

- **Minnesota's participation in the national "Streamlined Sales Tax Project" could address a significant portion of the use tax gap, but its success depends on changes in federal law or voluntary cooperation by large businesses.**

If successful, the project could substantially reduce the tax gap because having businesses collect the sales tax on behalf of the state would replace the low-compliance use tax with the much higher-compliance sales tax. The project is designed to "streamline" the sales tax by making state sales tax laws consistent with a national model, thereby reducing the burden for multi-state businesses to collect sales taxes on behalf of states. Currently, Minnesota is one of approximately 21 states that meet all or almost all of the features of the national model adopted by the multi-state group. In spite of this progress, states still cannot legally compel out-of-state businesses to collect sales tax for their residents' purchases unless they have a physical presence in the state. States are hoping that the streamlined tax laws will encourage Congress to enact legislation to require out-of-state sellers to collect sales tax for states participating in the project.

Until the federal law change occurs, states are trying to induce businesses to voluntarily participate. One means of doing so is the Streamlined Sales Tax Amnesty Program, under which states offer sales tax amnesty to businesses that are not registered to collect sales tax in their state. Unregistered businesses that register and agree to collect and remit taxes for participating states will not be audited for sales prior to the registration date. Minnesota's sales tax amnesty program began on October 1, 2005.

Identifying Noncompliant Businesses

Because the department audits only a small percentage of businesses, it needs to have the data and tools necessary to target its audits at those businesses most likely to be noncompliant. However, we found that:

- **The department lacks data and tools needed to systematically identify businesses that underreport sales and use taxes.**

Lack of third-party information on taxable sales makes it harder to identify noncompliant businesses.

For the individual income tax, computerized data matching is the primary means of identifying noncompliance, but this technique is not as effective an option for finding sales and use tax noncompliance. There are no standard, third-party sources of business sales data that are comparable to the third-party wage or investment income data available under the income tax system. The lack of third-party sales information limits the department's ability to conduct automated data matching and initiate office or automated audits based on discrepancies discovered.

To compensate, the department uses a variety of techniques to identify businesses likely to have underreported their tax liabilities. For example, during an audit of one business, staff may discover transactions for which other businesses did not charge sales tax when they should have. Auditors also use leads from other states to help identify compliance problems with multi-state businesses. Other techniques include looking for businesses that report sales or use tax amounts outside of norms. To be efficient, this technique requires computerized data to efficiently identify businesses outside the norm.

In 2005, the department's data warehouse did not include some available information about Minnesota businesses that could help target sales and use tax audits. For example, the data warehouse did not have federal tax return data on corporations. These data could be used to compare sales figures reported on a business' tax return with sales reported on the federal income tax returns. Although these data are self-reported and therefore not as reliable as third-party information, the department believes that this information helps identify noncompliance.[6] The department obtains federal tax return data, but it does not integrate this information into its data warehouse. As a result, sales tax auditors have to look up these data one company at a time, reducing the number of businesses it can screen prior to selecting audits.

The department plans to upgrade its data warehouse to improve its ability to identify noncompliance.

The department plans to improve how it identifies noncompliant businesses by upgrading its data warehouse to include data from federal tax returns and other sources. These changes would allow sales tax auditors to more efficiently screen businesses for audit potential. During the first phase of the data warehouse upgrade, which is scheduled to be complete in early 2006, the department will add Internal Revenue Service data from federal returns and incorporate audit production data into the warehouse. In future upgrades, the department plans to add state agency data on Minnesota businesses.

Audit Productivity

When selecting which businesses to audit, the department needs to consider whether its audits will yield additional revenue and whether they will improve voluntary compliance. In this section, we examine overall productivity in fiscal year 2005, analyze productivity by audit project, and assess how overall productivity changed after the Legislature increased the department's compliance funding. Our analysis of these three issues focuses on the amount of additional revenue raised by the audits. We do not include effects on voluntary compliance because, while important, we cannot quantify this effect for individual projects.

Overall audit productivity is good, even without considering the impact of audits on voluntary compliance.

Overall Audit Productivity

We measured overall productivity in terms of assessments actually collected per dollar spent. Assessments include additional taxes, penalties, and interest as well as refunds denied as the result of an audit. Assessments are net of any overpayments made by the business that were found during the audit. Costs include the Corporate and Sales Tax Division's expenses attributable to sales and use tax audits, including payroll, equipment and supplies, computer support, and administrative overhead. It also includes estimated Collection Division expenses for collecting delinquent payments. In our analysis of overall productivity, we found that:

- **Overall, sales and use tax audits are productive, raising about $5.40 in revenue for every dollar spent in fiscal year 2005.**

We estimated that audits completed in fiscal year 2005 will yield about $72 million in additional revenue for the state, or about $5.41 per dollar spent on sales and use tax audit and collection activities. These productivity measures likely understate the total effect of audits because they do not include revenue gains from improved voluntary compliance resulting from audits.

One factor that affects audit productivity is the percentage of assessments that are ultimately collected. As of September 30, 2005, the department had collected

[6] Also, sales figures reported on an income tax return may not be the same as sales that are subject to the sales tax.

about $67 million out of the $97 million in assessments made in sales and use tax audits that were completed in fiscal year 2005. Past collection trends suggest that it will probably collect another $5 million within the next year, raising overall collections to about $72 million, or 75 percent of the net assessments. The actual amount ultimately collected may be even higher because an unusually large amount of fiscal year 2005 assessments—about $18 million—remained in the appeals process.

The department collects most of its sales and use tax assessments shortly after the audit closes. This reduces the cost to collect its assessments because a relatively small portion of assessments go to the Collection Division for action. In fiscal year 2005, the department collected about 61 percent of its sales and use tax assessments within 90 days. In contrast, only about 44 percent of income tax assessments were collected within 90 days.

Productivity of Audit Projects

While sales and use tax audits are productive overall, the average results mask variation among audit projects. Because of data limitations, we measured productivity for specific projects in a different way than for overall productivity. We used the amount assessed instead of the amount actually collected because the department does not track collections by project. And, we used hours spent on each audit project instead of actual expenses because the department does not track expenses by project. In our analysis of assessments per audit hour by project, we found that:

- **Productivity of specific audit projects varies widely, suggesting that some audit resources may not be effectively targeted.**

However, some auditors spent many hours on audit projects with low revenue return.

Based on two-year averages for fiscal years 2004-05, assessments per audit hour among the various audit types ranged from $56 to $2,196, as shown in Table 3.4.[7] Auditors spent many hours on some sales tax projects with low productivity, raising questions about the level of resources devoted to these projects. For example, in fiscal years 2004 and 2005, the department spent a total of about 5,500 hours on self review projects, which had less than one-tenth the average productivity.[8] In fact, during recent years, productivity of self-review projects has steadily declined, going from $300 to $43 per hour between fiscal years 2002 and 2005. While self review projects serve an education purpose, this project is a time-intensive way to educate businesses. Also, the Corporate and Sales Tax Division does little monitoring to determine how much the self reviews improve voluntary compliance in subsequent years.[9] Division

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[7] During fiscal years 2004-05, managed audits had the lowest productivity, but this may be an anomaly because of one managed audit by a large company in fiscal year 2005. This managed audit found that the company had overpaid sales and use taxes by several million dollars, causing the overall return for managed audits to be negative for that year. In contrast, managed audits completed during fiscal year 2004 had an average return of $543 per audit hour.

[8] Unlike most audits, the department uses administrative support staff to work on self review projects.

[9] The Income Tax Division's education letters serve a similar purpose but take fewer resources. Also, the Income Tax Division monitors taxpayers to see if the education letters affect voluntary compliance.

staff said that it is difficult to monitor future compliance without conducting field audits. Sales tax returns do not have sufficient detail to monitor the specific sales and use tax provisions generally covered by self review projects.

Table 3.4: Productivity of Sales and Use Tax Audits by Type of Audit, Fiscal Years 2004-05

	Assessments (in thousands)	Audit Hours	Assessments per Hour
Field Audits			
General	$142,667	192,492	$ 741
Special Enforcement	6,874	4,929	1,395
Research and Development	4,012	11,473	350
Refund Claim Audits	23,653	10,772	2,196
Nexus Audits	8,550	11,445	747
Office Audits	1,400	2,873	487
Self Review Audits	309	5,530	56
Managed Audits[a]	-3,061	3,495	-876
Type Unknown / Other	7	45	150
Two-Year Total	$184,411	243,052	$ 759

NOTE: Assessment and audit hour figures are two-year totals for audits completed during fiscal years 2004 and 2005. Assessments include denied refunds, additional taxes, penalties, and interest resulting from audits. They are net of tax changes found in audits that are in favor of the taxpayer.

[a] Managed audits had negative assessments because of one managed audit that found the business overpaid its sales and use taxes by several million dollars.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue sales and use tax audit data.

Refund claims and special enforcement audits were highly productive.

During fiscal years 2004-05, auditors also devoted over 19,000 hours to one field audit project that had a return of $237 per hour, less than one-third the average return.[10] Department staff said that they frequently use these audits to train new staff. Our review of how productivity varies by staff experience suggests that training explains some but not all of the low productivity for this project. Experienced auditors conducted many of the audits for this project, and their audits also had low productivity.

However, further expanding these audits may not yield much additional revenue.

Two types of projects had unusually high productivity, but devoting more resources to these projects would not necessarily produce higher returns. On average, the division's audits of sales tax refund claims are the most productive. However, expanding this type of audit may not be productive because the department already reviews all claims for audit potential and conducts office audits for the half with the most audit potential. Special enforcement field audits were also highly productive. According to department staff, expanding these projects would be difficult because they are complex audits that typically require auditors to indirectly estimate sales because the businesses lack sales records. Also, staff said that assessments from these audits have been hard to collect.

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[10] Audit selection criteria are not public data. Because this is a narrowly focused audit project, describing it in more detail would disclose too much about the selection criteria.

The department targeted audits at industries with low compliance rates, but audits of two of these targeted industries had productivity levels that were substantially below average. As shown in Table 3.3, the construction and service industries had the lowest and third-lowest compliance rates among eight industries examined by the tax gap study. But during fiscal years 2004-05, audits of these two industries generated below-average assessments per audit hour. Average productivity was $424 and $532 per hour for construction and service industry audits, respectively, compared with the overall average of $759. There are a variety of reasons these audits may have low productivity, including their use as training audits. But the results raise questions about whether the department needs to improve how it selects businesses to audit in these industries or whether it needs to more effectively conduct these audits.

Productivity of audits varies widely among regional offices.

Productivity of audits also varies widely among regional offices. A variety of factors influence office productivity, including audit selection techniques. In fiscal years 2004-05, the division's seven regional offices in Minnesota spent about 55 percent of their audit hours on audit projects defined by the central office. For their remaining audit time, the regional offices have wide latitude in choosing businesses to audit. The productivity of these regionally selected audits varied considerably among the seven regional offices. During fiscal years 2004-05, average assessments per audit hour ranged from $203 to $927 among these offices. The office with highest productivity appears to place greater emphasis on getting to know the businesses in its region to identify likely cases of noncompliance. Its staff use a variety of sources to research businesses, including newspapers, the Internet, and business publications. While other offices do research to become familiar with businesses in their area, they tend to place greater emphasis on picking categories of businesses to audit. Other factors that affect office productivity include staff experience and stability. The office with the highest productivity also has the most experienced staff and has had low turnover. Another factor that may partially explain productivity differences is that businesses located in the Twin Cities metropolitan area are larger than businesses from other areas of the state. Since audits of larger businesses tend to be more productive than audits of smaller businesses, offices in the Twin Cites area could be expected to have above-average productivity.

Recent Trends in Audit Productivity

We also examined how productivity changed after the Legislature increased funding for compliance efforts in each of the past several years. As with the income tax, it is important to monitor sales tax audit productivity for signs of diminishing returns from added compliance funding. We found that:

- **Investments in sales tax auditing have not yet reached the point of diminishing returns.**

In fact, between fiscal years 2002 and 2005, sales and use tax audit productivity increased from about $4.57 to $5.41 in collections per dollar spent. While there may be diminishing returns on some audit projects, they are not large enough to offset the general increase in audit productivity since 2002. One reason for the increase in productivity may be that the department improved how it targeted its audits. In 2003, the Corporate and Sales Tax Division adopted the structured audit program, which targeted about half of the sales tax audits to eight project categories expected to have high audit potential.

Monitoring Audit Effectiveness

Project monitoring is important because it helps identify projects that are not effective. The department can either redirect resources to more effective audits or attempt to fix ineffective projects. In our review of project monitoring, we found that:

- **The Department of Revenue has a good data system for tracking audit performance, though it has not effectively used the performance data in its audit planning decisions.**

The department tracks a variety of audit performance measures.

The department has an audit information system that, for each audit, tracks detailed assessment information, the office and employees who performed the audit, hours spent on the audit, and information on the business that was audited. The data allow managers to track key productivity measures, including number of audits completed, average assessments per audit, assessments per audit hour, and average time per audit. These performance measures can be summarized by audit type, audit project, and the office that conducted the audit.

Corporate and Sales Tax Division managers use performance data to help plan projects, but in fiscal year 2005 the division continued to allocate a large number of hours to audit projects that had low productivity in previous years. For example, among structured field audit projects, one project had the lowest average dollars assessed per audit hour for both fiscal years 2003 and 2004. Despite these results, the department devoted about 11,000 hours to this project in fiscal year 2005, making it the largest field audit project that year. Its performance in 2005 continued to be less than half of the average productivity for field audits. Division staff acknowledged that the division should reduce the number of hours devoted to these projects in future years.

The department needs to revise or cut back audit projects that are not producing adequate results.

The department does not usually determine sales and use tax compliance rates for businesses it audits, even though a major objective has been to target businesses with low compliance. The only audits for which it systematically calculates audit compliance rates are the research and development projects. Under these projects, division staff determine the compliance rates for a random sample of businesses and generalize to the entire industry with quantifiable precision. Division staff said that they do not determine compliance rates for other audits because other audits are not randomly chosen. Without random selection, the compliance rates cannot be generalized to a larger population of businesses. We believe that tracking compliance rates would still be useful. Although audited businesses in a particular industry may not be representative of the entire industry, they do represent the audit projects chosen by the department. Tracking compliance rates would reveal how well the department targeted its audits at businesses with low compliance.

TAXPAYER ASSISTANCE

Unlike the income tax division, which serves nearly 2.5 million taxpayers, sales and use tax administration focuses on about 264,000 businesses. Still, taxpayer assistance for the sales and use tax range from services for one-person home businesses that file returns once a year to those for sophisticated corporations with tax and finance units that complete and file monthly tax returns.

Educating Taxpayers

Given limited resources, it is important for the division to determine which of its key compliance concerns should be addressed through improved written guidance, training classes, direct outreach to specific taxpayer groups, or a combination thereof. In evaluating education efforts for the sales and use tax, we found that:

- **The Department of Revenue has effectively used its website to provide "self-service" education materials but offers a limited array of classroom training.**

The department focuses on providing Internet-based education resources for businesses.

In keeping with the Department of Revenue's shift to a self-service model of taxpayer assistance, the department has revamped its sales and use tax website, adding numerous fact sheets, opinions, and filing-related documents. The sales and use tax education coordinator has delegated authority to modify the sales and use website content directly (rather than doing it centrally), which allows for timely updates. Sales and use taxpayers also use the website for various e-services, including filing returns, making tax payments, obtaining a Minnesota Business Tax Identification number needed to transact business with the department, and updating their registration information.

The division tries to target education efforts at specific compliance concerns. For example, the division uses the results of its research and development audits to identify compliance issues that can be addressed through education, primarily written guidance, such as fact sheets. These research and development audits are generally targeted at specific industries, such as veterinarians or security firms, not at general segments of the business population, such as sole proprietorships or other small businesses. According to the education coordinator, audit trends and findings are also informally integrated into taxpayer education class offerings and curriculum because auditors teach the classes and often give examples from their work.

Although the division's focus is clearly on providing written, Internet-based education resources, it also offers a limited set of classroom training courses. Most of the sessions are for one of three courses: basic rules for sales tax, capital equipment exemption rules, and sales tax border issues. This latter course is offered for businesses situated near Minnesota's borders with Wisconsin, North Dakota, and South Dakota.[11] The division offers one industry-based course, which covers sales tax rules for advertising. The division increased the number of sessions offered over the past three fiscal years—from 24 sessions and about 450 participants in fiscal year 2003 to 37 sessions and 850 participants in fiscal year 2005. In addition to classroom training, division staff on an ad hoc basis offer special interest classes or presentations to industry groups or professional associations.

Staffing constraints limit the amount of taxpayer training the department can provide. The department has one sales and use tax education coordinator who

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[11] The department had offered a border issues class for businesses located near the Minnesota-Iowa border but discontinued it because of low interest.

spends about 30 percent of her time on taxpayer education; most of her time is spent designing and delivering internal training for division auditors. The coordinator recommends for management approval which classes to offer and arranges for instructors, most of whom are sales and use tax auditors. The education coordinator said that there is demand for additional taxpayer training, and she would like to offer additional special issue classes and add more sessions of the basic courses as well. However, since department auditors teach most of the classes, teaching time means reduced audit time—an audit productivity tradeoff that may not be to the department's benefit. According to the division director, the division devotes fewer resources to taxpayer education than it used to, but the director also believes that education-related efforts are now more efficiently delivered.

The department has had limited success diverting callers to automated sources of refund-status information.

We also found that:

- **More direct outreach is needed to businesses whose proprietors do not speak English.**

According to division managers, most businesses have a greater capacity to handle state tax obligations than do individual taxpayers, making businesses better candidates for a self-service model of education than individuals. However, not all businesses may be well served under this model. According to department officials, an important gap in assistance for sales and use taxpayers is that directed at small business owners with limited English proficiency. In its fiscal year 2004-05 and 2006-07 business plans, the division identified as a priority adapting informational materials and training courses to better assist non-English speaking taxpayers. However, as of July 2005, the division had translated four fact sheets to Spanish—a very small proportion of the fact sheets, revenue notices, forms, and instructions it publishes. None of the division training courses to date have been dedicated to non-English speaking taxpayers.

Responding to Taxpayer Inquiries

Taxpayers who have questions can contact either a traditional call center or a group of policy staff.

Sales and use taxpayers who call or write with questions go to one of two work teams in the Corporate and Sales Tax Division.[12] The "call center" is a traditional telephone assistance group similar to that in the Income Tax Division, with calls going through the department's computerized call routing system. Call center staff answer questions about taxpayer accounts, e-filing, and technical tax compliance issues. A second "policy" team staffed by tax auditors handles tax law and compliance questions in addition to other duties related to specific sales tax programs.[13] Calls to policy staff generally go to their direct lines, not through the call center system. The division has one published e-mail address for all sales and use tax questions. Messages to this address go to one division staff member who then directs the e-mail either to a call center employee or to an auditor in the policy group.

[12] After a 2005 reorganization, both of these work teams report to the same supervisor.

[13] Among other specialty programs, the division's policy services group administers requests for sales tax exemption and claims for sales tax refunds.

As shown in Table 3.5, the department received about 30 percent more taxpayer inquiries in fiscal year 2005 than it did in fiscal year 2003. The call center saw an increase in both telephone and e-mail workload, with nearly a 40 percent increase in taxpayer inquiries over the three fiscal years. In contrast, the total number of inquiries directed to policy staff declined by about 13 percent from fiscal year 2003 to fiscal year 2005. The frequency of calls to policy staff declined while the number of incoming e-mails increased.

In recent years, the number of telephone and e-mail inquiries to the call center has increased, while the number directed to policy staff has decreased.

Table 3.5: Taxpayer Inquiries by Telephone and Correspondence, Fiscal Years 2003-05

	FY 2003	FY 2004	FY 2005	Percentage Change FY 2003-05
Telephone Calls				
Call Center	72,566	91038	103,424	43%
Policy Staff	14,489	12,769	11,897	-18
Subtotal	87,055	103,807	115,321	33
Correspondence				
E-mail to Call Center	11,634	11,937	13,994	20
E-mail to Policy Staff	2,332[a]	2,827	3,257	40
Letters to Policy Staff	714	448	195	-73
Subtotal	14,680	15,212	17,446	19
Total Contacts	101,735	119,019	132,767	31%

[a] The department began counting e-mails directed to policy staff in mid-fiscal year 2003. As a result, the count of e-mails directed to the call center is overstated and the count of e-mail to the policy staff is understated.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue taxpayer assistance data.

For both the call center and policy staff, we found that:

- **Many taxpayers do not receive prompt assistance when they call or e-mail with questions, particularly around certain filing deadlines.**

The division's data on call center and policy group workloads is collected differently and may not be directly comparable. The data we obtained for the call center are from standard reports generated by the department's computerized call routing system. In contrast, the policy group workload and other indicators are hand-tallied by policy staff and reported monthly to the group manager.

Access to Call Center Assistance

While call center workload has increased significantly over the last three fiscal years, staffing has remained constant at five permanent staff and one lead worker. Throughout the year, the call center receives far more inquiries by phone than e-mail. Workload demand is heaviest in January and February when both the annual filing deadline and a quarterly filing deadline occur. In fiscal year 2005, for example, the average number of incoming calls per month for January and February (21,100) was more than triple the average for the other ten months (6,100). The division has supplemented its telephone assistance staff with temporary employees during the workload peaks.

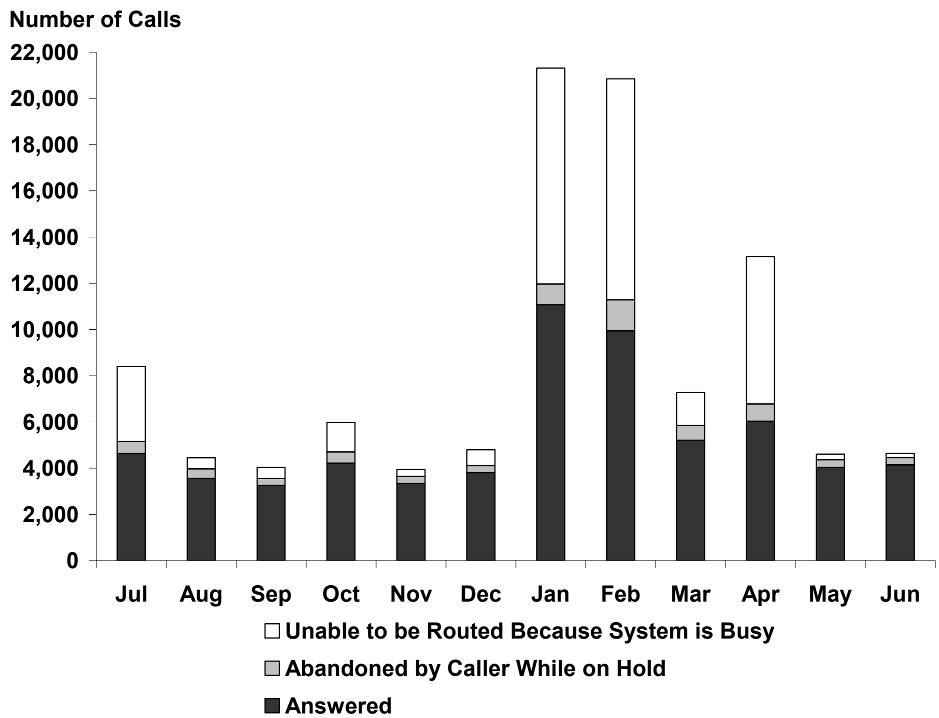
Even with temporary staffing, many taxpayers are not able to get through to a representative during periods of heavy demand. We found that:

In January and February 2005, callers had about a 50 percent chance of getting through to an assistance representative.

- **On average, about one-third of calls in fiscal year 2005 went unanswered when all call center representatives and hold queues were busy.**

During January and February 2005, the division added four temporary workers; but even with that, call center representatives answered only about half of incoming calls, as shown in Figure 3.1. The frequency of callers receiving "system busy" messages also increased around quarterly filing deadlines in July, October, and April. In these months, 39 percent, 21 percent, and 48 percent of call attempts, respectively, could not get through. It is likely that during these periods of high demand, frustrated callers exacerbate overflow problems by repeatedly hanging up and dialing again.

Figure 3.1: Calls to Sales and Use Tax Call Center Representatives by Month, Fiscal Year 2005



SOURCE: Office of the Legislative Auditor analysis of Department of Revenue taxpayer assistance telephone system data.

Various factors affect the call center staff's ability to handle inquiries at filing deadlines. According to call center staff, roughly 30 percent of the calls received during the January and February filing peak are requests from annual filers to reset passwords for the department's electronic filing system that the taxpayers had forgotten since filing the previous year.[14] The Department of Revenue does not have an automated password reset service, although it is exploring options for establishing one. In addition, with only five permanent staff fielding telephone calls, absence of one staff person can have a big impact on the number of calls that can be answered. One consequence of tight staffing constraints at a call center is that it is more difficult to schedule group training and staff meetings, and call center staff have had little time for training over the past several years.

An automated means of resetting passwords for the electronic filing system would help reduce demand for call center assistance.

According to the lead worker, temporary staffing is only a partial solution, because these staff are not able to handle all types of inquiries, only a subset of simpler ones—such as password resets. During January 2005, password reset calls were routed to temporary staff. According to the lead worker, this worked efficiently for a week or so, then callers discovered that they had a higher likelihood of being routed to a representative by selecting the password reset option at the opening menu regardless of their question type. In the end, the temporary staff started receiving questions that they were not able to answer, and the benefit of routing password callers to the temporary staff was reduced.

Access to Technical Tax Assistance

In general, the policy staff receive far fewer inquiries from taxpayers than the call center, and over the last three fiscal years, the number of telephone calls and e-mails directed to policy staff has declined. As with the call center, the technical tax assistance workload for policy staff peaks early in the calendar year, as shown in Figure 3.2. However, throughout the year, demand for assistance does not vary as much as it does for the call center. In assessing how well staff met this demand, we found that:

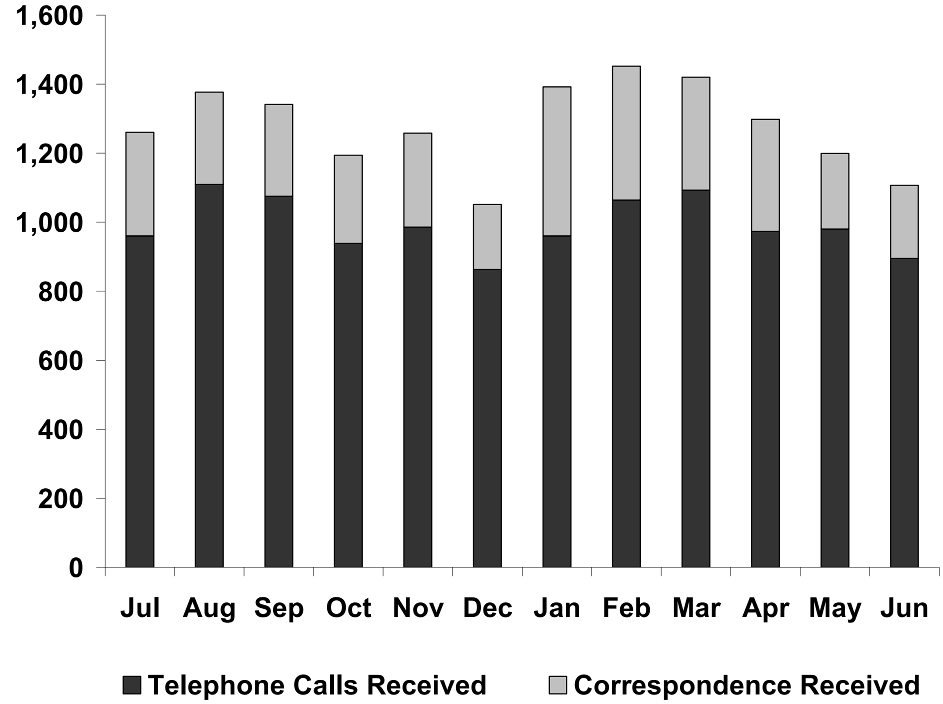
Policy staff receive far fewer inquiries than the call center.

- **It is not possible to determine how accessible policy staff are by telephone, but timeliness of responses to written inquiries slowed during fiscal year 2005.**

It is more difficult to assess whether taxpayers who call with questions have a reasonable level of access to policy staff. Policy staff tallies of incoming telephone calls are not comparable to the number of incoming calls to the call center. Because policy calls are not routed through the computerized call routing telephone system, policy staff counts of calls are those actually received. The division cannot count call attempts that receive a busy signal or go to staff voicemail. Incoming calls go directly to 1 of 12 policy staff members or their voicemail, with the number of calls per staff member varying considerably. For example, the staff person who handles requests for sales tax exemption status receives many more calls per month than other staff members.

[14] The division started tracking the reason for taxpayers' calls in March 2005 after the annual filing deadline.

Figure 3.2: Tax Assistance Inquiries to Policy Staff by Month, Fiscal Year 2005

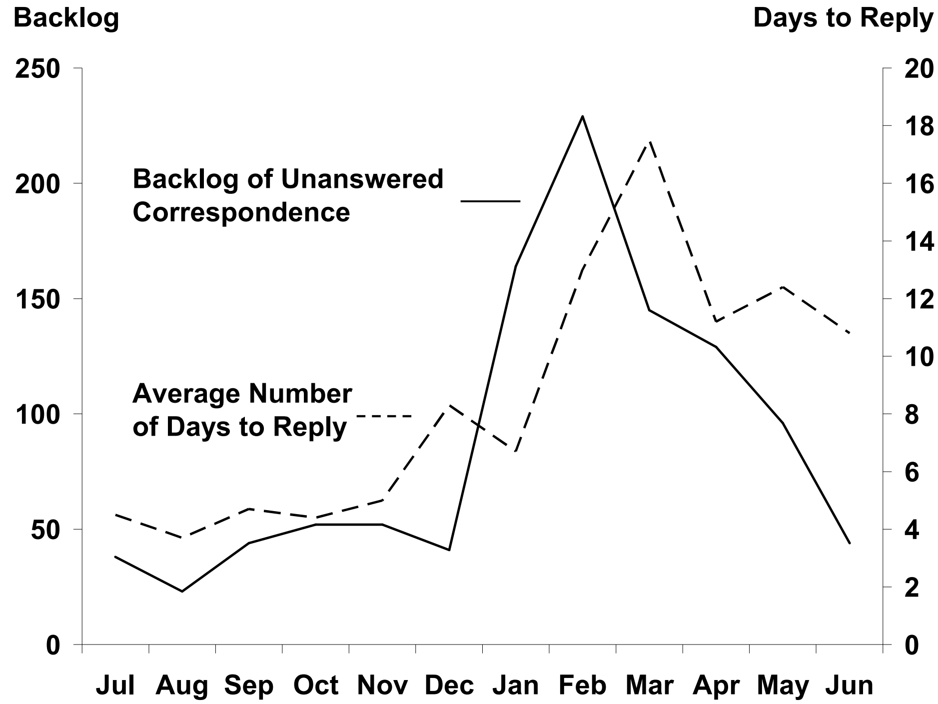


SOURCE: Office of the Legislative Auditor analysis of Department of Revenue taxpayer assistance data.

On average in fiscal year 2005, it took policy staff 10 days to respond to written inquiries, most of which were submitted by e-mail.

In spite of declining workloads in fiscal year 2005, it took policy staff longer to respond to written inquiries. Policy staff track how long it takes them to respond to questions submitted by letter and e-mail. On average in fiscal years 2003 and 2004, staff responded to e-mails and letters within four-and-a-half to five days. In fiscal year 2005, average response time increased to nearly 10 days. The group also tracks the backlog of unanswered correspondence at the end of each month. As shown in Figure 3.3, both the volume of unanswered letters and the average number of days to send a reply increased in the January to March timeframe. In February 2005, for example, about 230 inquires remained unanswered, and it took, on average, nearly two weeks for staff to reply to questions. According to the policy unit manager, the division had three staff members who generally answered technical tax e-mail. In January 2005, one of the three left, and response times slowed almost immediately. Longer response times may also be related to increasing complexity of the questions.

Figure 3.3: Backlogs and Response Time for Correspondence to Policy Staff, Fiscal Year 2005



SOURCE: Office of the Legislative Auditor analysis of Department of Revenue taxpayer assistance data.

Quality of Assistance

We also assessed how well the department manages the quality of assistance provided to sales and use taxpayers who call or write with questions. We found that:

- **The Department of Revenue does not have a quality review program for sales and use taxpayer assistance; as a result, it does not know the extent to which taxpayers receive correct answers.**

The department does not test the accuracy of answers provided by sales and use tax staff.

The division does not have a process in place to systematically assess the accuracy and completeness of responses to taxpayer inquiries. Although the call center telephone system allows calls to be monitored and recorded, the division does not take advantage of these features. Policy staff are not on a telephone system with call monitoring capacity, which obviously limits supervisors' ability to evaluate call quality. Supervisors for both groups can access written replies to taxpayers, but they have not systematically done so.

Supervisors said that policy and call center staff are experienced employees, and they are confident that the staff provide correct answers. They pointed to a 2004 survey of businesses in which most respondents reported that they found phone service to be helpful and knowledgeable. However, satisfaction ratings are not a substitute for call quality performance data, particularly if survey respondents are not aware that they may have received an incorrect answer. We have no reason to doubt that division staff are knowledgeable, but when the answers staff provide can affect a taxpayer's compliance, supervisors should use performance data to back up their assumptions about the accuracy of assistance provided.

CONCLUSIONS

Better targeting of resources could improve the impact of sales and use tax compliance efforts.

After a 2002 change to identify and target resources toward projects with high audit potential, sales and use tax audit productivity has improved. However, the department needs to follow through by evaluating whether audit projects are having the intended impact. Even with more focused audit activity, noncompliance continues to be a problem for the use tax. The department is appropriately pursuing alternate strategies to improve compliance—including the Streamlined Sales Tax Project, but its success depends on changes in federal law or voluntary changes by large multi-state businesses.

Many businesses have sufficient in-house expertise to navigate sales and use tax laws, and these taxpayers are probably well-served by the array of written guidance available on the department's sales and use tax website. But for some taxpayers, self-service cannot fully substitute for personal assistance. For instance, the department itself has recognized that it needs to devote additional attention to helping business owners who do not speak English. And overall, the department needs to improve access to telephone assistance and do more to ensure that taxpayers get the right answers when they call or write with questions.

RECOMMENDATIONS

Improve Audit Productivity

RECOMMENDATIONS

To improve audit productivity, the Department of Revenue should:

- ***Expedite improvements in the data warehouse, including the addition of new data on Minnesota businesses;***
- ***Encourage regional office staff to share successful audit selection techniques and adopt divisionwide the practices of regional offices that have demonstrated productive audit selection techniques;***
- ***Modify or eliminate unproductive audit projects; and***
- ***Track tax compliance rates for its audit projects.***

Improving the data warehouse would enable auditors to efficiently examine financial information on businesses rather than collect the information one business at a time, as is currently done. Computerized analysis would allow auditors to screen more businesses, increasing the likelihood of finding businesses that may be out of compliance.

Although auditors share information informally, a more structured process of sharing successful audit techniques could improve audit productivity. Specifically, a structured process to identify and adopt the best practices of productive regional offices could improve the performance of less productive offices. The Corporate and Sales Tax Division could help regional offices share best practices through its monthly meetings of regional office supervisors. Beginning in fall 2005, division managers invited lead auditors, who typically play a key role in audit selection, to attend these meetings on a quarterly basis.

The department should monitor the performance of different types of audits to identify those with low productivity. It should determine whether these unproductive projects can be modified, and if so, it should keep monitoring productivity after making necessary changes. If not, the department should reduce the number of audits conducted under these projects or eliminate them altogether. If a project with low productivity serves an educational purpose, such as the self review projects, the department may also, to the extent possible, monitor the project's effect on voluntary compliance to determine whether the project is worth keeping.

Tracking compliance rates would give the division another analytical tool to measure the extent to which it is targeting businesses with low compliance rates. Tracking would also tell the division whether audits of businesses with low compliance are effective.

Evaluate Education Services

RECOMMENDATIONS

To help ensure that education resources are effectively targeted, the Department of Revenue should:

- ***Review and revise its education course offerings and materials to ensure that they are closely linked to the department's stated compliance priorities for the sales and use tax;***

- ***Initiate needed research to assess how to best deliver education services for specific groups of taxpayers, particularly taxpayers with limited English proficiency; and***

- ***Create a performance plan that lays out specific objectives for taxpayer education and outreach, steps to meet those objectives, and measures for assessing progress.***

The department has stated that its sales and use tax compliance priorities include (1) focusing on those taxpayers who are furthest from compliance and (2) reducing the compliance burden for non-English speaking taxpayers. Both of these efforts have taxpayer education components. The department should do more to delineate sales and use tax compliance concerns that could be addressed through education and to assess education needs and preferences among affected taxpayer groups. Going through the process of explicitly aligning compliance priorities, taxpayer preferences, and education services will also help the department establish meaningful performance goals and measures needed to evaluate education services.

Increase Access to Telephone Assistance

RECOMMENDATIONS

To improve access to call center telephone and e-mail assistance, the Department of Revenue should:

- ***Pursue automated service options that would help reduce demand;***
- ***Use staffing, scheduling, and call routing options to improve access to telephone assistance; and***
- ***In doing so, consider merging all or part of the call center and technical tax assistance workload.***

The department should consider several strategies for managing its telephone assistance workload and improving a caller's chance of obtaining prompt assistance. First, to the extent it can, the division should make more use of automated service options for common transactions, such as obtaining e-file passwords or ordering forms and publications. The division also may be able to make better use of the telephone system menus and routing options to ensure that representatives get to high-priority calls.

Second, loss of a single staff member or an unusual spike in demand can cause significant declines in access to timely assistance. The Department of Revenue has a service goal of answering 70 percent of calls within two minutes. But given that call center performance at certain times of the year is well below that target, we think the division should set interim goals for the percentage of calls that it wants to answer and make staffing plans accordingly. The division has a number of options: hiring additional permanent staff, using temporary staff, shifting workload to the call center (along with a change in staffing), or having technical assistance staff from the policy group providing call center assistance during times of high demand.

Fully merging the call center and policy work teams would be difficult, and division staff were not convinced that it would be a good idea. Call center staff and the auditors in the policy group are in two different job classifications, with the policy staff in higher-graded positions. The manager also said that policy staff often build relationships over time with business taxpayers, and from the taxpayer's point of view, being able to call a specific policy staff member is good taxpayer service.

Assess the Quality of Assistance

RECOMMENDATIONS

To better ensure the quality and accuracy assistance provided by e-mail and telephone, the Department of Revenue should:

- ***Establish quality-related performance goals and measures,***
- ***Develop and implement a quality review process, and***
- ***Use quality review results to develop and implement staff training plans.***

When taxpayers call or write with sales and use tax questions, they expect to get correct answers. We think the department should do more than assume that its staff are providing accurate information by developing and implementing a quality assessment program. For call center staff, the telephone system allows supervisors to tape calls and later review them for accuracy and quality of customer service. Similarly, e-mail correspondence is also relatively easy to review. Assessing technical tax assistance provided by policy staff is more difficult because their telephone system does not support monitoring and recording of calls. Still, these staff provide much of their assistance by e-mail, and this may be the primary means of assessing the quality and accuracy of policy staff responses to taxpayer inquiries.

4 Collection

SUMMARY

At the end of fiscal year 2005, Minnesota taxpayers owed the state over $450 million in assessed taxes that were not paid on time. Recent growth in the amount of tax debt has resulted directly from increased audit activity, particularly of income tax returns. The Department of Revenue Collection Division has collected more tax debt each year. However, these increases have not kept pace with the influx of new debt, and 20 percent of debts have been in the collection inventory for more than five years. Cumbersome case routing, inconsistent collection procedures, and easily attained performance standards contributed to inefficient debt collection. The Collection Division needs to make better use of data on debts, debtors, and the results of specific collection activities to identify collection strategies best suited to specific types of debts. The division has recently taken several actions to address problems, but the Department of Revenue may need to make additional investments in information technology to support further improvement.

In general, taxpayers who owe taxes to the state because they filed a return with a balance due or were audited have to pay by a certain deadline. If a taxpayer does not pay on time, the account becomes delinquent, and the case is referred to the Department of Revenue's Collection Division for action. In addition to collecting tax debt, the Collection Division also collects some types of nontax debt on behalf of other state agencies, such as delinquent child support payments or overpayments of state benefits.

If a taxpayer does not pay a balance due on time, the case is referred to the department's Collection Division for action.

Our work focused on collection of tax debt, which accounted for about 90 percent of all debt the division collected in fiscal year 2005. Specifically, this chapter focuses on the following questions:

- **How successful is the Department of Revenue in collecting delinquent tax payments?**
- **Does the Department of Revenue effectively manage its debt collection responsibilities?**

To answer these questions, we interviewed Collection Division employees about collection policies and procedures, reviewed the Collection Division manual, and obtained and analyzed division data on tax debts, types of collection actions, and amounts collected. Our work focused on actions taken to collect delinquent tax payments. Due to time constraints, we did not assess the performance of the division's telephone assistance center.

AMOUNT OF TAX DEBT

The total amount of tax debt owed to the state was $460 million at the end of fiscal year 2005.

The state's inventory of delinquent taxes fluctuates because tax debts are being added and removed daily. The Collection Division maintains a case management computer system to hold information about debts and debtors and to manage workflow. To monitor trends, the Collection Division captures snapshot data from this information system on a monthly basis.

For a variety of reasons, data from the collection case management system can be difficult to interpret. Although we discuss other data issues below, it is important to understand that much of the data that the department captures and reports overstates the actual amount of delinquent tax payments owed. For a given tax debt, more than one individual or business may be liable for payment of the tax due.[1] If this is the case, the collection information system includes a record for each debtor and associates the full amount of the debt with each one. Much of the data that the division captures are from this "debtor-based" view, and as a result, they overstate the actual amount of tax debt. The department only started capturing information that is debt-based (without the duplicate counts of the same debt) in October 2003. Throughout this chapter, we will distinguish between data that include duplicate counts of the same debt (debtor-based) and data that do not (debt-based).

Comparing various measures of state tax debt for fiscal years 2000-05, we found that:

- **The amount of tax debt owed to the state is large and growing because debt collections have not kept pace with incoming delinquencies.**

As shown in Table 4.1, the total amount of tax debt increased, from about $437 million at the end of fiscal year 2004 to about $460 million at the end of fiscal year 2005 (the only two fiscal years for which the division was able to provide debt-based data without duplicate counts). This was about a 5 percent increase. Other division data that are debtor-based (which include duplicate counts) also show that the amount of delinquent tax payments has been growing, with an average increase of 8.6 percent per year between fiscal years 2000 and 2005. Some of this increase may be accounted for by inflation, which grew by an average of 2.5 percent per year. Other than inflation, increases in the tax debt inventory occur when the amount of incoming debt exceeds the amount of debt collected or otherwise removed from inventory.[2]

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[1] For example, if a business owes delinquent sales tax, the department's information system will likely include records for multiple debtors—the business itself plus any officers of the business who are individually liable.

[2] The division does not have a precise record of the amount of incoming debt in a given time period. Instead, the division imputes the amount of incoming debt by measuring the difference in total tax debt at two points in time and subtracting tax collected during that period. Because of the way some cases are accounted for and because of timing issues, this imputed amount of incoming tax debt may not be accurate.

Table 4.1: Tax Debt, Fiscal Years 2004-05

	FY 2004	FY 2005	Percentage Change
Amount of Tax Debt	$436,735,078	$459,636,780	5.2%
Number of Tax Debts	207,499	213,130	2.7

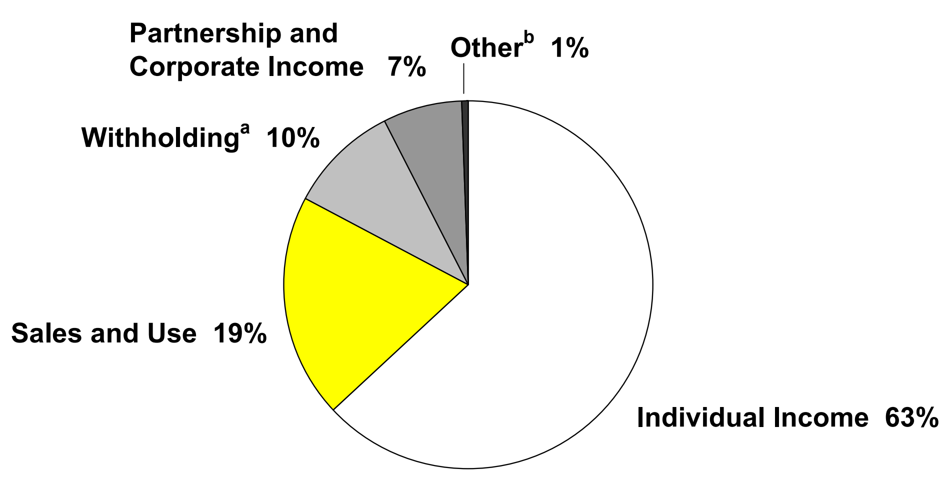
NOTE: Data are for the end of each fiscal year.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue collection case management data.

Recent growth in the amount of tax debt owed to the state is largely the result of more income tax audits.

Most of the delinquent taxes were associated with the individual income tax and the sales and use tax. As shown in Figure 4.1, individual income tax delinquencies accounted for 63 percent of tax debt at the end of fiscal year 2005; sales and use tax debt accounted for another 19 percent. According to department officials, most of the increase in new tax debts over the past several years was related to increased individual income tax audit activity, including pursuit of nonfilers. As discussed in Chapter 2, the department implemented a significantly larger nonfiler audit program beginning in fiscal year 2002. About 90 percent of nonfiler assessments are not paid within 60 days of assessment; thus, these accounts go to the Collection Division.

Figure 4.1: Tax Debt by Source, June 2005



NOTE: Percentages are based on $460 million in tax debt owed at the end of fiscal year 2005.

[a] This refers to individual income tax withholding that employers did not remit on time.

[b] The largest contributors to this category are debts related to the health care provider tax and the estate tax.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue data.

When considering the additional revenue to be gained from collecting delinquent payments, it is important to note that, at any given time:

- **Not all tax debts can be actively pursued.**

The Collection Division does not actively pursue a case if (1) the taxpayer is in bankruptcy proceedings; (2) the taxpayer has entered into an installment payment plan and is making timely payments; or (3) the department has temporarily suspended collection action (for example, because of temporary inability to pay or an ongoing appeal).[3] The division also does not pursue tax debts deemed to be "permanently uncollectible." A case is deemed uncollectible if the statute of limitations has expired, the debt was discharged in bankruptcy, or the only liable debtor has died or is indigent.

At the end of fiscal year 2005, an estimated 22 percent of tax debt was not available for active collection. Of this amount, about one-third was debt already being collected through installment payment plans. Another third was debt deemed uncollectible, and about one-quarter could not be pursued because the debtor was in the midst of bankruptcy proceedings. The remaining amount was not available for collection because the division had suspended the collection process for other reasons.[4] From a practical perspective, the working inventory of tax debt that collectors try to recover was roughly 75 percent of the debt on the books.

As previously discussed, we encountered some problems in obtaining and analyzing department data on tax delinquencies, which raised some concerns. Specifically, we found that:

- **The department's commonly reported collection data do not present an accurate picture of trends in state tax debt.**

The department needs to improve the way it collects and reports information on tax debts.

For several reasons, we did not find the division's reports of total state tax debt to be transparent or easily understood. First, for several years, the department did not follow its policy to regularly "charge off," or remove, debts considered permanently uncollectible from the state's inventory of tax debt. Following a $12 million charge-off in fiscal year 2000, the department did not remove uncollectible debts again until it charged off $29 million and $23 million in fiscal years 2004 and 2005, respectively.[5] Without regular charge-offs, department data overstate the amount of tax debt that the state can reasonably expect to collect. Second, to track the debt inventory, the division is supposed to regularly capture information on the number and amount of debts at specific points in time. It failed to capture these "snapshots" of the tax debt inventory for several months during 2003, so the department does not know what the tax debt inventory was at

[3] By federal law, creditors must stop debt collection activities during bankruptcy proceedings.

[4] The division's data on the amount of debt by collection status is debtor-based (with duplicates) and, thus, cannot be directly compared to the total amount of tax debt reported earlier, which was debt-based (without duplicates).

[5] According to division officials, the process of determining which debts should be deemed uncollectible and charged off consumes resources without a revenue benefit. As the department faced serious budget reductions in fiscal years 2001-03, officials chose not to do the case reviews that are required before a debt can be charged off.

the close of fiscal year 2003.[6] Together, these problems make it difficult to track debt over time, which, in turn, impedes the division's ability to understand how it might need to modify collection efforts.

Finally, although division managers track the age of debts (time since becoming delinquent) as an indicator of how quickly debts are being collected, for at least two years the computer program used to calculate case age was not measuring what the managers intended. Instead of tracking elapsed time since a tax payment went to the collection division for action, the data being extracted from the case management system was tracking time in the current case status. For example, if a 10-year-old debt changed from an active status to suspense status within the past year, its case age was calculated as less than one year. As a result, the data division managers had been using and reporting in department performance reports was erroneous, showing that most debts were less than a year old. The division corrected this measurement problem when it was discovered in November 2005. As we discuss in more detail below, the corrected data present a very different picture of how quickly the department resolves collection cases.

THE COLLECTION PROCESS

The Collection Division's goal is to collect debts as quickly as possible, at the lowest cost to the state.

As discussed earlier, tax debt collections have been increasing but have not kept pace with incoming delinquencies. The Collection Division itself has little control over the number or type of cases it receives, but its goal is to collect debts as quickly as possible, at the lowest cost to the taxpayer, while respecting debtors' rights. Table 4.2 illustrates the primary steps involved in collecting tax debts. To assess how well this process works, we evaluated trends in the amount of debt collected each year, the debt collection process, and how the division uses collection results and other data to target collection efforts.

In assessing trends in the amount collected and how quickly the department collects tax debts, we found that:

- **Additional funding helped the department increase the amount of tax debt collected each year, but most debts were not resolved quickly.**

As shown in Table 4.3, tax debt collected increased from about $150 million in fiscal year 2000 to about $191 million in fiscal year 2005. On average, the amount collected increased by 5 percent per year, but the average masks a significant increase in collections for fiscal year 2004 (a 27 percent increase from fiscal year 2003) followed by a 13 percent decrease from fiscal year 2004 to fiscal year 2005. According to the department, the fiscal year 2004 collection spike was due primarily to several multimillion dollar cases being closed, but also to short-term collection "pushes" within the division.

[6] At our request, the department estimated the amount of tax debt at the close of that fiscal year.

Table 4.2: Steps in the Collection Process, 2005

1. Declare Tax Payment Delinquent	For tax amounts due that are reported on a tax return, the payment becomes delinquent immediately after the filing due date. For additional assessments resulting from an audit, the payment becomes delinquent 60 days after the date of assessment.
2. Send First Notice	The department is required to notify the debtor of the delinquency amount, source, and due date. The notice also describes the debtor's rights and payment methods, including the option to pay in installments.
3. Identify Assets and Send Demand Letter	Collection staff use existing department data, such as that collected from tax returns and federal information returns, to identify assets. These assets may include savings accounts, wages, and investments. Once it has identified available assets, the department sends a demand letter informing the taxpayer that it will levy these assets in 30 days if the debt is not paid.
4. Levy Known Assets	If the taxpayer does not respond to the demand letter, the department levies the assets. These assets may not be sufficient to pay the debt in full. If the debtor agrees to pay the remainder in full or though installments, other collection action will be suspended.
5. Search for Other Assets and Levy	If the debt is still not resolved, the case is referred to collection agents who search for assets not previously identified and levy them.
6. Use Special Enforcement Tools	Agents may also use other special enforcement tools, such as offsetting state payments to the debtor, revoking a state-issued professional license, or seizing property.
7. Refer Case to Outside Collection Agency	If the department is unable to collect a debt, it is generally referred to an outside collection agency. These agencies may work the collection case for up to two years.
8. Deem Debt Uncollectible	If a debt has not been successfully collected by the department or an outside collection agency, the case will be reviewed to determine if the debt should be declared uncollectible. The department is supposed to remove uncollectible debt from the state's books.

NOTE: Not all cases proceed through each step. At various points, the debt collection process may be suspended. For example, if a taxpayer agrees to pay the debt in installments, the department stops enforced collection action as long as payments are made on time. Active collection also must stop if the debtor is in bankruptcy proceedings or if the related tax assessment is being appealed.

SOURCE: Office of the Legislative Auditor.

About 20 to 25 percent of debt is referred to outside collection agencies, but these agencies account for only 2 percent of annual collections.

Cases worked directly by Collection Division staff account for about 94 percent of reported collection revenue. Although roughly 20 to 25 percent of debt is referred to outside collection agencies, debt collected by the outside agencies accounts for about 2 percent of collection revenue each year.[7] The cases referred to outside collection agencies, however, are often older debts that Collection Division staff have not been able to collect, so it is to be expected that the outside agencies would collect a smaller proportion of debt.

[7] It is not possible to accurately calculate the percentage of debt successfully collected by outside agencies because department figures for the total amount of debt placed with collection agencies is debtor-based data and includes duplicate counts.

Table 4.3: Tax Debt Collected, Fiscal Years 2000-05

Collection Source	Amount Collected (in millions)						Average Annual Percentage Increase
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	
Collection Division	[a]	$150.7	$154.4	$163.5	$208.6	$178.1	
Nondelinquent Installment Agreements[b]	[a]	7.5	6.9	7.9	8.2	9.9	
Outside Collection Agency	[a]	2.2	2.9	2.8	3.7	3.3	
Total	$149.7	$160.4	$164.2	$174.2	$220.4	$191.3	5.0%

NOTE: Amounts are not adjusted for inflation, which grew an average of 2.5 percent per year during the same time period.

[a] Complete, detailed data are not available.

[b] Some taxpayers do not pay the full amount of tax due at the time they file their tax returns or at the close of an audit, but they voluntarily arrange to pay the balance due in installment payments. These taxpayers' accounts are not considered delinquent, but the Department of Revenue Collection Division administers the payment agreements.

SOURCE: Office of the Legislative Auditor Analysis of Department of Revenue data.

According to department data, additional staff hired with compliance initiative funding have, as intended, helped increase annual collections. Although the division director reports that division staffing has not returned to its mid-1990s peak, staffing has increased from about 193 in fiscal year 2000 to about 225 at the end of fiscal year 2005, a 17 percent increase. As required by statute, the division tracked the additional revenue associated with compliance initiative funding (essentially the revenue collected by staff hired with additional funds). According to the director, the return is good, but will likely improve with time because it takes some time for new hires to learn their jobs and become fully productive. Moreover, debt collection with additional staffing has not kept pace with the influx of cases associated with increased audit activity.

The division is not meeting its performance goal for the time it takes to collect a debt. For fiscal years 2006-07, the division's goal is to have 75 percent of debts be less than one year in inventory. However, as shown in Figure 4.2, as of November 2005, only 40 percent of debts were less than one year old, and 20 percent were more than five years old. The percentage of debts over five years old is particularly troublesome because the division had, by November 2005, charged off many old debts that were deemed uncollectible.

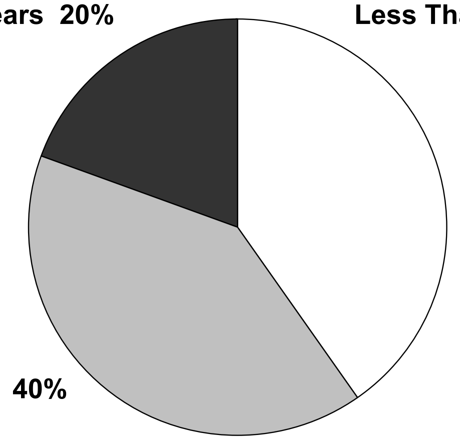
The department is not meeting its goal to collect most debts within a year.

While the speed with which the division can collect a debt depends on the debtor's cooperation, division collection procedures also influence how quickly a debt can be collected. We discussed with division staff the process of collecting debts, and we found that:

- **Some division collection practices are inefficient and allow inconsistent treatment of taxpayers.**

However, we could not determine the precise impact of these practices on the amount and pace of debt collection because of limitations in the department's data, which we discuss in more detail later in the chapter.

Figure 4.2: Age of Tax Debts, November 2005



NOTE: Percentages are based on 199,951 debts in the collection inventory at the end of November 2005. Debt age is the total time the debt has been in the Collection Division inventory.

SOURCE: Office of the Legislative Auditor analysis of Department of Revenue collections case management data.

The department's collection process has too many steps.

The division's case-routing procedures are cumbersome. According to the division director, the case management system routes cases through 45 different "functions" that reflect the status of the case (such as bankruptcy) or a particular step in the collection process (such as searching for debtor assets). When a case changes to a different status, it is often routed to a different work group for action. Within a group, a case can be routed among various individuals. In total, the division director estimated that current collection procedures and case routing include over 22,000 possible routing actions. While some movement of cases through these collection steps is automated, many require collection staff to manually initiate action. Cumulatively, these actions slow the debt collection process and can result in lost momentum in dealing with debtors.

The department does not do enough to tailor collection techniques to the type of debt.

In general, division staff handle all collection cases using the same sequence of steps, regardless of the type or size of the debt. For example, the division does not focus its resources on the collection cases that account for the majority of outstanding debt. As shown in Table 4.4, about 8 percent of cases—those with debt amounts greater than $10,000—account for about 72 percent of all tax debt. About 14 percent of these high-dollar cases are in bankruptcy, suspense, uncollectible, or pay plan status, leaving about 86 percent available for active collection action. But according to the division director, each incoming case is essentially handled the same way.[8] Individual collection agents may place a higher priority on high-dollar cases in their work inventories, but focusing on high-dollar debts is not an established procedure. According to the director, the dollar amount of the case is not the only factor to be considered when collecting the debt.

[8] Debts of active businesses are an exception. These debts follow the same path as others, but skip one asset research step.

Table 4.4: Distribution of Tax Debts by Size of Debt, June 2005

Size of Debt	Percentage of Cases	Percentage of Total Debt
$1 – 500	39.1%	1.9%
$501 – 1,000	17.5	2.7
$1001 – 5,000	29.5	14.1
$5,001 – 10,000	6.3	9.4
$10,001 – 50,000	6.2	27.2
More than $50,000	1.4	44.7
Total	100.0%	100.0%

NOTE: Percentages are calculated from debtor-based data that include duplicate records.

SOURCE: Office of the Legislative Auditor Analysis of Department of Revenue collection data.

The Collection Division's organizational structure and policies allowed debtors in similar situations to be treated differently. For many years, division staff were assigned to one of sixteen units, with each unit essentially functioning independently. Unit supervisors developed their own procedures, and in some cases, modified case routing rules in the collection management information system. In addition, the division did not have a written, detailed procedure manual, which further contributed to varying collection techniques among work groups. According to the division director, these factors have resulted in debtors in similar situations being treated differently.

The department does not have a quality review program for collection cases.

Aspects of the division's quality assurance and performance evaluation processes lack appropriate balance and standards. According to the division director, performance standards for the amount of debt to be collected annually were easy to meet. In addition, staff performance standards heavily emphasized quantity measures without being adequately balanced by quality measures. Overemphasizing quantitative performance measures can result in inadequate incentive to ensure that cases are handled according to division policy or that debtors are treated fairly. The director has since removed the quantitative performance standards from staff position descriptions while new standards are being developed. In large part because the division did not have standardized collection procedures until very recently, it also does not have a program to review the quality of staff's collection work.

While some inefficiencies in collection procedures are readily apparent, the division lacks key tools—primarily information—that would help it make specific, analytically-driven changes to collection practices. We found that:

- **The Collection Division lacks key data and analysis needed to assess productivity, making it difficult for managers to know whether the division uses the right collection actions at the right time.**

As discussed earlier, use of a highly standardized collection process has contributed to inefficient debt collection. However, to effectively tailor collection actions, the division needs to routinely obtain and analyze additional data on debts, debtors, and the outcomes of different collection strategies.

Often in response to our requests for information, Collection Division managers told us that, as currently structured, they could not obtain important data from their information systems. For example, they could not answer the following questions:

Managers do not have the data they need to answer important questions about the efficiency and effectiveness of the collection process.

- How much new debt enters the collection process each month, and what is the source of the debts?
- How long does it take to collect an income tax debt, a sales tax debt, and other debt types?
- What proportion of debts, by type of debt, are resolved at each step of the current collection process?
- What types of debts should be "fast-tracked" within the Collection Division or sent directly to outside collection agencies?
- How collectible are debts resulting from key audit programs, such as the Income Tax Division's nonfiler program?
- What is the return on investment for collecting specific types of debt?

To answer these questions, the division needs to augment its management information in a number of areas. For example, the division needs additional descriptive data on the debts in the collection inventory. It also needs the ability to link this descriptive information to the type and timing of collection actions and to the results of these actions. Finally, to more accurately determine the return on investment, the division needs better data on the cost of collecting different types of debts. It was not always clear to us what data could be extracted from existing systems and what data could be produced only if the information system were modified in some way. Nevertheless, for the division to make measurable progress in tailoring collection actions to the characteristics of a debt, it needs to know—not assume—what factors influence efficient collection of delinquent taxes due.

Improving data on the proportion of audit assessments that ultimately gets collected is important from a strategic perspective.

This information is important from a strategic perspective as well. For the department to critically assess its audit efforts, it should consider the extent to which audit assessments go to delinquent status and are ultimately collected. Although the department needs to establish that it pursues all taxpayers who do not pay assessed taxes, the department may want to allocate resources based in part on whether the assessments are likely to be collected. For example, thousands of income tax nonfiler audits result in debts being referred to the Collection Division. Indications are that many of these debts are never collected. The department could decide to limit the resources invested in collecting nonfilers' past taxes due and focus on the extent to which nonfilers improve their compliance in the years following the audit.

The Department of Revenue hired a new director of collections in 2004. The 18 months since has been a transition period, with the director making a number of changes to the division's organization and practices to address many of the weaknesses discussed thus far. Based on division plans and actions to date, we found that:

- **Recent changes should improve consistency and streamline collection processes, but it is too early to assess their actual impact.**

Overall, we think these changes target division problems that need to be addressed, but because they were implemented so recently, the actual impact on efficiency and effectiveness is unknown.

Recent Collection Division initiatives to improve its performance hold promise.

In July 2005, the division implemented a new organizational structure that, among other changes, consolidated special enforcement programs into a single group. Under the new structure, staff in the special enforcement group will work concurrently with the lead staff person on the case. Along with this change, the director intends to cross-train staff in the special enforcement group on several specialty programs, granting additional flexibility that had been missing.

To address another deficiency, the division in late 2005 implemented a detailed, online procedures manual. Previously, the division revised and published an online policy manual, the contents of which it controlled centrally.[9] The procedure manual is more detailed, giving step-by-step procedures for implementing various collection activities, such as placing a lien on a debtor's assets or levying bank accounts. According to the director, the division will use the procedure manual as the basis for more objective, standards-based assessments of case quality. As of December 2005, the division was developing a quality review program, but it was not yet in place.

The division has made some progress streamlining collection processes. For example, as a first collection step, staff routinely did "call campaigns" to contact debtors and assumed that was a productive step. Upon analyzing this process, however, the division determined that call campaigns for individual taxpayers were not particularly effective, because the calls were made during business hours when debtors were frequently not home. As a result, the division changed its procedures for making initial contact with individual debtors. The division is examining other aspects of the collection process with the intent of testing whether a collection practice produces the intended outcome.

CONCLUSIONS

The department needs to think more strategically about where to focus collection resources.

Although the data tracking tax debts over time are flawed, it is clear that the volume of state tax debts is growing. Recent investments in additional collection staff resources have, as intended, boosted annual collections. But because of weaknesses in the collection process, the state probably did not benefit from these investments as much as it could have. Recent Collection Division initiatives to improve its performance hold promise. However, the division will be hamstrung in its efforts to improve efficiency and effectiveness if the department does not invest in the information needed to support analytical decision-making—whether this means reprogramming to extract more useful

[9] Minnesota Department of Revenue, *Collection Manual* (St. Paul, 2004).

data from existing systems, modifying the division's case management system, or investing in new applications.

Improved data and analysis will be key to further progress.

The department also needs to think strategically about where to place collection resources. It is important from an overall compliance perspective for taxpayers to know that, if they are delinquent in paying taxes due, the state will pursue collection of the debt. However, the division also needs to consider the revenue yield from its activities. We think the collection process would be more successful if the division allocated additional resources to high-dollar debts and tailored collection techniques based on the characteristics of the debt.

RECOMMENDATIONS

Improve Data Collection and Analysis

RECOMMENDATIONS

To help manage and maintain data on tax debts, the Department of Revenue should:

- ***Regularly identify and remove from the collection system debts deemed permanently uncollectible,***
- ***Establish a standard set of descriptive measures for tax debts and debtors that portray the actual number and amount of each, and***
- ***Capture data on debts and cases at regular intervals.***

Collection Division staff, Department of Revenue senior managers, and legislators need shared access to understandable, accurate data about state tax debts. The division has already started to look at how it gathers and reports information, but it needs to do more to ensure that all stakeholders know, among other things, how many tax debts are on the books, which are available for collection, and how old the debts are. These data should not include duplicate counts of debts, and presentation of the data in and outside of the division should make clear what is and is not being counted. Given the dynamic nature of the debt inventory, the division should have processes in place to capture these data at regular intervals, including back-up contingencies in the case of staff absence or turnover. To better monitor trends, the division should also establish and follow procedures to charge off uncollectible debt at regular intervals.

RECOMMENDATION

To better manage the collection process and improve productivity, the Department of Revenue should allocate the necessary information technology staff resources to help define additional Collection Division data needs and implement related technical solutions.

Division managers told us that to work more strategically, they need better, more detailed information about debts, debtors, and the results of various collection actions. Division staff, however, need help to define specific data needs and to determine whether the information can be collected from existing system or if other changes need to be made. As a first step, we think the Department of Revenue should dedicate an information technology specialist or consultant, if funding allows, to the division to help determine what needs to be done. The department will then be in a better position to decide whether it should make additional information technology investments, such as a cost-accounting system.[10]

Streamline Collection Processes

RECOMMENDATION

To improve timely collection of debts, the Department of Revenue should simplify its collection procedures and case routing rules.

The Collection Division's case management system is too complex. While the division cannot control the timeliness of debtors' actions, it can influence the administrative time spent collecting debts. With its thousands of potential case hand-offs and 46 "status functions," we agree with division staff that simplified case routing presents a good opportunity for speeding the collection process. Because case routing is linked to the division's organization of work groups, changes to the case management system may mean that the division will also need to make organizational changes and revise its procedure manual.

Use Collection Resources More Strategically

RECOMMENDATIONS

To better target debt collection resources, the Department of Revenue should:

- ***Focus more intensive collection efforts on the high-dollar cases that account for most of the outstanding debt; and***
- ***Analyze past collection results to identify collection techniques best suited to specific debt or debtor characteristics, and modify collection strategies as appropriate.***

In the past year, the division has standardized collection procedures across work groups, and this is important for ensuring equitable treatment of debtors. But having standardized work processes does not mean that the collection process for

[10] Although not a focus of our evaluation, the Collection Division also collects debts for other state agencies. These other agencies are supposed to reimburse the Department of Revenue based on the cost of collecting debts. Without a basic system to track these costs, however, the department is not able to establish fees commensurate with the resources expended to collect other agencies' debts.

all types of debt need to be the same. As the division implements our other recommendations to improve data analysis and revise case routing, the division should look for other opportunities to tailor collection strategies as appropriate for specific types of debts or debtors. For example, division staff believe that they may be investing too many resources trying to collect on certain income tax nonfiler cases. If additional data analysis supports their theory, the department may want to consider outsourcing some or all of these debts or making other changes in its collection approach.

Improve Performance Management

RECOMMENDATIONS

To improve division performance, the Department of Revenue should:

- ***Design and implement a program to review case quality,***
- ***Establish complementary division and individual performance goals and measures that include both quantity and quality elements, and***
- ***Revise the employee performance review system to align with division goals.***

Our evaluation was limited in scope, and we did not extensively review the collection process from a debtor's perspective. Still, it was clear that the division needs to balance its quantitative performance goals with measures of case quality in order to ensure that an appropriate level of attention is directed at protecting taxpayers' rights. The division director agrees and has work underway to revise individual employee performance appraisals and to establish division performance measures that balance productivity with quality work.

List of Recommendations

Income Tax (pp. 15-45)

To improve audit productivity and address key contributors to the tax gap, the Department of Revenue should:

- Join the Internal Revenue Service's Fed-State tax return processing program;
- Expedite development of the data system that will handle federal audit reports submitted in electronic format;
- Expedite integration of data on drivers' licenses, motor vehicle registrations, and hunting and fishing licenses into the data warehouse; and
- Continue working to reduce employee turnover among income tax field auditors, including taking measures to make pay more competitive.

To further improve audit productivity, the Legislature should require employers to submit state withholding data in a common electronic format.

To better target audit resources, the Department of Revenue should improve its evaluation of income tax audit projects, including measuring their impact on voluntary compliance.

To bring more focus to education services and to help reduce the income tax gap, the Department of Revenue should create a performance plan that lays out specific objectives for taxpayer education and outreach, steps to meet those objectives, and measures for assessing progress.

To help taxpayers make educated decisions when choosing a tax preparer, the Legislature should amend state law to require the Department of Revenue to publish the names of tax preparers that have received certain civil penalties.

To improve access to telephone assistance during periods of high demand, the Department of Revenue should:

- Establish reasonable service goals for the percentage of calls answered and use staffing, scheduling options, and call routing techniques to meet these goals;
- To the extent possible, modify the automated telephone system to more strongly encourage callers to use the automated refund status options; and
- Alter the call routing protocols as needed to place a high priority on technical tax calls.

To better aid compliance among taxpayers with limited English proficiency, the Department of Revenue should:

- Assess the demand for more education materials and telephone assistance services in other languages; and
- As warranted, translate more written materials and add automated phone menus in other languages.

To better assess the quality of assistance provided, the Department of Revenue should:

- Improve the checklist used for assessing telephone calls and monitor more calls involving technical tax questions, and
- Develop performance goals and measures for responses to taxpayers' written inquiries and evaluate the accuracy of these responses.

Sales and Use Tax (pp. 47-69)

To improve audit productivity, the Department of Revenue should:

- Expedite improvements in the data warehouse, including the addition of new data on Minnesota businesses;
- Encourage regional office staff to share successful audit selection techniques and adopt divisionwide the practices of regional offices that have demonstrated productive audit selection techniques;
- Modify or eliminate unproductive audit projects; and
- Track tax compliance rates for its audit projects.

To help ensure that education resources are effectively targeted, the Department of Revenue should:

- Review and revise its education course offerings and materials to ensure that they are closely linked to the department's stated compliance priorities for the sales and use tax;
- Initiate needed research to assess how to best deliver education services for specific groups of taxpayers, particularly taxpayers with limited English proficiency; and
- Create a performance plan that lays out specific objectives for taxpayer education and outreach, steps to meet those objectives, and measures for assessing progress.

To improve access to call center telephone and e-mail assistance, the Department of Revenue should:

- Pursue automated service options that would help reduce demand;
- Use staffing, scheduling, and call routing options to improve access to telephone assistance; and
- In doing so, consider merging all or part of the call center and technical tax assistance workload.

To better ensure the quality and accuracy assistance provided by e-mail and telephone, the Department of Revenue should:

- Establish quality-related performance goals and measures,
- Develop and implement a quality review process, and
- Use quality review results to develop and implement staff training plans.

Collection (pp. 71-84)

To help manage and maintain data on tax debts, the Department of Revenue should:

- Regularly identify and remove from the collection system debts deemed permanently uncollectible,
- Establish a standard set of descriptive measures for tax debts and debtors that portray the actual number and amount of each, and
- Capture data on debts and cases at regular intervals.

To better manage the collection process and improve productivity, the Department of Revenue should allocate the necessary information technology staff resources to help define additional Collection Division data needs and implement related technical solutions.

To improve timely collection of debts, the Department of Revenue should simplify its collection procedures and case routing rules.

To better target debt collection resources, the Department of Revenue should:

- Focus more intensive collection efforts on the high-dollar cases that account for most of the outstanding debt; and
- Analyze past collection results to identify collection techniques best suited to specific debt or debtor characteristics, and modify collection strategies as appropriate.

To improve division performance, the Department of Revenue should:

- Design and implement a program to review case quality,
- Establish complementary division and individual performance goals and measures that include both quantity and quality elements, and
- Revise the employee performance review system to align with division goals.

MINNESOTA · REVENUE

February 17, 2006

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
140 Centennial Office Building
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

This is in response to a series of recommendations the Office of the Legislative Auditor (OLA) made in connection with its evaluation of the Department of Revenue tax compliance activities. The evaluation focused on the department's tax compliance activities in three major areas: individual income tax, sales and use taxes, and collection of delinquent taxes.

Overall, the evaluation concurs with the department's estimate of the scope of non-compliance and recognizes the appropriateness of the strategies the agency employs to improve tax compliance. Among these are:

- The gap between the amount of tax that should be paid and the amount of tax that is paid is nearly $1.1 billion - $604 million in income tax and about $500 million in sales and use tax. (The department is in the process of updating the tax gap estimates for the income tax and the sales tax.)
- Improving tax compliance requires a comprehensive approach which includes:
  - providing taxpayers with high-quality services and information they need to meet their tax obligations;
  - auditing taxpayers to resolve discrepancies, discourage tax evasion and identify levels and patterns of non-compliance; and
  - enforcing the tax laws for those who do not comply voluntarily.
- Auditing is an effective means for gaining overall compliance with the tax system and for generating additional revenue, raising about $6 to $7 for each dollar spent.

The department agrees with the vast majority of recommendations made by the OLA. The recommendations align with efforts already under way in the department to improve the delivery of services to citizens and overall compliance with Minnesota's tax system. More specifically, the department:

- recently completed the first phase of a three-phase process to upgrade our data warehouses for detecting non-compliance among income tax and sales tax filers. The final phase will result in the acquiring of more sophisticated analytical tools to detect non-compliance.
- instituted an annual electronic match of employer filed W-2 forms with the amount reported by individuals on their income tax returns.
- is in the process of developing more effective ways to deliver telephone assistance to taxpayers. Once complete, the department will be able to better serve limited English speaking citizens, more efficiently serve callers during peak periods and provide

- higher-quality responses to taxpayer inquiries.

  (The department is one of five states to offer income tax instructions in Spanish. It also publishes Working Family Credit instructions in ten languages.)

- is evaluating options for improving our computer systems. This effort will address most of the shortcomings of the current systems that the OLA identified in its evaluation.

- is in the midst of a workforce planning process that includes strategies for retaining newly-hired employees as well as highly experienced employees. This effort includes strengthening reward and recognition programs, expanding learning and growth opportunities and increasing compensation scales.

- is streamlining systems for the collection of delinquent taxes along the lines recommended in the OLA's evaluation.

The department is willing to share any information about these developments and welcomes further public discussions on the direction and progress of these efforts.

The OLA's evaluation and recommendations provide helpful suggestions for making these efforts more effective and provides a useful tool to guide the department in its effort to improve compliance with the state's tax system.

Sincerely,

Daniel A. Salomone
Commissioner

Recent Program Evaluations

Forthcoming Evaluations
Liquor Regulation, March 2006
Public Assistance Eligibility Determination for Non-Citizens, Spring 2006

Agriculture
Pesticide Regulation, March 2006
Animal Feedlot Regulation, January 1999

Criminal Justice
Substance Abuse Treatment, February 2006
Community Supervision of Sex Offenders, January 2005
CriMNet, March 2004
Chronic Offenders, February 2001
District Courts, January 2001

Education, K-12 and Preschool
School District Integration Revenue, November 2005
No Child Left Behind, February/March 2004
Charter School Financial Accountability, June 2003
Teacher Recruitment and Retention: Summary of Major Studies, March 2002
Early Childhood Education Programs, January 2001
School District Finances, February 2000
Minnesota State High School League, June 1998
Remedial Education, January 1998

Education, Postsecondary
Compensation at the University of Minnesota, February 2004
Higher Education Tuition Reciprocity, September 2003
The MnSCU Merger, August 2000

Environment and Natural Resources
State-Funded Trails for Motorized Recreation, January 2003
Water Quality: Permitting and Compliance Monitoring, January 2002
Minnesota Pollution Control Agency Funding, January 2002
Recycling and Waste Reduction, January 2002
State Park Management, January 2000
Counties' Use of Administrative Penalties for Solid and Hazardous Waste Violations, February 1999
Metropolitan Mosquito Control District, January 1999
School Trust Land, March 1998

Financial Institutions, Insurance, and Regulated Industries
Energy Conservation Improvement Program, January 2005
Directory of Regulated Occupations in Minnesota, February 1999
Occupational Regulation, February 1999

Government Operations
Tax Compliance, March 2006
Professional/Technical Contracting, January 2003
State Employee Health Insurance, February 2002
State Archaeologist, April 2001
State Employee Compensation, February 2000
State Mandates on Local Governments, January 2000
Fire Services: A Best Practices Review, April 1999
State Building Code, January 1999
9-1-1- Dispatching: A Best Practices Review, March 1998
State Building Maintenance, February 1998

Health
Nursing Home Inspections, February 2005
Minnesota Care, January 2003
Insurance for Behavioral Health Care, February 2001

Human Services
Substance Abuse Treatment, February 2006
Child Support Enforcement, February 2006
Child Care Reimbursement Rates, January 2005
Medicaid Home and Community-Based Waiver Services for Persons with Mental Retardation or Related Conditions, February 2004
Controlling Improper Payments in the Medicaid Assistance Program, August 2003
Economic Status of Welfare Recipients, January 2002
Juvenile Out-of-Home Placement, January 1999
Child Protective Services, January 1998

Housing and Local Government
Preserving Housing: A Best Practices Review, April 2003
Managing Local Government Computer Systems: A Best Practices Review, April 2002
Local E-Government: A Best Practices Review, April 2002
Affordable Housing, January 2001
Preventive Maintenance for Local Government Buildings: A Best Practices Review, April 2000

Jobs, Training, and Labor
Workforce Development Services, February 2005
Financing Unemployment Insurance, January 2002

Miscellaneous
Gambling Regulation and Oversight, January 2005
Minnesota State Lottery, February 2004

Transportation
Metropolitan Airports Commission, January 2003
Transit Services, February 1998

Evaluation reports can be obtained free of charge from the Legislative Auditor's Office, Program Evaluation Division, Room 140 Centennial Building, 658 Cedar Street, Saint Paul, Minnesota 55155, 651/296-4708. Full text versions of recent reports are also available at the OLA website: http://www.auditor.leg.state.mn.us

#2

Senate State Government Budget Division
March 14, 2006

Office of the Legislative Auditor
State of Minnesota

Tax Compliance / Evaluation

Mainframe Computers / Security Audit

Council on Black Minnesotans / Financial Audit

Presentation to:

Senate State Government Budget Division

March 14, 2006

1

Office of the Legislative Auditor
State of Minnesota

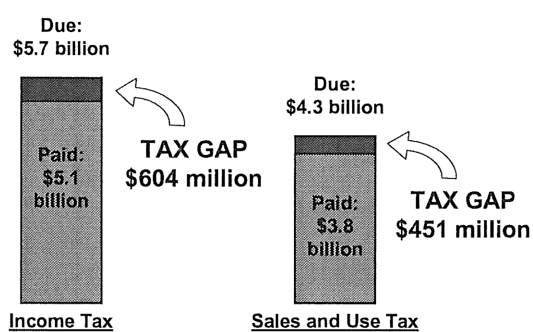
Tax Compliance / Evaluation

March 2006

Deborah Parker Junod, Manager

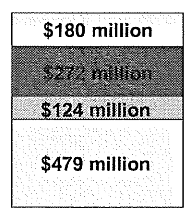
2

Minnesota Has A Tax Compliance Problem



3

Minnesota Has A Tax Compliance Problem



Unpaid Sales Tax

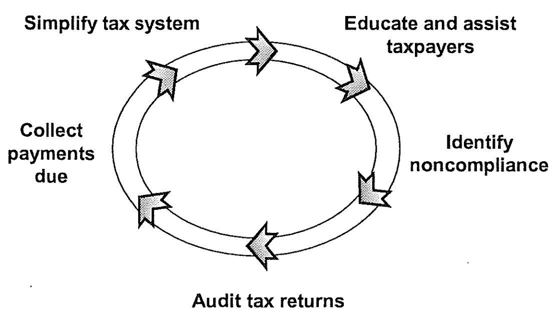
Unpaid Use Tax

Income Tax Nonfilers

Underreported Income
-- Mostly from self-employment

4

Tax Compliance Strategies



5

Tax Compliance Efforts Can Be Improved

Strategies are sound

But need to improve:

- Access to telephone assistance
- Audit productivity
- Data for finding noncompliance
- Collection of delinquent payments

6

Tax Audit Objectives

- Raise revenue
- Target the tax gap
- Encourage long-term voluntary compliance

7

On Average, Audits Are Productive

Income tax audits ⇨ Raise $6.70 per dollar spent

Sales and use tax audits ⇨ Raise $5.40 per dollar spent

- Estimates do not include added revenue that may come from better voluntary compliance

8

Some Resources Should Be Redirected

- Too many audits resulted in no change to tax due
- Audit projects repeated in spite of below-average results

9

Mixed Success Targeting The Tax Gap

TAX GAP	DUE TO
$124 million	Income Tax Nonfilers
$479 million	Underreported Income (Largely from self-employment)
$451 million	Unpaid Sales & Use Tax

10

Mixed Success Targeting The Tax Gap

Nonfilers	Substantial Progress
Underreported Income	Limited Progress
Unpaid Sales & Use Tax	Limited Progress

11

Can Make Better Use Of Data To Find Noncompliance

- Not participating in Fed-State electronic filing program
- Ineffective use of W-2 Wage and Tax Statements

12

Recommendation to the Legislature

Require Minnesota employers to file W-2 Wage and Tax Statements electronically, in a common format

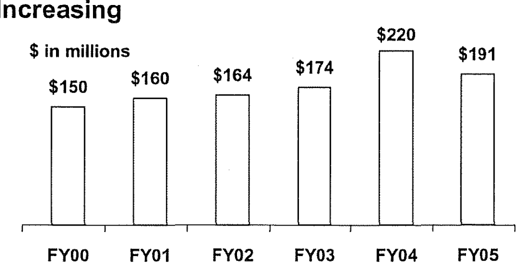
13

Amount Of Delinquent Tax Payments Owed To The State Is Increasing

- Delinquent payments include:
  - Balance due reported on return but not paid
  - Audit assessment not paid within 60 days
- $459 million at the end of FY 2005
- 63% of debts — late income tax payments
- Growing by roughly 8% per year since FY 2000
- Growth attributed to increased auditing

14

Amount Of Delinquent Tax Collected Is Increasing



- Collections increasing by 5% per year
- Not keeping pace with incoming delinquencies

15

Collection Process Is Inefficient

- Too many steps and case hand-offs
- Collection techniques not tailored to debt type or debtor characteristics
- Result — delays collecting debts
  - 60% of debts are more than a year old
- Data and analysis not sufficient

16

Conclusions

- No trouble putting compliance initiative funding to good use
- Sound strategies, room to improve execution
- Refine current efforts before growing much more

17

OLA Office of the Legislative Auditor
State of Minnesota

Mainframe Computers Security Audit

December 2005

Christopher Buse, Manager

18

Why Audit?

- Deliver critical services
  - Social service programs
  - Tax collections
  - Driver and motor vehicle licensing
  - Accounting and general ledger
  - Payroll and personnel
- Store vast amounts of nonpublic data
- History of problems

19

Mainframe Environment

- Under the Office of Enterprise Technology since July 1, 2005
- Extremely complex
  - Three mainframe computers
  - Accessed by thousands of people daily
  - Thousands of purchased and custom-developed software programs

20

Audit Objective

- Assess the adequacy of controls designed to protect the integrity and confidentiality of data

21

Conclusions

- Mainframe data was vulnerable to
  - Loss
  - Tampering
  - Unauthorized disclosure
- Security weaknesses from prior audits were not completely addressed

22

Audit Findings

- Eight findings in report
- Three critical
  - No comprehensive security program
  - Excessive access to computer programs and data
  - Unauthorized changes to critical system files could occur and could go undetected

23

OLA Office of the Legislative Auditor
State of Minnesota

Council on Black Minnesotans Financial Audit

March 2006

David Poliseno, Manager

24

Audit Objectives

- To assess the council's internal control structure
- To determine if the council complied with legal compliance requirements
- To follow up on prior audit findings

25

Prior Audit Report

- Issued in September 2002
- Contained twelve findings, five critical
  - One employee falsified time records
  - Inappropriate per diems
  - Improper grant administration
  - Financial activities not properly recorded
  - Special expense policy not followed

26

Conclusions

- Nine findings, five critical
- Many internal control weakness
- Some instances of noncompliance
- Six of twelve prior audit findings not resolved

27

Current Audit Findings

- Unsupported payroll expenditures
- Per diem overpayments totaling $1,430 not collected
- Improperly spent grant funds totaling $51,000 not repaid
- Receipts not deposited in the state treasury or recorded in the state's accounting system
- Council meetings not well attended

28

Possible Solutions

- The council should work with other state agencies to resolve deficiencies
  - Department of Administration
  - Department of Finance
  - Department of Education
  - Office of the Attorney General

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Reports issued by the
Office of the Legislative Auditor
are available at:

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MINNESOTA · REVENUE

Expanded Tax Compliance Initiatives

Fiscal years 2006 – 2007

Report to the Minnesota Legislature

March 2006

MINNESOTA · REVENUE

March 2006

To the members of the legislature of the state of Minnesota:

The Minnesota Legislature appropriated $17.8 million to the Department of Revenue in the 2006–07 biennium to generate an added $90.7 million in revenue through stepped up tax enforcement activities. This is the first of two reports on progress toward achieving this goal.

(The appropriation to the increased tax compliance activities was authorized by the legislature under Laws of Minnesota 2005, Chapter 156, Article 1, Section15, subdivisions 2 and 3.)

As of December 31, 2005, the department spent $2.4 million of the approximately $17.8 million appropriated. This expenditure has led to the collection of $17.1 million, or 19 percent of anticipated $90.7 million for the biennium.

Of the $17.1 million collected,

- $10.8 million was generated from identifying nonfilers and increasing the number of audits of individuals and businesses, including the payers of lawful gambling taxes, insurance taxes, tobacco taxes and alcoholic beverage taxes.
- $6.3 million was produced from increases in delinquent tax collection activities.

Based on the results to date, the department is on track to collect the estimated $90.7 in added revenue for the biennium. The department is generating about $7 in added revenue for every $1 spent on these expanded tax enforcement activities.

Revenue gains from increased tax enforcement efforts are generally slowest during the initial months, primarily due to the time required to hire and train new employees. Now that the department has completed the initial hiring and training process, the revenue gains should accelerate.

The activities described in this report are a part of the department's on-going effort to identify and address patterns of noncompliance with the state's tax laws. Copies of this report are available at www.taxes.state.mn.us.

Please contact me if you need additional information about the results achieved in this report.

Sincerely,

Daniel A. Salomone
Commissioner

Laws of Minnesota 2005, Chapter 156, Article 1, Section 15, Subdivision 2-3.

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Summary of Findings

The Minnesota Legislature appropriated $17.8 million to the Department of Revenue for the 2006-07 biennium to collect $90.7 million through expanded tax compliance activities (Laws of Minnesota 2005, Chapter 156, article 1, section 15, and subdivision 2-3). This report summarizes the results the department has achieved through the end of December 2005, and is the first of two reports for the biennium. During this period — with 25 percent of the biennium completed — the department has:

- Collected and deposited in the general fund $17.1 million, or 19 percent, of the anticipated $90.7 million sought through the tax compliance initiatives.
- Resolved a total of 7,937 noncompliant individual income tax cases.
- Identified a total of 420 noncompliant sales and use tax payers and 435 noncompliant corporate tax payers.
- Expended $2.4 million and hired 92.9 full-time equivalents (FTEs).

To collect the $17.1 million to date, the department has spent $2.4 million, or approximately $1 for every $7 collected. In the remaining months of the FY 2006-07 biennium, the department expects to achieve the legislated goal.

Expanded Tax Compliance Initiatives Report 2006

This report was prepared by the Minnesota Department of Revenue (the department) and developed for the legislature in response to a legislative directive (Laws of Minnesota 2005, Chapter 156, article 1, section15, subdivision 2-3). Copies of this report are available on the Department of Revenue website at www.taxes.state.mn.us.

Cost of report preparation: $28 x 30 hours = $840
Report printing cost: $25.
Total estimated cost of this report: $865.

Purpose of this Report

This is the first of two reports by the department for the FY 2006-07 biennium. It provides performance results in accordance with the 2005 session mandate.

For the FY 2006-07 biennium, the department was appropriated $17.8 million from the general fund to identify and collect tax liabilities from individuals and businesses that currently do not pay taxes owed. This initiative is expected to result in new general fund revenues of $90.7 million by the end of the biennium.

The 2005 session mandate directs the department to report performance results for the following:

- The number of noncompliant corporate taxpayers each year and the percentage and dollar amount of valid tax liabilities collected;

- The number of noncompliant sales and use taxpayers each year and the percentage and dollar amount of the valid tax liabilities collected;

- The number of noncompliant individual income tax cases resolved each year and the percentage and dollar amount of valid tax liabilities collected; and

- Base level expenditures and staff positions provided at the budget activity level related to compliance and audit activities, including baseline information as of January 1, 2004.

The first report provides background and a description of the current performance of the expanded tax compliance initiative within the department. Biennium-to-date results referenced in this report reflect the time period of July 2005 to December 2005.

This report is organized into four sections:

I. FY 2004 Compliance and Enforcement Base Performance

II. FY 2006-07 Expanded Tax Compliance Initiative Performance

- Year-to-Date Expenditures/Full-Time Equivalents (FTEs) Hired
- Year-to-Date Revenues

III. Observations and Trends

IV. Appendix - Methodology

I. FY 2004 Compliance and Enforcement Base Performance

A key element of the department's strategic plan is to ensure that *everyone pays the right amount, no more, no less*. To make this vision operational, the department is focusing on methods for measuring compliance with Minnesota's tax system.

The department conducted two studies to measure the tax gap—the difference between the amount of taxes actually paid and the amount of taxes that should have been paid. The first of the two studies, conducted in 2002, revealed a sales tax gap of about $500 million; that is expected to grow to $700 million by 2007. The second study, conducted in 2004, focused on the individual income tax. This study revealed an annual gap of about $604 million.

To eliminate or minimize these gaps, the department is conducting the following activities in order to pursue noncompliant taxpayers, including, but not limited to: (1) auditing taxpayer filings to correct errors and detect abuse; (2) identifying taxpayers who should file, but did not ("nonfilers"); (3) identifying unreported taxable activity; (4) providing taxpayer outreach and education programs; and (5) pursuing collection activities on delinquent accounts.

In Table 1.0, the department provides an estimate of dollars expended and revenues generated from audit and compliance activities conducted in FY 2004. For the tax types listed in table 1.0, assessments are made from audits. The taxpayer generally has 90 days to appeal any assessment before the case is sent to the Collection Division for enforced compliance. Appendix A describes the methodology for Table 1.0.

Table 1.0
FY 2004 Estimated Direct Compliance and Enforcement Activity Base Revenue

Tax Type/Function	FTE	Estimated Compliance Revenues	Estimated Expenditures	Ratio (rev:exp)
Collection	212.6	$ 237,944,307	$12,860,841	18.5
Individual Income Tax	113.3	10,006,215	6,414,008	1.5
Withholding	10.2	1,708,873	517,932	3.3
Sales and Use/Corp Taxes	185.0	84,789,980	12,136,735	6.9
Special Taxes	34.0	4,629,019	2,074,556	2.2
Tax Operations	29.5	23,770,893	1,509,403	15.7
TOTAL	584.6	$ 362,849,287	$35,513,475	*10.2*

The base revenues generated from all audit and compliance activities is a function of multiple variables such as the retention of experienced revenue tax specialists (RTS), as well as the number of analytical software applications tools deployed by the department for audit selection. The ratio of revenues to expenditures continues to remain high, despite recruitment and retention issues that are described in detail in section III.

II. Performance of the FY 2006-07 Expanded Tax Compliance Initiative

Expenditures and Full-time Equivalents

As of December 31, 2005, the department has spent approximately $2.4 million for this initiative for the FY 2006-2007 biennium. Payroll is the largest expenditure category accounting for 87 percent of total expenditures. Table 2.0 shows these expenditures in detail.

Table 2.0.
FY 2006-07 Expanded Tax Compliance Expenditures through 12/31/05

	Expenditures	% of Total
Payroll	$2,094,201	87.43%
Contractual	-	0%
Equipment	$73,350	3.06%
Supplies	$5,380	.22%
Travel	$63,904	2.67%
Other	$158,380	6.61%
Total	*$2,395,215*	*100.00%*

On average, it takes the department approximately one to two months to fill positions for this initiative. Table 2.1 shows the number of staff hired to date. Since July 2005, approximately 92.9 FTEs have been hired in the Revenue Tax Specialist (RTS) or Revenue Collection Officer (RCO) classifications.

Table 2.1
Expanded Tax Compliance Initiative FTE

	FY 2006 YTD Actual	FY 2007 Planned	FY 2006-2007 Planned
Initiative FTEs	92	144	144

Noncompliant Taxpayers and noncompliance cases

The expanded tax compliance initiative provides funding to increase audit and collection activity. The tax types selected to be the focus of the expanded direct compliance efforts are income tax, sales and use tax, corporate tax, insurance tax, gambling tax and withholding tax. Initiative funding will be used to strategically improve compliance and identify noncompliant taxpayers and resolve noncompliant cases.

The number of individual income tax noncompliant cases resolved and the number of taxpayers that are not in compliance with the sales and use and corporate tax laws are tracked as a performance measure for this initiative.

For individual income tax, there have been 7,937 noncompliant taxpayer cases resolved as a result of the tax compliance initiative. An individual income taxpayer case is resolved if the following occurs:

- The auditor files a return for a nonfiling taxpayer; or
- The auditor is able to get the nonfiling taxpayer to file a return;
- The auditor completes an audit report. This audit report may indicate a balance due, a refund or no change to the return.

There has been a total of 420 businesses and 435 corporations that have been identified as noncompliant with the sales and use and corporate tax laws. Different from income tax, a business or corporation is noncompliant with the tax laws if the audit or other compliance actions result in a change in taxpayer liability.

Revenues

Additional revenue is generated from these stepped-up compliance actions. Through the end of December 2005 (with 25 percent of the biennium completed), the total revenue collected from the tax compliance initiative and deposited into the general fund is $17.1 million. Table 2.2 provides detailed data related to the total revenues collected for each tax type/function from this initiative. By the end of FY 2006, the department expects to achieve the legislated goal.

Table 2.2
Biennium Year-To-Date Compliance Initiative Revenue Results

Tax Type/Function	Actual Compliance Collections	Biennium Target	% of Target Achieved
Collection	$6,331,128	$41,300,000	15%
Individual Income Tax	$2,684,470	$9,050,000	30%
Withholding	$230,809	$1,200,000	19%
Sales and Use/Corp Taxes	$6,976,898	$35,173,192	20%
Special Taxes	$736,774	$2,200,000	33%
Tax Operations Early Audit[1]	$169,623	$1,728,000	10%
TOTAL	***$17,129,703***	***$90,651,192***	***19%***

III. Observations and Trends

Important trends affecting tax compliance to note:

- Revenue production from compliance efforts is a function of the number of filled positions in the revenue tax specialist (RTS) and revenue collection officer (RCO) classifications. In FY 2005, the turnover rate or the rate of new hires to resignations for the RTS classification series was 35 percent. The department continues to identify and implement strategies aimed at minimizing the turnover rate for this position classification. For the first half of FY 2006, the turnover rate has slightly declined to 26 percent. This is what the department has done over the last 12 months to decrease turnover for this classification:
    - In consultation with the Department of Employee Relations (DOER), the starting salary for all RTS employees hired since January 2003 has been adjusted. This has resulted in retroactive pay adjustments for approximately 110 RTS employees

[1] In Table 2.3, the amount in this table for Tax Operations Early Audit includes collections from refund reductions only. Collections for payments received from accounts receivable and refund offsets are not included in this table because this data was not available when the report was compiled. This data will be included in the final report for the expanded tax initiatives of the FY 2006-07 biennium.

    - The starting pay for new RTS employees has been adjusted to be more competitive with other employers.
    - Improved rewards, recognition and tuition reimbursement policies for all employees.

- The department initiated a data warehouse project in November 2003. The objectives of this project are to reduce redundant data storage, increase compliance opportunities and enable increased efficiency throughout the department. Two of the project's three phases of this project have been compiled. This data warehouse project will directly impact the tax compliance initiatives by improving business intelligence. Improved business intelligence will enable the department to more effectively identify more productive audit selection and collection opportunities.

IV. Appendix – Methodology

Table 1.0

a. Expenditures:

The base for compliance activity expenditures in FY 2004 was derived by compiling payroll expenditures for the number of full-time equivalents (FTE) engaged in compliance and enforcement activities. These FTEs were identified by management in each tax type/ functional area. Payroll expenditures for FTEs were extracted from the Information Access (IA) warehouse. Employer payroll tax, retirement and insurance were included in the data extraction. The count of FTEs was derived by the total number of hours worked in FY 2004 and divided by 2,096.

b. Revenues:

Collections:
The base consists of total collections as reported in the Lotus Notes database called CD FY04 performance. The total revenue production is the sum of collections from tax debt and nontax debt, minus bad checks.

Sales and Use Tax:
The estimate for base collections is derived from a rolling average of estimated (or actual) collections over a period of four fiscal years, FY 2001 to FY 2004. Included in this estimate are the following compliance activities:

- Actual dollars collected from field and managed audits within 90 days of the order date including claims denied, remaining claims applied, and interest paid on claims allowed that was applied. The estimate does not include the additional claims/credits found during an audit by a revenue tax specialist.
- Dollars from nexus voluntary disclosure. It is assumed that 100 percent is collected on liability reported.
- Dollars from nexus investigations. It is assumed that 85 percent is collected from liability reported and assessed.
- Dollars from office audits. It is assumed that 50 percent is collected on assessments.
- Dollars from self-reviews. It is assumed that 100 percent is collected on additional tax reported.
- Dollars from non-filers. It is assumed that 50 percent is collected on assessments.

Corporate Tax:
The estimate for base collections is derived from a rolling average of three fiscal years, FY 2002 to FY 2004. Included in this estimate are the following compliance activities:

- Dollars collected from payments paid on proposal as a result of additional tax assessments as recorded in the corporate inventory system.
- Dollars collected from payments received from nexus activities.

- Dollars collected from claims denied. If the audit results in additional tax being assessed, only the reduction of the claim to zero is included. For this base estimate in this report, a ten-year average of claims denied is used.
- Over-assessments from audits that result in refunding tax as recorded in the corporate inventory system.

Individual Income Tax:
The estimate for base collections is derived from a rolling average of three fiscal years, FY 2001 to FY 2003. Included in this estimate are the following compliance activities:
- Dollars collected from payments received during the proposal period for office audits, field audits and nonfiler audits.
- Dollars collected from refunds denied during the early audit phase of processing a tax return.

Withholding Tax:
The estimate for base collections is derived from dollars paid on proposal during the first 90 days of the tax order date, minus dollars transferred out and refunded.

Special Taxes:
The estimate is derived from assessments from direct compliance activities from the following taxes: gambling, insurance, solid waste management, metropolitan landfill contingency action trust fund (MLCAT), dry cleaner, cigarette, tobacco, occupation, liquor, wine, malt beverages, common carrier, mortgage and deed, MinnesotaCare and mining tax. For the taxes listed, except MinnesotaCare, it is assumed that 100 percent is collected from additional tax assessments made.

Tax Operations:
The estimate is based on calendar year 2004 and includes the following:
- Refund reductions from current and prior year returns including: tax year 1996 and prior years, M-1 returns, M-1X returns PR-X returns, PR returns, and political contribution refund returns;
- Payments received from accounts receivable during 90 days of the tax order date; and
- Refund off-sets which took place during the 90 days of the tax order date.

MINNESOTA · REVENUE

Improving Minnesota State Debt Collection

Study and Recommendations

presented to the Governor and Legislature
of the State of Minnesota

February 15, 2006

This report was prepared in accordance with the Laws of Minnesota 2005, Chapter 156, article 1, section 15, subdivision 3.

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The estimated cost to prepare this report is $10,000 and 640 hours.

Improving Minnesota State Debt Collection

Study and Recommendations

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Introduction

Purpose of the study

The 2005 Minnesota Legislature directed the Minnesota Department of Revenue to prepare a study of state and local government practices for collecting debt, and present it to the Governor and Legislature by February 15, 2006.

The legislation directs the Commissioner of Revenue, in consultation with other state agencies and local units of government, to develop recommendations for:

- consolidating and coordinating the collection of debt owed to governmental units;
- eliminating the fragmentation of contacts from government agencies with debtors owing such debts; and
- reducing the cost of collecting debt owed to governmental units.

To develop recommendations for improving government debt collection processes, this report:

- evaluates the status of debt collections for state[1] debt;
- identifies areas where collection processes and tools can be used more effectively; and
- identifies ways in which to make the process of paying delinquent debts more user-friendly and understandable to the debtor.

Faced with increased fiscal pressures, state and local governments must find more efficient ways to deliver public services, including the collection of debts. Governor Pawlenty's "Drive to Excellence" project has identified numerous opportunities to streamline agency business processes to improve the delivery of services and reduce costs. While consolidated debt collection is not part of the initial phases of the current Drive to Excellence effort, it is consistent with the project's goals of providing better public services at lower cost.

Methodology

Information on current state agency collection practices was obtained through surveys and interviews. Agencies were asked to provide information about the tools and techniques they use in collecting debts owed them, including estimates of their costs of collection, return on investments in collections, and the number of employees engaged in the collection process (FTE).

In November 2005, surveys were sent to 25 agencies. Of that number, 18 responded. Site visits were conducted at selected agencies.

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[1] This report focuses on the collection of state agency debt. Many of the issues and recommendations might also apply to the collection of local government debt. Although the legislation directed that this study also evaluate city and county debt, the large number of local units of government, their diversity, and study time constraints made that impossible. This study recommends that the potential for state collection of local government debt be explored separately, and that a pilot project be created to identify issues and opportunities for more efficient collection of local government debt.

2. Data collected from the agencies was compared to agency data sent to the Department of Finance and reported in their June and/or September 2005 reports.

As part of our research, we looked at industry-standard debt collection principles. Those principles included:

- Have aggressive but fair programs to recover delinquent debts.
- Promote the resolution of delinquencies as quickly as possible since the ability of an agency to collect its delinquent debts decreases as the debt ages.
- Adhere to data practice policies by protecting debtor information.
- Utilize available tools to effectively and efficiently collect the debt.

How state agency debt is currently collected

Although all agencies are required[2] to send debts older than 121 days to the Department of Revenue, there are, in effect, two different collection systems: the methods used by state agencies before debt is referred to Revenue, and the system established by the Department of Revenue for collecting non-tax debt.

Self-managed collection by state agencies

***Agencies do not use a common, best-practices approach to debt collection*.** Collection practices for non-tax debt vary widely across state agencies. Not all state agencies refer their debt to the Department of Revenue's Collection Division, and some refer only a portion of their debts.

The table below illustrates the degree of non-uniformity in non-tax debt collection. Of the 18 agencies that responded to the survey on collection practices, 14 listed a combined total of 17 collection tools (not including "other."). One agency reported using eight tools; four listed none.

Collection tool	Number of agencies using
Personal contact	2
Payment plans	3
Revenue recapture	4
Negotiated settlement	1
Judgments	3
Insurance claims	1
Dept. of Revenue referral	5
Invoices	3
Send past due notices	3
Phone calls	3
File liens	4
Add late penalty payments	1
File bankruptcy claims	1
Send dunning letters	2
Conciliation Court	2
Refuse additional services	1
License revocation	1
Other	6

The current requirement to refer debts to the Collection Division is not enforced. According to statute, delinquent debts older than 121 days are to be referred to the Collection Division. However, there are no consequences for the agency that does not refer its debt to Revenue.

2 Minnesota Statutes 16D

4.

Referrals to the Department of Revenue

The Department of Revenue's Collection Division has collected non-tax debt on behalf of other agencies since 1994, when legislation provided for a centralized debt collection service within the Department of Revenue.[3] Some agencies use the Department of Revenue's collection service for all debt; others refer selected debts to Revenue; still others do not refer any of their debts to the Department of Revenue.

At the time of this report, the Department of Revenue Collection Division's inventory of state agency debt was $298 million. For comparison, the department's tax debt inventory during the same period was $322 million. Within the Collection Division's current inventory of non-tax debt, 40 percent of the debtors also have a debt with the Department of Revenue or have at least two debts with different agencies and debt types. For example, a debtor may have debts with Hennepin County and Revenue, or with Ramsey County and MNSCU.

Collection tools and techniques

The department has statutory authority to use a broad range of tools for collecting debt, including:

Filing of liens – A lien is a claim or encumbrance against real or personal property for the payment of a debt.

License clearance – A program that allows the revocation or denial of any license needed to do a professional service.

Revenue recapture – Takes the refunds of individual debtors and applies them to debts they owe a Minnesota state or local agency.

Offer in compromise – An agreement to accept partial payment of a tax debt in order to settle an account.

Payment agreements – An agreement between the debtor and the department stating the amount owed and repayment requirements agreed to.

Seizure of personal and real property – Forcibly taking legal possession of a debtor's real or personal property.

Bank levies – A legal action that orders a financial institution to withdraw funds from a debtor's account to pay a debt.

Wage levies – A legal action that orders an employer to withhold a portion of a debtor's wages to pay a debt.

Vendor set-off – A program that intercepts funds payable to a business or individuals who are vendors of the State and have a state debt.

Electronic payments – A payment made online via the Internet, by phone, or by electronic funds transfer (EFT).

Credit/debt card payments for business and individuals – Debtors can use these forms of payment to pay their delinquent debt.

Referrals to private collection agencies – Referrals are made when all other means of collecting have been exhausted.

Lottery prize intercept –winnings of over $599 may also be intercepted and applied to delinquent taxes and debts.

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[3] The enabling legislation referred to this service as the Minnesota Collection Enterprise, or MCE. However, the Department of Revenue's non-tax debt collection activities are no longer administered separately from tax debt activities. (For clarity, this report will refer only to the Department of Revenue's Collection Division, or simply the Collection Division.)

Debt referral

Electronic referrals account for 98 percent of the debts referred to the Collection Division. State agencies refer debts by means of:

- Access databases.
- Spread sheets.
- Inventory databases.
- Automated files from accounting systems.

Agency reporting

The referring agencies receive monthly inventory reports that provide information on closed cases, inventory balance, balance changes, new debts, and payment summaries.

Debtor resources

Debtors are able to set up payment plans, make payments by credit or debit card, or make a one-time payment via the department's website. Payment history is not available.

Fees

When the debt is referred, a statutory fee of 15 percent of the debt is imposed. An additional 10 percent fee is imposed if resolving the debt requires action beyond letters and phone calls. These fees are charged to the debtor and placed in the state's general fund.

Current problems

We identified problems in three areas: in ensuring the integrity of information regarding the debt and debtor ("authentication"); in how agencies interpret and report accounts receivable data; and with the level of discretion that state agencies have in determining when to refer debt.

1. Debt/debtor authentication not consistently reliable

"Debt/debtor authentication" ensures the accuracy of information regarding both the debtor and the debt. An authenticated debt is one where the debtor, the debt type, and the amount owed have been reliably identified.

Authenticating debts and debtors is problematic for some agencies. In the past, Revenue provided the service of looking up social security numbers based on the debtor information provided by the referring agency. This practice was discontinued because the difficulties of cross-matching records led to an unaccepably high error rate. Billing the wrong person undermines citizen confidence in state government. Other consequences can include:

- The incorrect individual's refund is offset.
- Hardship is created for the wrong individual.
- Disclosure violations result from contact with the wrong individual.
- Enforced collection action is taken against the incorrect individual or business.
- Once the incorrect individual is attached to a debt in the Revenue system, more errors are likely to occur, with additional debts being assigned to the incorrect individual.

Over 70 percent of the agencies currently referring debt to the Collection Division had debtor authentication rates of 94 percent or better. Those agencies accounted for 89 percent of the total debts referred.

2. Tracking and reporting delinquent accounts receivable

Our survey responses indicate a wide variation in how agencies gather collection information and track delinquent accounts receivable. Some use the information reported to the Department of Finance. Two agencies do not track the age of their debts.

The Collection Division had non-tax debt totaling $298 million at the time of this report, yet survey respondents reported only $13.1 million. We attribute this discrepancy to the lack of a common understanding of what is meant by "delinquent debt."

In fact, some agencies had more delinquent debt at the Collection Division than their survey responses indicated. Others listed more delinquent debt on their survey response than they have at the Collection Division. Other findings:

- Some agencies did not include debts greater than 121 days on the accounts receivable survey, but did include them on the finance report.
- Many agencies had numbers for uncollectible debt on the accounts receivable

survey, but that information was not reflected in the figures reported to the Department of Finance in the "doubtful" section. Some of the available accounts receivable for debt collection reported to finance is overstated.

Incompatible accounts receivable systems

The lack of uniform reporting may result from the lack of consistent accounts receivable systems used by state agencies. Some have old mainframe systems that are in need of an upgrade. Agencies using old mainframe systems include Revenue and DEED Unemployment Overpayments. Some, including MnSCU Loan Services and Homeland Security, use purchased software. Others have hired companies to come in and build their systems. This category includes DEED Unemployment Insurance Taxes, DNR, Agriculture, and DHS Child Support. A few of the smaller agencies rely on access databases or excel spreadsheets for their accounts receivable systems. Finally, 12 state agencies use the Minnesota Accounts Procurement System Accounts Receivable Sub System (MAPS ARS).

Inadequate information on costs of collecting debt

Minnesota lacks an enterprise-wide method of measuring return on its collection investments. Developing estimates for overall statewide cost to collect debt or return on investment is extremely difficult, due to lack of information. Survey responses indicate that most agencies do not calculate their return on investment (ROI) or cost to collect. Where information was provided, survey responses revealed inconsistencies in tracking investments associated with collecting debt. Some examples:

- For cost to collect, one agency reported only Department of Revenue fees, even though it also reported some FTEs dedicated to collecting debt. No ROI information was provided.
- For another agency, cost to collect included salary and fringe benefits for a person working on collecting the debt within the agency.
- Information on ROI for another agency included only a dollar amount to collect restitution.
- Cost to collect for one agency was based on four hours assigned to collecting debt bi-weekly. ROI was measured by delinquent debt amount less the uncollectible amount.
- Cost to collect for another was one FTE salary.
- No information was reported on cost to collect or ROI. Respondents added comments such as "not knowable until well into the process for each individual case," or "Too minimal to report."

3. Inconsistent debt collection practices

Statewide debt collection for Minnesota is fragmented and inefficient. The law as it stands lacks clarity and results in a hodgepodge of collection procedures and practices. As a result:

- state agencies assign debt collection different levels of priority.
- debtors receive varying levels of service to aid them in resolving their debts.
- the Collection Division may lack authority to negotiate with debtors.
- debts may be recalled by referring agencies, resulting in duplication of efforts.
- referring agencies may be collecting on the same debt at the same time.
- payments are often made to the referring agency rather than the Collection Division, resulting in adjustments or unnecessary collection actions.

Recommendations for enhanced debt collection

We recommend a centralized statewide debt collection system, to be administered by the Department of Revenue Collection Division. These recommendations cannot be implemented without law changes.

Centralized state debt collection

We recommend that agency debts be referred 90 days after they are incurred. During the initial 90-day period, the state agency would follow standardized collection procedures. Debts that remain uncollectible at the end of this time would be referred to the Department of Revenue.

Standardized procedures

1. During the 90-day period, the referring agency would send the debtor a letter outlining information about the debt, possible collection actions, collection tools that could be used, and information on how to dispute the debt. The Department of Revenue will provide language for this letter.

2. After the 90-day period, unresolved debts would be referred to the Department of Revenue's Collection Division. The Collection Division would then become fully responsible for handling the collection of the debt. At that point, referring agencies would only become involved in the collection process if the debt or debtor is disputed.

3. The Collection Division would identify appropriate collection tools and techniques, based on best practices and established thresholds. The division would have full authority to make offers in compromise, as appropriate.

4. Debts may be routed to a private collection agency for collection action or held for a certain period of time in order to capture any tax refunds.

5. The Collection Division would send a monthly charge-off and payment report to referring agencies instructing them to reduce their debts in inventory by specific dollar amounts. The Department of Finance would receive a copy of the report.

6. The agency would have to reduce the debt and apply payments on its system. Alternatively, if there were one statewide accounts receivable system, the Collection Division could easily charge off the debt or apply payments, and agencies could focus on other activities within their agency.

Reporting

We recommend that the Collection Division be responsible for reporting collection activity to all referring agencies. Reports would be monthly, and at a minimum would include dollars collected and inventory status. We also recommend the development of a web access tool that would allow agencies to refer debt and view information.

Referring agencies could access their debtor information, including current balances and collection action history. This web-based tool would provide inventory reports, debts loaded, debt balances, and all transactions made to and from the Collection Division. The agency would use this tool to make referrals on-line.

Authentication

In order for appropriate and effective collection actions to occur, all debt and debtors must be authenticated. We recommend law changes to authorize agencies to obtain debtor information at the origination of the debt.

Customer service

Customer contact is an important piece of effective debt collection. The Collection Division would have a call center responsible for providing the debtor with customer service. Proposed hours of operation are 7:00 am to 5:00 pm CST, Monday through Friday.

We also recommend development of a secure, web-based application to allow debtors access to their transaction information. They would be able to view balances, make payments, set up a payment plan, and view their account history.

Fees

We recommend that the current collection fee structure (15 percent, plus an additional 10 percent) be changed to one fixed rate of 17 percent. (Our review of fees actually charged over the past five years revealed an average fee of 17.24 percent). The 17 percent would continue to be charged to the debtor, and would be deposited into the general fund as non-dedicated receipts.

When debts are referred to private collection agencies, those costs would be funded from the collection fees deposited into the general fund. Collection costs recovered would be appropriated to the Minnesota Department of Revenue Collection Division to pay private agencies for their services. Collection costs in excess of private agency fees would remain in the general fund as non-dedicated receipts.

Write-off authority

We recommend a uniform write-off amount of $24.99 for all types of agency debt.

Recalling debts

Having once referred a debt to the Collection Division, the agency would not be able to recall the debt (unless the information regarding the debt or debtor is discovered to be in error). The debt would become the responsibility of the Collection Division.

Distribution of payments

We recommend that payments continue to be applied first to child support debt (if any). We also recommend giving debtors some discretion in determining the allocation of payments to other debts.

Statutes of limitations

We recommend that Minnesota's statutes of limitations be uniform for all types of debt.

10. **State Agency Accounts Receivable System**

The most effective way to streamline debt collection would be to have one statewide accounts receivable (A/R) system used by all agencies.

We recommend that agencies now in the process of developing accounting/AR systems ensure that their new systems are capable of handling all their agency debts. We also recommend that agencies collaborate to build and use the same accounting/AR system. We recommend that the state upgrade the MAPS ARS system currently used by 12 agencies.

Vendor set-off

We recommend the creation of one web-based system for vendor set-off. Before a payment is made to anyone who provides goods or services to the State of Minnesota, this system would check to see if the entity owes money to a state agency. If there is money owing, payments would be applied towards the debt.

Implementation

As with all recommendations, steps must be taken to ensure successful implementation. It is imperative that prior to referral, state agencies:

- Authenticate the identity of the debtor.
- Ensure the accuracy of the debt.
- Provide the debtor with all rights to contest the debt.

Further study

We recommend that the potential for state collection of local government debt be explored separately, and that a pilot project be created to identify issues and opportunities for more efficient collection of local government debt.

Federal debt collection

Our recommendations align with processes used by the federal government to manage accounts receivable. More information about those processes is available at the U.S. Treasury's Financial Management Service (FMS) website: (www.fms.treas.gov).

The Debt Collection Improvement Act of 1996 (DCIA) and other statutes provide tools for administering a centralized program for the collection of delinquent tax and non-tax debts.

Since centralization, the Treasury has sharply increased collections, adding numerous payment streams and categories of debt. FMS consistently collects more than $3 billion each year in delinquent debt.

Other states' collection practices

Research was conducted to find out how other states handle debt collection. The range of duties varied greatly:

- Eleven states use private collection agencies for collection of tax and/or other agency debts.
- Twelve states partner with other state agencies at different levels to collect state debt.
- Five agencies have centralized collection for state agency debt. (Kentucky, New Jersey, Oregon, Utah, and South Carolina).
- All states capture refunds to pay taxes and other agency debts.

Whenever debts are referred for collection to a centralized agency or private collection agency, it is the referring agency's responsibility to validate, authenticate, or verify the debt being referred.

The streamline process is already under way

We also note that, in the course of this study, we identified areas where we could streamline existing procedures, and have begun to implement these improvements:

- Establishing performance standards.
- Focusing on resolving debts quicker.
- Streamlining collection workflow.
- Enhancing technology to provide more statistical data.

12. Conclusion

We believe these recommendations will provide more efficient and effective centralized debt collection service for the State of Minnesota. These recommendations align with the Governor's Drive to Excellence initiative.

The recommendations contained in this report would improve the collection of government debt for:

- debtors, who would benefit from streamlined services;
- state agencies, which would be able to focus resources on activities that support the agency mission rather than on debt collection;
- the State of Minnesota, which would benefit from consistent and accurate measurements of government debt and debt collection.

We are confident that a more efficient and effective process would result in increased debt collections overall.

O L A **OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA

Financial Audit Division Report

Minnesota Office of Enterprise Technology

Mainframe Security Audit
As of October 2005

DECEMBER 7, 2005 **05-55**

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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If you have comments about our work, or you want to suggest an audit, investigation, or evaluation, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

O L A

OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Gopal Khanna, Chief Information Officer
Minnesota Office of Enterprise Technology

We have conducted an information technology audit of security controls established to protect the integrity and confidentiality of data stored on the state's mainframe computers. The Office of Enterprise Technology is responsible for managing these computers. Part of this responsibility includes the establishment of security measures to protect sensitive government data and computer resources. Our audit assessed the adequacy of mainframe security controls as of October 2005. The Report Summary highlights our overall conclusions. Our specific audit objectives and conclusions are contained in Chapter 2 of this report.

This audit identified serious security weaknesses that exposed government data to an unacceptable risk of loss, misuse, or disclosure.

We would like to thank staff from the Office of Enterprise Technology for their cooperation during this audit.

/s/ James R. Nobles	*/s/ Claudia J. Gudvangen*
James R. Nobles Legislative Auditor	Claudia J. Gudvangen, CPA Deputy Legislative Auditor

End of Fieldwork: October 21, 2005

Report Signed On: December 5, 2005

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Chris Buse, CPA, CISA, CISSP	Information Technology Audit Manager
Mark Mathison, CPA, CISA	Auditor-in-Charge
Eric Wion, CPA, CISA, CISSP	Auditor
John Kelcher	Auditor

Exit Conference

We discussed the findings and recommendations in this report with the following staff of the Minnesota Office of Enterprise Technology on November 23, 2005:

Gopal Khanna	Chief Information Officer
Steve Stedman	Chief Technology Officer
Jack Yarbrough	Director of Shared Services
Greg Dzieweczynski	Director of Interagency Services
Jim Steinwand	Security Services Manager

Minnesota Office of Enterprise Technology
Mainframe Security Audit

Report Summary

Conclusion:

Even though the Office of Enterprise Technology deployed multiple layers of security, data stored on the state's central mainframe computers was still vulnerable to loss, tampering, and unauthorized disclosure.

Key Findings:

- The Office of Enterprise Technology does not have a comprehensive security program to address pertinent technology risks. (Finding 1, page 5)
- Access to mainframe computer programs and data was not adequately restricted. (Finding 2, page 7)
- Unauthorized changes to critical system files could occur and could go undetected. (Finding 6, page 11)

The audit report contained eight audit findings relating to internal control over the Office of Enterprise Technology's mainframe computing environment.

Audit Scope:

Audit Period:
As of October 2005

Audit Scope:
Security controls designed to protect the integrity and confidentiality of data stored on the state's mainframe computers

Background:

The Office of Enterprise Technology (OET) is responsible for managing the central mainframe computing facility, which houses some of the state's most important business systems and data. The complexity of the mainframe environment makes it difficult to secure. Thousands of software products run on the mainframe computers, any of which could affect security.

The 2005 Legislature created OET to provide technology leadership and oversight for state government. The new agency began operations on July 1, 2005, assuming the staff and resources of the Minnesota Office of Technology and the InterTechnologies Group, both former divisions of the Department of Administration. The Legislature placed OET under the direction of a Chief Information Officer, a cabinet-level position appointed by the Governor.

Chapter 1. Introduction

This audit assessed the adequacy of controls designed to protect the integrity and confidentiality of data stored on the state's mainframe computers.

The Office of Enterprise Technology (OET) is now responsible for managing the central mainframe computing facility. The 2005 Legislature created OET to provide technology leadership and oversight for state government. The new agency began operations on July 1, 2005, assuming the staff and resources of the Minnesota Office of Technology and the InterTechnologies Group, both former divisions of the Department of Administration. The Legislature placed OET under the direction of a Chief Information Officer, a cabinet-level position appointed by the Governor. On August 15, 2005, Governor Tim Pawlenty appointed Gopal Khanna to serve as the first Chief Information Officer for the State of Minnesota.

The mainframe computers house some of the state's most important business systems and data. These systems help state agencies deliver critical government services, including:

- administering social service programs, such as Medical Assistance, Temporary Assistance to Needy Families, and Food Stamps;
- collecting and recording tax payments;
- licensing drivers and motor vehicles;
- processing payments to vendors and maintaining accounting records; and
- paying the state's workforce

The OET uses multiple layers of security to protect these business systems and data. For example, OET uses security tools to control network connections to its mainframe computers. OET also restricts physical access to the mainframe computing facility. One of the most important security layers is an access control software package called ACF2, which protects against the unauthorized destruction, disclosure, or modification of data. ACF2 will not permit a person or an installed software product to access data unless a security officer or the data owner explicitly authorizes that access. ACF2 security rules define these explicit authorizations.

Security officers at OET have primary responsibility for administering ACF2. However, OET delegates some of its security administration duties to security officers who work for several of the largest state agencies. Together, OET and these agency security officers manage thousands of ACF2 security rules, as well as accounts that have clearance to access mainframe data. OET and agency security officers created many of these accounts for employees that need to interact with specific business systems. Software products installed on the mainframes use the remaining accounts.

In 2000, our office conducted an audit that assessed the adequacy of selected mainframe security controls. That audit included many of the same areas that we reviewed during this audit. In our October 2000 report, we concluded that an excessive number of people either had widespread access to data or could obtain that level of clearance through weaknesses in the security infrastructure. The report contained four findings and six recommendations that addressed a broad array of security issues. Many of the issues cited by our audit also were included in a June 1999 report, written by a consulting firm engaged by the InterTechnologies Group.

In December 2001, the InterTechnologies Group reported to our office, the Department of Finance, and the Governor that it had completed four and partially completed one of the six recommendations in our October 2000 report. In May 2002, we conducted a follow-up audit and concluded that we did not concur with the reported completion status. We found that the four recommendations classified as completed were only partially completed, and security weaknesses still existed. However, we noted that the InterTechnologies Group had made progress in addressing the security weaknesses in our October 2000 report.

Audit Approach

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of internal controls that are relevant to the audit objectives. *Government Auditing Standards* also require that we plan our work to provide reasonable assurance that the agency complied with financial-related legal provisions that are significant to the audit. In determining the agency's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

OET had few documented policies, procedures, and standards for its mainframe environment, causing us to place extensive reliance on external sources for evaluation criteria. To assess the adequacy of controls, we obtained criteria from the *Control Objectives for Information and Related Technology* (COBIT). Published by the IT Governance Institute, COBIT includes 34 high-level control objectives and 318 detailed control objectives, grouped in four domains: Planning and Organization, Acquisition and Implementation, Delivery and Support, and Monitoring. We also used mainframe security standards developed by the United States Defense Information Systems Agency for the Department of Defense and published in the *OS/390 & z/OS Security Technical Implementation Guide*. Finally, we obtained evaluation criteria from information published by the developers of products installed on the mainframe, such as ACF2.

This information technology audit included a review of security data that the Minnesota Data Practices Act classifies as nonpublic. To protect state resources and comply with the Minnesota Data Practices Act, we withheld specific security-related details from this publicly released report. We communicated the pertinent details to OET administration in a separate, nonpublic document.

Chapter 2. Mainframe Security Controls

Chapter Conclusions

Even though the Office of Enterprise Technology deployed multiple layers of security, data stored on the state's mainframe computers was still vulnerable to loss, tampering, and unauthorized disclosure. Of particular concern, our audit identified security weaknesses from prior audits that management did not adequately address.

This information technology audit is another in a series of audits done by our office that focused on mainframe security. We spend a significant portion of our technical audit resources on the mainframe environment because state government could not function without it. From collecting taxes to administering social service programs, state agencies depend on the continuous availability of the central mainframe computers. We also concentrate on this environment because it houses enormous quantities of data. Protecting the integrity and confidentiality of this data is vital to both state government and the citizens that it serves.

The complexity of the mainframe environment makes it difficult to secure. Thousands of software products run on the mainframe computers, any of which could affect security. Furthermore, thousands of employees and business partners need access to fulfill their job duties. Adding to this complexity, many connections to the mainframe computers now occur over the Internet. In fact, some state agencies now use the mainframe computers to host their web-based computer applications.

Audit Objective

We designed our audit work to answer the following question:

- Did the Office of Enterprise Technology (OET) design and implement appropriate controls to protect the integrity and confidentiality of mainframe data?

To answer this question, we interviewed information technology professionals and reviewed documentation to gain an understanding of controls. We also used computer assisted audit tools to gather and analyze mainframe security data.

Though we addressed our objectives and conclusions to OET, it is important to note that the Department of Administration managed the state's mainframe computers until June 30, 2005.

Current Findings and Recommendations

1. The Office of Enterprise Technology does not have a comprehensive security program to address pertinent technology risks.

The number, type, and pervasiveness of issues in this and prior audits indicate that there are serious problems with the mainframe security program. We identified several factors that are contributing to its ineffectiveness:

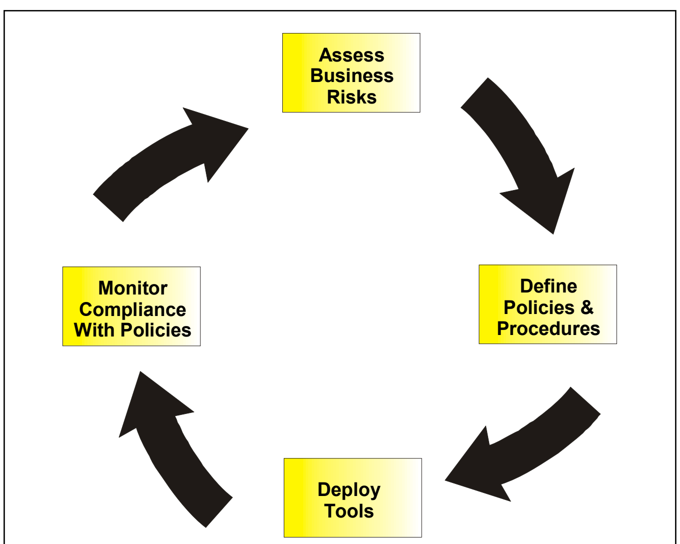
Unclear Authority and Responsibility

Management has not given any one group the authority and responsibility to develop a comprehensive security program. OET has a Security Services Unit, which spends most of its time managing ACF2 security rules and accounts. However, other operational groups throughout the organization perform tasks that affect mainframe security as well. In many cases, these groups make security decisions without consulting Security Services employees. Many of the detailed security weaknesses that we brought to management's attention resulted from decisions made by employees that were not part of Security Services.

Inadequate Resources

Management told us that the Security Services Unit is doing more with less, which is true. The unit now has fewer staff than it did during our last audit. Unfortunately, complex security issues often require staff to spend significant amounts of time doing research and testing. We question whether the current unit will have sufficient resources to remedy all of the outstanding audit issues and complete its daily security responsibilities.

Few Written Policies, Procedures, and Standards



Source: Auditor prepared

We found few written policies, procedures, and standards in any of the areas that we audited. Policies, procedures, and standards are typically the products of a formal risk management process. They outline management's security expectations and methods to fulfill those expectations. Organizations typically begin this process by performing a detailed risk analysis to identify potential vulnerabilities. The results of this analysis help organizations design policies, procedures, and standards to reduce their exposures to a level that executive management is willing to accept. Security professionals then deploy tools, such as access control software, to enforce the standards sanctioned by management. Information provided by these tools helps organizations monitor compliance and fine-tune subsequent risk assessments in the ongoing security management lifecycle.

Absent written guidelines, Security Services employees had difficulty providing us with answers to basic security questions, such as:

- What are the criteria for granting people or groups different types of extremely powerful or system-wide security clearances?
- What mitigating controls did management require to ensure that people or groups did not abuse extremely powerful security clearances?
- Who has authority to make decisions that affect mainframe security, and what is the scope of their authority?

Security professionals cannot make consistent decisions without standards to refer to as guidance. Had it proactively defined and communicated its security expectations, we think that management may have averted many of the findings in this report.

In its broadest sense, a security program is nothing more than formal ways to manage risk. Management only has two choices: either accept or mitigate the threats that it faces. However, making informed decisions requires ongoing assessments of operations to determine what can go wrong. In its June 1999 report, a consulting firm told the InterTechnologies Group that it was in an undesirable position of accepting risk without understanding what those risks were. Our audit results confirm that OET is still in that same undesirable situation today because it does not do enough proactive security planning.

Recommendations

- *The Office of Enterprise Technology should give some person or group the authority and responsibility to develop and implement a comprehensive security program.*
- *The person or group in charge of the security program should be provided sufficient resources to:*
    - *lead organization-wide risk assessment efforts;*
    - *coordinate the development and dissemination of policies, procedures, and standards;*
    - *ensure that security tools are properly configured; and*
    - *monitor compliance with policies, procedures, and standards.*

2. Access to mainframe computer programs and data was not adequately restricted.

Our audit identified many people and software products with security clearances that provided much broader access than necessary. In some cases, security weaknesses exposed mainframe data to an unnecessary risk of loss, tampering, or unauthorized disclosure. Other weaknesses could have resulted in disruptions to critical mainframe services. The following sections discuss some of the most significant security weaknesses that we brought to management's attention. In the short-term, OET needs to remedy the specific security weaknesses identified by our audit. Implementing the recommendations discussed in Finding 1 will help the organization manage security more proactively and avoid similar issues in the future.

Weak Controls Over Computer Programs That Can Bypass Security

By design, some mainframe computer programs have the ability to circumvent security. Access to these high-risk programs and the special libraries where they reside should be limited to select individuals who need clearance to fulfill their job duties. Furthermore, most experts agree that any modifications to these programs should take place through a regimented change management process with well-defined checks and balances. Without strong security and change control procedures, unscrupulous individuals could alter and use these programs to steal data or perform mischievous acts.

Our audit identified between 65 and 224 accounts with the ability to update these types of high-risk programs, stored in over 400 libraries. In our opinion, many of these accounts did not need this clearance. We also found two libraries that had weak security settings, giving any person with mainframe access the ability to make unauthorized program changes.

Finally, as discussed in Finding 6, OET did not deploy robust change management procedures or consistently log modifications to these high-risk programs. As a result, unauthorized changes could occur and could go undetected.

Unsecured Tape Management Utility Programs

State agencies store vast quantities of data on magnetic tape. Using improperly secured utility programs, unauthorized persons could have viewed, modified, or deleted any tape data in the mainframe environment. Typically, only information technology professionals who manage tape libraries need clearance to use these types of powerful utility programs. At the time of our audit, approximately 4,100 people and software products had this clearance.

Poorly Written Security Rules

ACF2 security software provides robust protection by default. In fact, ACF2 will not permit a person or an installed software product to access data or use any mainframe computer resource unless a security rule explicitly authorizes that action. However, we identified many poorly written ACF2 security rules. Some of these rules gave large groups of people or everyone on the mainframe inappropriate clearance to read data, while others provided clearance to change or delete data. We analyzed some of the files at risk and found extremely sensitive information, such as citizens' credit card numbers and personal information. We also found accounts and passwords for other state agency computers that interact with the mainframe. Using that information, we were able to access a computer owned by another state agency.

Inadequate Controls Over Accounts Without Passwords

By design, some accounts with access to the mainframe computers do not have passwords. Fortunately, ACF2 provides a number of compensating controls to prevent inappropriate use of these accounts. Organizations that fail to deploy these controls expose mainframe data and computer resources to extreme risk.

In our 2000 audit, we identified many mainframe accounts without passwords or other compensating controls. Since our last audit, OET applied compensating controls to most of these accounts. However, we still found over 200 accounts without passwords that were susceptible to abuse.

Excessive Access to Powerful Commands

Information technology professionals use operating system commands to perform extremely sensitive functions, such as starting and stopping the mainframes. They also issue powerful commands to administer core software products that run on the mainframes, such as ACF2. Commands can pose extreme risks if not properly controlled. Therefore, organizations must limit the ability to issue certain commands to specific individuals who need that capability.

We found weaknesses in the ACF2 security rules that define who can issue certain powerful commands. Of greatest significance, security rules gave virtually all people with mainframe clearance the ability to issue some commands that could impact system functionality or reveal security information. These security weaknesses resulted in one instance where an employee at another state agency erroneously issued a sensitive command that disrupted mainframe computer processing for a short period.

Database Security Information Was Not Adequately Controlled

Due to weak security settings, people with access to some mainframe databases could obtain nonpublic security data. Database security information should only be accessible to system administrators and security professionals. The inappropriate security settings that we found gave people the means to identify all accounts with access to the databases as well as the security permissions assigned to each account.

Recommendation

- *The Office of Enterprise Technology should fix the specific issues that we brought to its attention by adjusting security clearances to only give people and software products the minimum clearance necessary.*

3. Unsecured methods can be used to connect to the mainframe computers.

The mainframe computers let people establish and do work over unencrypted connections. Unencrypted connections are risky because account names, passwords, and other types of nonpublic data can flow over public networks in a human readable form. Encryption is an important control because it makes data unreadable to people who intercept network transmissions for unauthorized purposes.

Recommendation

- *The Office of Enterprise Technology should replace unsecured connection methods with those that use encryption.*

4. Some unneeded mainframe accounts were not disabled or removed.

Security professionals in OET and some large state agencies did not promptly remove or disable unneeded mainframe accounts. Inactivating unnecessary accounts is a key control to prevent former employees or other unauthorized persons from accessing the mainframes. The Security Services Unit developed processes to identify and inactivate accounts. However, some inactive accounts were not identified because of flaws in the unit's procedures. We found over 50 accounts that belonged to people who left state service or were on extended leaves of absence. We also found over 900 accounts assigned to software products that security officers did not remove or disable. All of these software accounts were inactive for at least one year, and some had been inactive for over ten.

Recommendation

- *The Office of Enterprise Technology should develop procedures to promptly remove or disable unneeded accounts.*

5. Procedures to confirm the identity of people with access to the mainframe computers were weak in several respects.

OET relies on unique accounts and passwords to validate the identity of people with access to the mainframes. Commonly referred to as single factor authentication, this approach places complete reliance on a secret password, known only by one person. Organizations that use single factor authentication need controls to ensure that passwords are extremely difficult to guess. Without strong password controls, hackers and other unscrupulous individuals can assume the identity of legitimate system users to gain unauthorized access. We reported many detailed password-related weaknesses to management. However, described below are two particularly significant issues that came to our attention.

Static Passwords Allowed

Security officers configured many software program accounts so that ACF2 did not enforce periodic password changes. They did this to prevent mission critical tasks from failing due to expired passwords. However, organizations that disable automated password change features must put in place their own controls to ensure that passwords to powerful accounts do not become widely known. Particularly with software accounts, an ever-increasing number of information technology professionals end up knowing passwords as time passes.

We found many accounts with very old passwords. As a result, it is safe to assume that the passwords were known by people who no longer had a business need to access the accounts, including people who no longer work for the state. Two of the oldest passwords belonged to accounts that last had their passwords changed in 1982.

Default Passwords Not Changed

Many software products come with default user accounts and passwords. It is important to change default passwords because hackers frequently use them to gain unauthorized access. In fact, lists of default accounts and passwords for most software products are available on the Internet.

We found one mainframe software product with a default password that was not changed. With this account and password, we were able to obtain an extremely powerful security clearance that gave us very broad access to mainframe data.

Finally, we question the appropriateness of single-factor authentication for security officers and other information technology professionals with extremely powerful security clearances. Most security experts agree that passwords alone are a weak form of authentication. Supplementing secret passwords with additional controls, such as smart cards or biometric devices, would make it much more difficult for hackers to gain access to the most powerful accounts with system-wide access to data.

Recommendations

- *The Office of Enterprise Technology should regularly change passwords to software accounts.*

- *The Office of Enterprise Technology should change default passwords after installing software.*

- *The Office of Enterprise Technology should consider additional authentication controls for security officers and other information technology professionals with extremely powerful security clearances.*

6. Unauthorized changes to critical system files could occur and could go undetected.

OET does not have all the necessary controls to prevent or detect unauthorized changes to files that could affect mainframe security. We assessed controls over certain high-risk computer programs that have the ability to bypass security. We also examined controls over some security-related mainframe operating system files. This testing revealed numerous information technology professionals and software products with clearances to change critical files. OET installed a mainframe software product that can help organizations control changes to critical system files. However, OET was not using the product to manage changes to most of the files that we tested.

To improve controls, OET needs to develop procedures to manage changes to critical files. These procedures should ensure that no individual has clearance to make critical system changes without independent oversight. They also should outline stringent documentation and testing requirements.

Recommendation

- *The Office of Enterprise Technology should develop controls to ensure that changes to critical mainframe programs go through a formal change management process.*

7. The Office of Enterprise Technology does not have a comprehensive security monitoring strategy.

OET lacked important controls to detect and quickly respond to security-related events, such as intrusion attempts or data modifications made by unauthorized people. We found that OET did not do a thorough job of defining what security events must be monitored. In addition, the agency did not identify who was responsible for performing some types of monitoring activities.

As discussed in Finding 1, OET has few security-related policies, procedures, and standards. Without standards, security professionals have had difficulty determining what monitoring data is most important to gather. For data that is currently gathered, security professionals have difficulty identifying anomalies because OET has few baseline standards to use as measurement criteria. To illustrate, employees in the Security Services Unit get a series of standard ACF2 security reports each day. Though they reviewed these reports, in many cases the process added little value because the security officers did not understand which items in the reports were exceptions.

For software products other than ACF2, it was not clear who was responsible for monitoring security events or if events were monitored at all. We found one security weakness that let us use one of the most powerful mainframe accounts. No employee recognized that we were able to gain this elevated level of security clearance until we notified management.

Recommendation

- *The Office of Enterprise Technology should develop a comprehensive strategy for monitoring security-related events.*

8. Physical access to the data center was not properly controlled.

The state's central data center houses mission critical computer equipment. To protect this sensitive equipment, access to the center must be restricted to only those people who need clearance to fulfill their job duties. Approximately 300 people had key cards that provided access to the data center. While most were OET staff, many did not need this level of security clearance.

The data center also houses computer equipment that belongs to other state agencies. Currently, physical barriers are not in place to keep employees from other agencies away from the mainframes and other OET computers. As more agencies move their equipment to the central data center, OET may need to explore additional physical access controls.

Recommendation

- *The Office of Enterprise Technology should limit access to the data center to only those people who need access to perform their job duties.*

Status of Prior Audit Issues
As of October 21, 2005

Most Recent Audit

Legislative Audit Report 02-26 was a follow-up audit to assess the status of various security weaknesses identified during a previous information technology audit, publicly released October 19, 2000, that focused on selected controls to help secure system-wide access to mainframe data. That report concluded that the agency had taken some steps to fix some of the weaknesses reported, but some security weaknesses still existed.

The scope of this audit included many of the same areas that we reviewed during 2000. Embedded in the findings of this report are references to prior audit issues that were not adequately addressed.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota Office of Enterprise Technology. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

Office of Enterprise Technology

December 5, 2005

Mr. James R. Nobles
Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to your office's audit of mainframe security at the Office of Enterprise Technology (OET). We appreciate the expertise and thoroughness displayed by your audit staff during the course of the audit.

While we may disagree with the magnitude of actual risk involved with some of the audit findings and recommendations at a detail level, we accept that the major thrust of the Office of Legislative Auditor report is on the whole an accurate assessment.

The report leaves one unfortunate and, I believe, misleading impression regarding our efforts to implement past recommendations. Contrary to the report, we have made substantial progress on many of the issues raised in previous audits. Although work remains in these areas because of resource limitations and evolving procedures, we have shared our plans and results with the OLA and continue to work on them. I know Commissioner Badgerow took the findings seriously and assure you we will increase our efforts to complete the work of making our environment secure, now and on an ongoing basis. As your office can attest, some of the detailed findings and issues identified during the course of both previous audits and the current audit have already been remedied. For previous audits, the OLA was kept involved in and informed about the remediation plan and the progress against that plan.

In any event, it's clear that not all of the planned improvements in conditions identified in previous audits have been implemented to your satisfaction, and that we haven't yet made an appropriate level of commitment to addressing the myriad administrative details of aggressive management of mainframe security. This is changing.

Similarly, our relatively minor disagreements with current OLA findings and recommendations should not be the basis for failure to reach agreement on proper approaches to problems and then act on those

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www.oet.state.mn.us

agreements. We are committed to maintaining a secure environment through a combination of sound security policies and rigorous administration of those policies.

As Mr. Buse noted in the report, the complexity of the mainframe environment is a complicating factor in security management; this, and the extent of involvement of so many stakeholders in routine operations, makes robust security both difficult and very necessary. The audit was directed at aspects of our environment that are the legitimate area for OET and agency staff involvement. The nature of this involvement and the nature of their jobs demand that significant authority must be granted for them to do their work.

To one degree or another, some conflict between security and authority to act is inevitable, even in the security community itself. The question of "who watches the watchers" has existed as long as control processes have been around. The point of the audit was that we need to do a better job establishing procedural safeguards, documentation and follow-up to govern the granting and administration of these authorities, even though the employees are screened, trained and supervised.

It's not enough to say that you found no evidence that security was breached from the outside, or that any damage was actually done to systems or data. Although the potential security issues raised in the audit were associated with people already within the system rather than people "in the wild" (which limits the practical exposure), the fact remains that luck isn't a sufficient strategy for prevention of violation, nor is administrative inconvenience an excuse for inaction.

Security is more than just a matter of technology, and the OLA audit properly points out our inadequacies in process and organization. When I arrived here three months ago, I immediately identified the many dimensions of security as one of our highest priorities. The audit appropriately draws attention to the needs in this area.

Before I respond to the specific findings and recommendations, I want you to know that I have directed the following actions to take place immediately to address the systemic issues and remedy the shortcomings of OET in this critical area:

- I will be appointing an executive-level Chief Information Security Officer for the state, with authority to build, implement, and maintain a robust security environment. The CISO will be independent of the operational side of our organization and shall have the responsibility for security policy and security administration for the enterprise.
- Policy changes and procedures will take time to develop and implement, and as was noted in the audit, resources and workload are major obstacles to complete implementation of security improvements. However, our obligation is to make the environment secure, and I will seek the financial, technological and human resources needed to implement changes in our procedures as recommended by the OLA. A detail plan for remediation, with timetables and responsibilities identified, will be developed in the very near future, and we will work with OLA to monitor its progress.
- I will incorporate into statewide strategic plans for information management specific long-term plans for maintaining a secure environment beyond the specific actions suggested by the audit.

With the changes in reporting and resources, I am confident that we will successfully address the shortcomings in our security and carry out our remediation strategies. We must be able to assure our clients and citizens that their data and their investments in our systems and networks are protected in an increasingly challenging and dangerous technology environment.

Once again, thank you for the work your office has done on behalf of the State, and for the opportunity afforded us to have a constructive discussion with you about the issues raised in the audit.

Sincerely,

/s/ Gopal K. Khanna

Gopal K. Khanna
State Chief Information Officer
Commissioner, Office of Enterprise Technology

Attachment
Specific Responses to
Findings and Recommendations

1. Finding: *The Office of Enterprise Technology does not have a comprehensive security program to address pertinent technology risks.*

Recommendations: The Office of Enterprise Technology should give some person or group the authority and responsibility to develop and implement a comprehensive security program.

The person or group in charge of the security program should be provided sufficient resources to:
- lead organization-wide risk assessment efforts;
- coordinate the development and dissemination of policies, procedures, and standards;
- ensure that security tools are properly configured; and
- monitor compliance with policies, procedures, and standards.

Response: We agree. The Commissioner of Enterprise Technology is planning to appoint a state Chief Information Security Officer, and OET is working with the state's security community to address the creation of an enterprise-wide comprehensive security program.

Internal to OET, the Security Services Unit and its current management have been given the necessary authority to cross interdepartmental lines to ensure that this unit can and will act decisively to: lead the organization-wide risk assessment efforts; coordinate the development and dissemination of policies, procedures and standards; ensure that security tools are properly configured; and monitor compliance with policies, procedures and standards. We are currently exploring what the necessary level of staffing resources should be for remedial and ongoing operations, as well as determining how to secure those resources.

2. Finding: *Access to mainframe computer programs and data was not adequately restricted.*

Recommendation: The Office of Enterprise Technology should fix the specific issues that we brought to its attention by adjusting security clearances to give people and software products only the minimum clearance necessary.

Response: We agree. The Security Services Unit has been working diligently to address the audit issues that relate to mainframe access, within the limits of current resources. We will address these access issues according to our evaluation of risk. Most of the individuals possessing such access rights need them to do their work and use their access authority with great discretion. For the small number of others identified by the OLA, we will work to achieve a greater degree of refinement in our access. However, in fairness to these individuals, all of them are considered trusted staff, have completed security background checks, including fingerprinting, prior to employment with OET, and are currently employed in positions where a level of access is required. These few are primarily the accounts addressed in this finding.

While addressing the Poorly Written Security Rule section of this finding, any and all credit card and personal information existed only in a temporary test file, which was immediately removed upon discovery, and the information does not exist anywhere on the mainframe system (to our knowledge). Also, a software flaw was discovered by the auditors and reported to the software vendor. This flaw allowed accounts and passwords from other agencies to be discovered, and affected all systems worldwide. The vendor immediately acknowledged the flaw and provided a fix for the software that removed the flaw. It is no longer possible to find accounts and passwords from other agencies on the system.

In response to the identification of over 200 accounts without passwords in another agency, OET has been working with that agency to remove those accounts entirely or put in place proper compensating controls over them. The number of such accounts has been reduced to 53 as of the date of this response.

The remaining issues presenting in this finding are in various stages of being addressed, remedied, and/or removed from the system by properly adjusting the security clearances given to people and software.

3. Finding: *Unsecured methods can be used to connect to the mainframe computers.*

Recommendation: The Office of Enterprise Technology should replace unsecured connection methods with those that use encryption.

Response: We agree. Policies, standards and procedures have been discussed for some time. Implementation plans are being developed and appropriate technologies are being investigated to remove the ability for anyone to send or receive unencrypted communications to the mainframe.

4. Finding: *Some unneeded mainframe accounts were not disabled or removed.*

Recommendation: The Office of Enterprise Technology should develop procedures to promptly remove or disable unneeded accounts.

Response: We agree. The Security Services Unit of OET recognizes, as does the Office of the Legislative Auditor, that other agencies must participate in the effort to promptly and properly remove or disable unneeded accounts. OET will work both internally and with the agencies to develop policies and procedures to remove unneeded accounts.

5. Finding: *Procedures to confirm the identity of people with access to the mainframe computers were weak in several respects.*

Recommendations:
- The Office of Enterprise Technology should regularly change passwords to software accounts.
- The Office of Enterprise Technology should change default passwords after installing software.

- The Office of Enterprise Technology should consider additional authentication controls for security officers and other information technology professionals with extremely powerful security clearances.

Response: We agree. OET will create policies and procedures to properly drive the changing of passwords to software accounts and the removal of default passwords after installing software. OET agrees that passwords alone, regardless of their strength, are often insufficient to properly protect valuable data and systems, and will begin the investigation of the use of two factor authentication (biometrics and tokens are an example of two factor authentication) for security officers and others with extremely powerful security clearances.

6. Finding: *Unauthorized changes to critical system files could occur and could go undetected.*

Recommendation: The Office of Enterprise Technology should develop controls to ensure that changes to critical mainframe programs go through a formal change-management process.

Response: We agree. On November 1, 2004, the Security Services Unit initiated an OET internal project to address the issues in this finding, but due largely to insufficient staffing, the project did not progress as quickly as hoped. OET did install software to assist in managing software and critical library changes, which primarily allowed the auditors to more fully discover our weaknesses. OET will again attempt to more fully utilize the installed software in the manner for which it was intended, and will revise and modify the current change control process to discover, prevent or detect unauthorized changes.

7. Finding: *The Office of Enterprise Technology does not have a comprehensive security monitoring strategy.*

Recommendation: The Office of Enterprise Technology should develop a comprehensive strategy for monitoring security-related events.

Response: We agree. OET will aggressively pursue the development and implementation of a comprehensive security monitoring strategy for ACF2 and other software products used in the mainframe environment

8. Finding: *Physical access to the data center was not properly controlled.*

Recommendation: The Office of Enterprise Technology should limit access to the data center to only those people who need access to perform their job duties.

Response: We agree. OET is already in the process of revising and implementing its data center physical access policy to limit access to only those people who need access to perform their job duties, and will make other changes as necessary to support this policy.

December 5, 2005

James R. Nobles, Legislative Auditor
First Floor South, Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Last week, I received a copy of the revised draft report containing the results of your office's recent information technology audit of security controls for data stored on the state's mainframe computers. This report acknowledges that the Department of Administration (Admin) managed the state's mainframe computers until June 30, 2005. Since Admin held this significant responsibility until the establishment of the Office of Enterprise Technology and was not invited to discuss the report findings and recommendations at the November 23, 2005 exit conference, I appreciate the opportunity to comment about the report, especially Admin's efforts to resolve prior audit issues. I want to affirm at the outset that I concur entirely with the need for increased attention to, and discipline around, information technology security. In today's environment, we can afford nothing less. And, in the year or so that I have been in this position, I have demonstrated this attention both through the Governor's assignment to me of a response to website security issues last spring, and the focus on enterprise security through the Drive to Excellence.

Turning to the report, however, the last page indicates that prior audit issues were not adequately addressed. In my view, this statement might mislead readers to believe that Admin's InterTechnologies Group (ITG) disregarded your office's prior audit recommendations and took no further corrective action than what was reported in the 2002 report.

Admin has consistently recognized that the audit issues raised in the 2000 and 2002 reports represented serious security weaknesses. ITG personnel persevered to strengthen the security control weaknesses limited only by available resources and worked diligently to implement the recommendations you suggested. We also engaged your IT audit professionals in discussions from time to time about whether ITG's progress-to-date and planned corrective actions were acceptable at minimizing security risks, just to ensure that we were addressing your staff's concerns in an appropriate manner. I believe that ITG personnel made considerable security control improvements that deserve further mention.

Office of the Commissioner
200 Administration Building
50 Sherburne Avenue
St. Paul, MN 55155
Phone: 651.296.1424 / Fax: 651.297.7909/TTY: 651.297.4357

To demonstrate Admin's commitment to resolve the audit issues, the following examples of corrective actions taken during the past three fiscal years are offered:

- By July 2002, ITG personnel developed and implemented a new re-certification process that enabled staff to review each account with certain powerful ACF2 privileges, to assess the necessity and appropriateness of each security privilege, and to re-certify or remove this privilege as warranted. By December 2004, ITG staff completed written procedures for the re-certification process. (These actions address prior audit recommendation #4.)
- By April 2003, ITG personnel subgrouped Production Support and Computer Operations major access groups into various categories and subsequently limited functional access to data and resources by each category. (This action addresses prior audit recommendation #1.)
- By April 2003, ITG personnel completed an assessment of accounts with certain powerful security privileges and limited access only to those who needed it to perform certain automated or administrative processes. For example, ITG reduced the number of logonids with the NON-CNCL privilege from 26 to 19; ITG found that the 19 are necessary and appropriate for mainframe start-up or business recovery purposes. (This action addresses prior audit recommendation #2.)
- In the fall of 2002, ITG installed an ACF2 upgrade but did not remove the Violation Exit as the OLA initially recommended. ITG staff met with OLA IT professionals about this action; the auditors expressed concern about TSO (Time Sharing Option) users who used the exit. To address this concern, ITG staff created rules for the TSO logonids and developed automated procedures for performing a daily check to see if newly added TSO logonids have rules written first to prevent their unauthorized read-only access to data. (This action addresses prior audit recommendation #5.)
- By December 2003, ITG personnel had added compensating controls the ACF2 developers designed for all but one account – a started task with the RESTRICT privilege. For this account, ITG staff added mitigating controls by making a program change that eliminated a job function from the logonid. Again, ITG relies on the re-certification process to identify those accounts without passwords that require compensating controls. (These actions address prior audit recommendation #3.)
- By January 31, 2004, ITG completed documentation describing ACF2 access authorizations for 1,634 data set rules and nearly all (99.8%) of the 6601 resource rules. A primary obstacle in completing this task was researching and identifying the owners of the rules since many were very old. In this process, ITG also developed criteria for inclusion in the USERDATA field in ACF2 rules. Newly created or recently modified rules are subject to review during the periodic rule monitoring process. (This action addresses prior audit recommendation #6.)
- ITG, in its security leadership role, also informed agency ACF2 administrators that they needed to review and document their 300 data access rules and 1300 resource rules. About 80% of these rules were documented. Also, ITG encouraged the OLA

auditors to address the agency administrators' documentation requirement in the respective agency audit reports. (This action addresses prior audit recommendation #6.)

Admin believed that it had addressed all of the ACF2 prior audit issues to the best of its ability and with available resources. ITG staff always recognized that, as new products emerge and personnel changes occur, new risks also emerge that could pose a threat to mainframe data. Thus, to protect the integrity of the data that resides on the state's mainframe computers against unauthorized use or loss, ITG staff were charged with continuously strengthening mainframe security controls to address new risks.

Thank you for the opportunity to respond to the report findings.

Best regards,

/s/ Dana Badgerow

Dana Badgerow
Commissioner

cc: Gopal Khanna, Office of Enterprise Technology

O L A **OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA

Financial Audit Division Report

Council on Black Minnesotans

Fiscal Years 2002 through 2005

February 3, 2006 **06-03**

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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All OLA reports are available at our Web Site: http://www.auditor.leg.state.mn.us

If you have comments about our work, or you want to suggest an audit, investigation, or evaluation, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Kevin Lindsey, Chair
Council on Black Minnesotans

Members of the Council on Black Minnesotans

Mr. Lester Collins, Executive Director
Council on Black Minnesotans

We conducted an audit of the Council on Black Minnesotans for the period July 1, 2001, through June 30, 2005. Our audit scope included employee payroll and board member per diem, space rental, grant revenues and expenditures, contractual services, other operating costs, and selected administrative expenditures. Our objectives focused on a review of the council's internal controls over these financial activities and compliance with applicable legal provisions.

The Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions for each area are contained in the individual chapters of this report.

We would like to thank the staff from the Council on Black Minnesotans and the Department of Administration for their cooperation during this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: September 19, 2005

Report Signed On: January 31, 2006

Table of Contents

Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
David Poliseno, CPA, CISA, CFE	Audit Manager
Ellen Sibley, CPA, CIA, CFE	Auditor-in-Charge
George Deden, CPA	Auditor
John Hakes, CPA	Auditor
Gena Hoffman	Auditor

Exit Conference

We discussed the results of the audit with the following staff of the Council on Black Minnesotans and the Department of Administration at an exit conference on January 20, 2006:

Council on Black Minnesotans	
Lester Collins	Executive Director
Roger Banks	Research Analyst
Rebecca Johnson	Office and Administrative Specialist
Department of Administration	
Larry Freund	Financial Management Director
Bruce Lemke	Accounting Director

Report Summary

Key Findings:

- Some Council on Black Minnesotans' payroll expenditures were not adequately supported by time and leave records. (Finding 1, page 6)
- The council did not comply with some legal provisions pertaining to administrative expenditures. (Finding 5, page 9)
- The council did not always accurately record its transactions in the accounting system or pay its invoices in a timely manner. (Finding 6, page 11)
- The council did not deposit or record approximately $29,000 in fundraising receipts in the state's accounting system. (Finding 9, page 15)

The audit report contained 9 audit findings relating to internal control and legal compliance. The council fully resolved 6 of the 12 findings included in our prior audit report.

Audit Scope:

Audit Period:
Fiscal Years 2002-2005

Selected Audit Areas:
- Payroll
- Administrative Expenditures

Agency Background:

The Council on Black Minnesotans' mission is to provide all individuals of African descent with equal access to state services and programs and to relate the needs of those individuals to the Legislature.

A General Fund appropriation funds the council's activities. Beginning in fiscal year 2003, the council received grant funds from the Minnesota Partnership for Action Against Tobacco to participate in tobacco control efforts in the African American community.

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Chapter 1. Introduction

The Council on Black Minnesotans was established by the Legislature in 1980 and operates under the authority of *Minnesota Statutes*, 3.9225. The council's mission is to provide all individuals of African descent with equal access to state services and programs and to relate the needs of those individuals to the Legislature. The council also works with other minority councils on common concerns and advises the Governor, Legislature, and other state agencies on issues that effect black Minnesotans. In addition, the council provides research and referral services. Council activities also include participating in tobacco control efforts to reduce tobacco use among the African American community. In addition, the council sponsors and coordinates the annual Martin Luther King, Jr. holiday celebration.

The council consists of 13 members appointed by the Governor and four non-voting members from the Minnesota Senate and House of Representatives. The council meets on a monthly basis, and employs four full-time and one part-time staff members. Lester Collins serves as the executive director of the council.

The council receives state appropriations to fund its operations. Additionally, in May 2002, acting as fiscal agent for the African American Tobacco Network, the council entered into a $245,000 grant from the Minnesota Partnership for Action against Tobacco. Pursuant to statute, the Department of Administration provides administrative services to the council, which includes entering payroll, receipt, and disbursement transactions into the state's accounting and payroll systems. Table 1-1 summarizes the council's financial activities for the four fiscal years ended June 30, 2005.

Table 1-1
Sources and Uses of Funds
Fiscal Years 2002-2005

	2002	2003	2004	2005
Sources:				
State Appropriations	$342,000	$352,000	$282,000	$282,000
Less: Cancelled or Reverted		(13,259)	(5,000)	
Net Appropriations	$342,000	$338,741	$277,000	$282,000
Receipts	20,847	20,567	81,701	81,686
Balance Forward In	17,408	66,963	46,995	61,921
Total Sources	$380,255	$426,271	$405,696	$425,607
Uses:				
Expenditures:				
Payroll	$198,791	$238,232	$277,556	$276,993
Rent	27,897	30,065	29,252	26,497
Contractual Services	18,373	10,500	1,061	10,703
Other Operating Costs	19,486	13,624	7,525	10,558
Other Administrative Expenditures	48,745	66,335	28,381	52,266
Balance Forward Out	66,963	46,995	61,921	48,590
Transfer Out	0	20,520	0	0
Total Uses	$380,255	$426,271	$405,696	$425,607

Source: Minnesota Accounting and Procurement System as of September 30, 2005.

Audit Approach

We conducted our audit in accordance with *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the council's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission, as our criteria to evaluate agency controls. The standards also require that we plan the audit to provide reasonable assurance that the council complied with financial-related legal provisions that are significant to the audit. In determining the council's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

To meet the audit objectives, we gained an understanding of the Council on Black Minnesotans financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations, and reviewed security clearances for various computer systems. We examined a sample of evidence supporting the council's internal controls and compliance with laws, regulations, contracts, and grant provisions.

Chapter 2. Payroll and Per Diem

Chapter Conclusions

The Council on Black Minnesotans' timesheets did not always reflect the actual hours worked in a pay period, as discussed in Finding 1. In addition, the council did not always review the payroll register report to ensure that payroll transactions were accurately recorded on the state's accounting system, as discussed in Finding 2.

The council overpaid $110 in per diems to two board members who claimed reimbursement for attending two meetings in one day. Also, the council did not pursue collection of the $1,430 overpayments we identified in our prior audit report. We repeated this issue in Finding 3 of the current audit report. In addition, the council did not comply with the statutory provision that required reporting to the Governor when council members missed three consecutive council meetings, as discussed in Finding 4.

Audit Objective

The primary objective of our review of payroll expenditures was to answer the following questions:

- Did the council's internal controls provide reasonable assurance that payroll expenditures were accurately recorded in the accounting records and in compliance with applicable legal provisions and management's authorization?
- Did the Council comply with significant finance-related legal provisions over payroll, including applicable bargaining agreements?
- Did the council pay per diems in accordance with applicable legal provisions?

Background

The Council on Black Minnesotans had four full-time employees and one part-time employee during the audit period. These employees were members of various bargaining units and compensation plans including the American Federation of State, County and Municipal Employees, Minnesota Association of Professional Employees, and the Managerial Plan. Payroll represented the council's largest expenditure and averaged about $248,000 each year.

Council on Black Minnesotans

Each pay period, council staff completed timesheets and leave requests, which were approved by the executive director. The council's payroll timekeeper batched the documents and faxed them to the Department of Administration for data input. The council staff later submitted the original documents to the department, and retained copies at the council office.

The council also paid per diems in the amount of $55 per day to board members for their participation in council activities. *Minnesota Statutes,* 15.0575, subd. 3, governs the council's per diem compensation.

Findings and Recommendations

1. Some Council on Black Minnesotans' payroll expenditures were not adequately supported by time and leave records.

The council did not always ensure that employees reported actual time and leave taken on their timesheets. In addition, in some cases, the council did not appear to use accrued sick and vacation time in accordance with applicable bargaining agreements. Finally, it did not appear that the council established and monitored employees' normal work hours. Our review of payroll activity disclosed the following concerns:

- The council allowed two employees to inappropriately record regular time for absences during the normal work hours. From January through June 2005, two individuals recorded about 174 hours for attending a 15-hour per week internship. The internship required class attendance and on-site training at other locations during the normal workweek. The executive director did not approve participation in the internship program as part of the work schedule and expected the employees to make up the time. However, the timesheets do not document absences or when the time away was made up. We also question the reasonableness of an employee working 11 to 14-hour days to make up time spent in the internship program.

- The council allowed employees to inappropriately use sick leave. For example, one employee used five hours of sick leave and two hours of vacation leave to care for a non-dependent child. The employee did not have enough vacation leave for the entire time, so the employee used sick leave as well. When we questioned whether council employees have discretion in recording the type of leave taken, the executive director stated that he was sensitive to employees' leave balances and he did allow employees to record leave according to the balance in the leave accounts. In addition, he said that he was unaware that bargaining agreements limit the use of sick leave to dependent children only.

The best control over the integrity of employees' hours is achieved when supervisors with direct knowledge of the state policies for recording time and provisions of the bargaining unit agreements review and approve the timesheets. Supervisors should be aware of employees' presence or absences from work. Lack of accountability and monitoring increases the risk that employees may misuse state time and underreport or inappropriately report leave and potentially receive payment for hours not worked. The executive director has ultimate responsibility for validating that employees have provided services and are entitled to payment, and to ensure that payroll activity is accurately recorded in SEMA4 (the state's payroll system) in compliance with related bargaining agreement provisions.

Recommendation

- *The council should establish procedures to ensure employee timesheets accurately record work performed on council activities and vacation and sick leave usage in accordance with state policy and collective bargaining agreements.*

2. PRIOR AUDIT FINDING NOT RESOLVED: The council did not always review the payroll register report to ensure that payroll and personnel transactions were entered accurately on SEMA4.

Each pay period, the Department of Administration entered council payroll and personnel transactions into SEMA4, which generated payments to council employees. The Department of Administration generally provided the council with the payroll register report for verification of payroll input. However, both council and department staff indicated that the department may not have always sent the reports to the council for verification. The council did not approve 7 of 14 payroll registers and it could not locate six other reports. SEMA4 Operating Policy and Procedure PAY0028 requires agencies to review the payroll register to verify that time and amounts were paid at the correct rate, and any necessary adjustments were processed.

Without reviewing the payroll register, the council cannot determine if the payroll was entered correctly, or if unauthorized transactions were processed.

Recommendation

- *The council should work with the department to ensure that it receives all of the payroll registers and review them each pay period to verify the accuracy of payroll and personnel transactions entered in SEMA4.*

3. PRIOR AUDIT FINDING NOT RESOLVED: The council inappropriately paid per diems to some council members and did not diligently pursue collection of the overpayments.

In July 2002, the council overpaid $110 in per diems to two board members who claimed reimbursement for attending two meetings in one day. In addition, the council did not collect overpayments of per diems noted in our prior audit report. Council members are entitled to $55 per day pursuant to *Minnesota Statutes*, 15.0575, subd. 3.

At the time of our last audit, the statute prohibited per diem compensation for full-time employees of the state, or a political subdivision of the state. The prior audit identified per diem payments totaling $1,430 for board members who were ineligible due to their employment status. Prior to July 2002, the council sent letters to these board members requesting repayment of the per diem amounts. However, as of September 2005, the council has not received any repayments.

Recommendation

- *The council should work with the Office of the Attorney General to pursue collection of the $1,540 in board member per diem overpayments.*

4. The council did not notify the Governor, as required by *Minnesota Statutes*, when members missed three consecutive meetings.

For the period October 2004 through December 2005, we identified seven council members who missed three or more consecutive meetings. The council did not notify the Governor's Office when this occurred. *Minnesota Statutes*, 15.0575, subd. 4, states:

> A member may be removed by the appointing authority at any time (1) for cause, after notice and hearings, or (2) after missing three consecutive meetings. The chair of the board shall inform the appointing authority of a member missing the three consecutive meetings. After the second consecutive missed meeting and before the next meeting, the secretary of the board shall notify the member in writing that the member may be removed for missing the next meeting.

Although there are legitimate reasons for occasional absences, certain members had difficulty attending council meetings on a regular basis. The council provided notification to members and the chair after members missed two consecutive meetings; however, subsequent absences did not result in a notification to the Governor's Office. Recently, the council began granting excused absences, which it did not include as a missed meeting. *Minnesota Statutes*, 15.0575, does not allow the council to grant excused absences to avoid the required notification to the Governor. Due to the number of absences, the council has not had a quorum at some meetings and, as a result, has been unable to conduct official business.

Recommendation

- *The council should notify the Governor of members who miss three consecutive meetings in accordance with Minnesota Statutes.*

Chapter 3. Administrative Expenditures

Chapter Conclusions

Generally, the Council on Black Minnesotans' internal controls provided reasonable assurance that administrative expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions. However, the council did not document its compliance with certain legal requirements for some contracts, as discussed in Finding 5. Also, the council did not always accurately record its transactions in the accounting system or pay its invoices in a timely manner, as discussed in Finding 6.

Audit Objectives

Our review of administrative expenditures focused on the following questions:

- Did the council's internal controls provide reasonable assurance that rent, contract services, supplies, and equipment were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization?

- For the items tested, did the council comply, in all material respects, with significant finance-related legal provisions concerning rent, contract services, supplies, and equipment?

Background Information

In addition to payroll, the council incurred about $400,000 in expenditures to support its operations during fiscal years 2002 through 2005. We focused our review on rent, contractual services, supplies, and equipment. The council entered into contracts totaling $40,636 and paid approximately 87 percent of these expenditures to vendors for the Martin Luther King, Jr. holiday celebration. The Department of Administration processed administrative expenditure transactions on behalf of the council.

Findings and Recommendations

5. PRIOR AUDIT FINDING PARTIALLY RESOLVED: The council did not comply with certain legal requirements for some contracts.

We reviewed various contracts entered into by the council during our audit period. Although the council made improvements in this area, we still identified the following weaknesses:

Council on Black Minnesotans

- The council entered into contracts totaling about $21,000 without ensuring that sufficient funds were available to meet the obligations, and allowed the vendors to begin work prior to the execution of the agreements. These contracts were for services provided in connection with the annual Martin Luther King, Jr. holiday celebration.

  Also, in October 2004, the board approved two annual plan agreements and the vendors began work on the Martin Luther King, Jr. celebration prior to properly executing the contracts. *Minnesota Statutes*, 16C.05, subd. 2, requires that all parties properly sign and execute the contract before the contract is valid to limit the state's liability and to clarify the responsibilities of the council and the contractor. Additionally, the council did not request encumbrance verification from the Department of Administration until November and December 2004. *Minnesota Statutes*, 16A.15, subd. 3, requires state agencies to either encumber funds or certify that sufficient funds exist prior to incurring any obligation to ensure that the agencies do not exceed their appropriation authority.

- The council did not always pay for services consistent with contract terms. Payments for 10 of 14 transactions tested were inconsistent with contract terms. In four of those cases, the council approved two original invoices and sent them along with two faxed copies to the Department of Administration for payment. As a result, the department made duplicate payments to the vendor. The department adjusted future invoices to correct the duplicate payments.

  In addition, the council approved four contract invoices that differed from the payment amounts in the contract. The Department of Administration adjusted the payments to match the contract amounts. The council should review the invoices to ensure that the invoices comply with the contract terms prior to submitting them to the Department of Administration for payment. In two other cases, the council paid the invoices after the contract due dates.

- The council incurred an obligation for space rental of $7,000, which exceeded the Department of Administration's $5,000 local purchasing authority for the council. The council did not follow competitive bidding requirements when incurring the obligation. The council increases the risk of unauthorized purchases and paying for noncompetitive prices by not following applicable purchasing requirements.

Recommendations

- *The council should ensure that all contracts are properly authorized and that funds have been encumbered prior to any work being performed on a project.*

- *The council should review all invoices to ensure that they comply with the terms and conditions of the contracts.*

- *The council should comply with the state's local purchasing authority.*

Council on Black Minnesotans

6. PRIOR AUDIT FINDING PARTIALLY RESOLVED: The council did not properly record its transactions in the state's accounting system (MAPS) or pay its invoices in a timely manner.

The council could not always provide sufficient documentation to support the payment record date for some MAPS transactions. In 14 out of 27 transactions tested, we could not determine the correct record date due to missing documentation such as packing slips and dates of service. The council received the invoices, approved them, and sent them to the Department of Administration for input. The Department of Finance uses the record date to determine the state's outstanding liabilities at year-end for financial reporting purposes.

The council also did not make timely payments for 2 of 27 payments tested. *Minnesota Statutes*, 16A.124, subd. 3, requires that vendors be paid within 30 days from the date the goods or the related invoices were received, whichever is later.

A Department of Administration internal audit report for fiscal year 2005 transactions identified similar concerns related to accurate coding and timely payment of expenditures.

Recommendations

- *The council should code the correct record date in the accounting system when processing payments.*

- *The council should pay invoices in accordance with the time frames established in law.*

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Chapter 4. Grant Revenues and Expenditures

Chapter Conclusions

The council's internal controls provided reasonable assurance that grant revenue and expenditure transactions were properly recorded in the state's accounting system and complied with applicable legal provisions and management's authorization. However, the council needs to resolve a $51,000 balance owed to the Minnesota Department of Education for the Clearinghouse of Best Educational Practice, as discussed in Finding 7.

For the items tested, the council generally complied with significant finance-related legal provisions concerning grants. However, the council did not document in-kind contributions to ensure compliance with a grant agreement, as discussed in Finding 8. Also, the council did not deposit or record approximately $29,000 in fundraising receipts on the state's accounting system, as discussed in Finding 9.

Audit Objectives

Our audit of the council's grant revenues and expenditures focused on the following objectives:

- Did the council's internal controls provide reasonable assurance that grant revenues and expenditures were properly recorded in the state's accounting system and complied with applicable legal provisions and management's authorization?
- For the items tested, did the council comply with significant finance-related legal provisions concerning grant revenues and expenditures?

Background

In May 2002, the council, acting as fiscal agent for the African American Tobacco Network, entered into a three-year grant totaling $245,000 with the Minnesota Partnership for Action Against Tobacco (MPAAT). The council had received $204,160 in grant funds through June 30, 2005. The purpose of the grant was to participate in tobacco control efforts to reduce tobacco use among the African American community. The council hired a network coordinator in fiscal year 2003 to implement the grant project work plan, including community and medical outreach and education. MPAAT extended the grant to December 31, 2005. The grant agreements required quarterly financial and program reports comparing budget to actual expenditures. In addition, MPAAT hired independent consultants to annually evaluate the grant progress.

Council on Black Minnesotans

Findings and Recommendations

7. PRIOR FINDING NOT RESOLVED: The council has not repaid its $51,000 Clearinghouse of Best Educational Practices grant to the Minnesota Department of Education (formerly the Department of Children, Families & Learning).

Our prior audit reported that the council intentionally transferred grant proceeds to a local foundation to avoid losing the grant revenue. In fiscal year 1999, the council received a $60,000 grant from the Department of Children, Families & Learning (CFL) to establish a Clearinghouse of Best Educational Practices. The grant period ended June 30, 1999, and all costs had to be incurred prior to that date. As of June 30, 1999, the council had received $58,000 from CFL and had not spent any of the grant funds. The council entered into an agreement with the foundation, which created the Council on Black Minnesotans Fund for Best Education Practices. The council subsequently spent about $51,000 on grant-related activities. Since our last audit, the council has repaid approximately $6,800 of unexpended grant funds to CFL as stipulated in the grant agreement. However, the council has yet to repay the $51,000 it spent.

Recommendation

- *The council should work with the Department of Education to resolve the $51,000 balance due for the Clearinghouse of Best Education Practices grant.*

8. The council did not document in-kind contributions to ensure compliance with a grant agreement.

As part of the $245,000 grant it received from the Minnesota Partnership for Action Against Tobacco (MPAAT), the council agreed to provide in-kind contributions totaling $72,000 in support of the grant activities. The council provided quarterly financial and program reports to MPAAT as required by the grant agreement. However, the council did not report any in-kind contributions. In addition, the council could not provide documentation that it met the in-kind requirement. The council should document this activity to ensure that the in-kind contributions complied with the grant agreement.

Recommendation

- *The council should document its in-kind contributions to ensure compliance with grant agreement terms.*

9. PRIOR AUDIT FINDING PARTIALLY RESOLVED: The council did not deposit about $29,000 in the state treasury or record the activity in MAPS.

From January 2002 through March 2005, the council collected about $29,000 in private donations for the annual Martin Luther King, Jr. holiday celebration. However, the council did not deposit these receipts in the state treasury or record the activity in the state's accounting system. Rather, the council used a local foundation to process the receipts and disbursements and record the financial activity. In addition to the donations, the council received an annual state appropriation to fund the holiday celebration. The governor appointed a commission to oversee the celebration. The council's executive director chaired the commission that administrated the event and had decision-making authority over use of the funds. The council includes all financial activity relating to the celebration when submitting information to the Legislature as a part of the biennial budget process, providing a further link that this is state activity. By not depositing the monies in the state treasury, the council is able to bypass state purchasing requirements.

Recommendation

- *The council should work with the Department of Finance to establish appropriate procedures for processing and recording receipts and disbursements for the annual Martin Luther King, Jr. holiday celebration.*

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Status of Prior Audit Issues
As of September 19, 2005

Most Recent Audit

Legislative Audit Report 02-60, issued in September 2002, covered the period July 1, 1998 through December 31, 2001. The audit scope included payroll and per diems, grant revenues and expenditures, contractual services, and other administrative expenditures. The report contained 12 findings, 6 of which have been fully resolved. However, Findings 1, 2, 6, 7, 8, and 9 were either partially resolved or not resolved at all. We have repeated those six findings in this report.

The prior audit report also identified an issue pertaining to an employee falsifying time and leave reports. As a result, we questioned about $5,500 of compensation paid to the employee. We referred the matter to the Office of the Attorney General, who entered into a settlement agreement with the former employee in September 2005.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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STATE OF MINNESOTA
COUNCIL ON BLACK MINNESOTANS
Wright Building • Suite 426
2233 University Avenue • St. Paul, MN 55114 • (651) 642-0811 • 643-3580 FAX

January 30, 2006

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Audit
140 Centennial Building
658 Cedar Building
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Please accept the response of the Council on Black Minnesotans to the draft audit report for the period July 1, 2001 through June 30, 2005.

Thanks for changes made during our discussions on January 20, 2006. Please note a request for changes in a few minor points in our response. We sincerely appreciate the efforts taken by your audit staff to clarify issues raised in the report. Additionally, we thank you for and greatly appreciate the professional and helpful manner in which the audit was conducted.

Please inform us if there are any issues or further recommendations that we appear not to have fully understood or covered adequately in our response.

Very truly yours,

/s/ Lester R. Collins

Lester R. Collins
Executive Director

cc: Kevin Lindsey, Chair

Council on Black Minnesotans Responses to the MN Office of the Legislative Auditor Report January 30, 2006

Prefacing Remarks:

The person responsible for implementing the enclosed recommendations is the Executive Director of this agency.

Chapter 2: Payroll and Per Diem

There are inconsistencies in the findings for bullets one (1) and two (2) in Item one (1).

Item One - Bullet One (1):

A work plan was developed that delineated the hours that interns were expected to work at the Council. This document expressed mutually agreed upon terms between the Executive Director and the interns and was developed in consultation with the Human Resource Division of the Department of Administration. Within this context it was specified when staff could make up time spent at their internships. In addition, the status of the internship process was reported to the Council on Black Minnesotan's Board of Directors on a regular basis.

We respectfully request that the last sentence under the first bullet be modified to reflect that there was only one staff person that worked from 11 to 14 hours a day to make up hours related to the internship program.

Item One (1) - Bullet Two (2):

While no formal monitoring process exists, the Executive Director has been fully aware of the presence and absence of all employees.

The Executive Director did not authorize an employee to use five (5) hours of sick leave And two (2) hours of vacation leave. Initially there was an error on an employee's timesheet. Human Resources staff identified this issue and brought it to the attention of the employee. The Executive Director was not made aware of this issue and was not consulted or involved in the negotiations associated with this issue.

The Council will use procedures to ensure that employee time is accurately recorded. This includes work performed on Council activities and vacation and sick leave usage. This will be done in accordance with state policy and collective bargaining agreement provisions.

Item Two (2)

Recommended change – The Council did not <u>always</u> review the payroll register to ensure that payroll and personnel transactions are entered accurately on SEMA4.

The Council agrees with the recommendation and will work with the Department of Administration to ensure that it receives all payroll registers each pay period and will verify the accuracy of payroll and personnel transactions. The new self serve payroll entry process will aid in this process.

Item Three (3)

For the purpose of clarification, it should be mentioned that prior to the ruling regarding the payment of per diem to board members the Council sought the advice and guidance of the Office of the Attorney General who advised the Council to cease and desist per diem payments. Subsequently to the decision to allow such payments, we continued to cease and desist. Verification relative to this situation was provided to the audit team.

The Council will vigorously seek repayment of the $1,430 for per diem over payment. The Council will also seek to pay per diem to those board members who are entitled to receive such payment as the result of the ruling that legitimized payment.

The Council has made sincere efforts to seek restitution of the per diem payments and will work with the Office of the Attorney General to collect a total of $1,540 in per diem overpayments. This effort will be concluded by July 1, 2006.

Item Four (4)

In the future, the Council will, in accordance with Minnesota Statues, notify the Governor of members who miss three (3) consecutive meetings.

Chapter Three (3): Administrative Expenditures

Item Five (5)

The Council will continue to work to resolve these issues, particularly the invoice and contract issues associated with the Dr. Rev. Martin Luther King Jr. Holiday Celebration. More specifically, concerted efforts will be made to ensure properly authorized contracts, the receipt and review of invoices, and that all transactions are in compliance with the Minnesota Local Purchasing Authority Guidelines.

In addition, the Council will consult with the Department of Administration to ensure that all legal requirements are understood and met. Currently the Council is in discussions that will result in its service level agreement being amended. It is anticipated that these *changes will more clearly delineate the roles of the Council and the Department of Administration.*

Item Six (6)

The Council will continue to work with the Department of Administration to ensure appropriate code utilization and that timely payment of expenditures will be made.

Chapter Four: Grant Revenues and Expenditures

Item Seven (7)

The Council will continue to work with the Minnesota Department of Education to resolve the $51,000 repayment issue associated the "Clearinghouse of Best Education Practices Grant. Efforts will be made to secure a letter from MDE indicating the successful resolution of this issue within ninety (90) days.

Item Eight (8)

The Council, through the Minnesota African American Tobacco Education Network (MAATEN), is developing an agreement with Minnesota Partnership for Action Against Tobacco (MPAAT) that will ensure compliance with contract specifications that require the provision of $72,000 in documented in kind services over a three year period. This process will be completed in the next thirty (30) days.

Item Nine (9)

The Council adhered to all state policies and procedures when state revenues were used. However, no process regarding this issue has been recommended for the handling of non-state revenues. In this respect, the Council will continue to work with the Department of Finance to establish an acceptable process for recording the receipts and disbursements for the annual Dr. Rev. Martin Luther King Jr. Holiday Celebration.

January 31, 2006

James R. Nobles, Legislative Auditor
First Floor South, Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to discuss with your staff the results of the audit of the Council on Black Minnesotans for the period of July 1, 2001 through June 30, 2005. We recognize the importance of sound financial management and are committed to working with the Council to address the issues identified in this report.

Currently, Admin's Financial Management & Reporting Division and the Council on Black Minnesotans have a signed agreement that emphasizes responsibilities of the parties and the value of strong communication of information to ensure each party can fulfill its mutually agreed-upon responsibilities successfully.

Concerning the payroll register issue addressed in Finding 2, Admin's Human Resources Division will send the payroll registers via e-mail to Lester Collins and his assistant at the Council on Black Minnesotans on the first Monday of the pay period. If there is no response by the following Monday, a copy will be faxed to the Council. If a response is not received by Wednesday of that same week, the Council's Board Chair will be notified. Patti Gaylord will be the person responsible in Admin.

Again, we will continue to make every effort to assist the Council of Black Minnesotans in properly managing their financial resources. In order to better accomplish this, we will look for improved communication from the Council, more timely knowledge of financial decisions, and a more timely receipt of complete transaction processing documentation.

Should you have any questions, please feel free to contact Larry Freund, Admin's Financial Management Director, at 651-201-2563 for assistance.

Very truly yours,

/s/ Dana B. Badgerow

Dana B. Badgerow
Commissioner

Office of the Commissioner
200 Administration Building, 50 Sherburne Avenue
Saint Paul, MN 55155
P: 651.201.2566 / F: 651.297.7909 /

#7

COUNCIL ON BLACK MINNESOTANS

AGENCY RESPONSES TO THE OFFICE LEGISLATIVE AUDITOR
ISSUED JANUARY 30, 2006

For

SENATOR SHEILA M. KISCADEN, CHAIR
STATE BUDGET DIVISION COMMITTEE

DISCUSSION ON THE 2006 LEGISLATIVE AUDIT REPORT

MARCH 14, 2006

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<u>**Council on Black Minnesotans Responses to the MN Office of the Legislative Auditor Report January 30, 2006**</u>

NOTE: Additional comments to the original report are being made in italics and bold font to clarify and supplement the Council's responses to the audit team. Supplemental documentation has been added to this report to more clearly delineate Council process and practice.

Prefacing Remarks:

For the purpose of consistency, the word <u>always</u> should be inserted when discussing the Payroll Register Report. In addition, the person responsible for implementing the enclosed recommendations is the Executive Director of this agency. ***The Audit staff agreed with this observation and revised their report.***

Chapter 2: Payroll and Per Diem

It should be noted that a wide range of issues were initially raised in this Payroll and Per Diem section. They had as their focus, alleged inappropriate and irregular record keeping and monitoring regarding vacation and sick leave. It was also stated that "the Council did not maintain complete record of Council activities, such as meeting times, number of hours for meeting It is unfortunate that Audit staff did not ask Council staff about issues identified or asked them to provide requisite information associated with these issues. Please examine copies of attached reports and calendars.

There are inconsistencies in the findings for bullets one (1) and two (2) in Item one (1).

Item One - Bullet One (1):

A work plan was developed that delineated the hours that interns were expected to work at the Council. This document expressed mutually agreed upon terms between the Executive Director and the interns and was developed in consultation with the Human Resource Division of the Department of Administration. Within this context it was specified when staff could make up time spent at their internships. In addition, the status of the internship process was reported to the Council on Black Minnesotan's Board of Directors on a regular basis.

A copy of a work plan is attached. It should be understood that Council staff was not mandated to participate in the internship program. Their participation was voluntary. And, there was agreement between staff and the Executive Director that delineated how the time spent in the internship would be made up so as to ensure that staff functions of the Council continued unabated.

Additional documentation attached includes a description of the internship program.

We respectfully requested that the last sentence under the first bullet be modified to reflect that there was only one staff person that worked from 11 to 14 hours a day to make up hours related to the internship program.

The second bullet implies that there was more than one instance where a problem regarding the use of sick time existed. This is not correct. The case cited below is the only case contained in their assessment. However, there was an initial concern expressed in a preliminary version of the report regarding the leave records of the executive director and another staff member. It was stated that "The Council could not provide assurance that it prohibited employees from recording regular time if an employee was sick or on vacation". These comments were demonstrated to be incorrect and were stricken from the Audit report

The Audit report also stated that "Lack of accountability and monitoring increases the risk that employees may misuse state time and underreport or inappropriately report leave and potentially receive payment for hours not worked". While this statement is true, this condition certainly did not exist at the Council. The Council staff and its supervisor work considerably more hours than they are paid for and seldom take leave. This includes evenings and weekends. Please examine the submitted sample calendars and calendar summaries.

Item One (1) - Bullet Two (2):

While no formal monitoring process exists, the Executive Director has been fully aware of the presence and absence of all employees.

The Executive Director did not authorize an employee to use five (5) hours of sick leave And two (2) hours of vacation leave. Initially there was an error on an employee's timesheet. Human Resources staff identified this issue and brought it to the attention of the employee. The Executive Director was not made aware of this issue and was not consulted or involved in the negotiations associated with this issue.

Relative to the error mentioned above, Council staff indicated on her time sheet that eight (8) hours had been worked on a specific date. This was not correct. This error was brought to the attention of the staff member by Human Resources staff. Subsequently, it was HR staff and the staff member involved that agreed to the vacation/sick leave time arrangement. The Executive Director was not involved in this process.

The Council will use procedures to ensure that employee time is accurately recorded. This includes work performed on Council activities and vacation and sick leave usage. This will be done in accordance with state policy and collective bargaining agreement provisions.

Item Two (2)

Recommended change – The Council did not always review the payroll register to ensure that payroll and personnel transactions are entered accurately on SEMA4.

As indicated above, the Council did not always receive the payroll register. However, it did sign and return all payroll registers that it received. Documents are attached that reveal that Human Resource staff and Administration Department staff were aware that glitches exist in this process.

The Council agrees with the recommendation and will work with the Department of Administration to ensure that it receives all payroll registers each pay period and will verify the accuracy of payroll and personnel transactions. The new self serve payroll entry process will aid in this process.

Item Three (3)

For the purpose of clarification, it should be mentioned that prior to the ruling regarding the payment of per diem to board members the Council sought the advice and guidance of the Office of the Attorney General who advised the Council to cease and desist per diem payments. Subsequently to the decision to allow such payments, we continued to cease and desist. Verification relative to this situation was provided to the audit team.

Clarification regarding the issue of per diem overpayments needs to be provided. Prior to the issue being raised, Council staff took steps to address this issue.

- ***In July 2001, the Council requested guidance of the Office of the Attorney General on this issue. We were told that we should cease making per diem payments to Board members who were employees of a governmental unit. We followed the advice. (Supporting documentation is attached)***
- ***In March 2001 a ruling that legitimized such payments was made, effective July 1, 2001***
- ***Some per diem payments were made after July 1st. Later, the Board decided that, because of a shortage of funds, no per diem payments would be made.***
- ***During the time frame delineated above, efforts have been made to collect $1,430 in per diem overpayments. (Attached are documents that reflect this effort).***

The Council will vigorously seek repayment of the $1,430 for per diem over payment. The Council will also seek to pay per diem to those board members who are entitled to receive such payment as the result of the ruling that legitimized payment.

The Council has made sincere efforts to seek restitution of the per diem payments and will work with the Office of the Attorney General to collect a total of $1,540 in per diem overpayments. This effort will be concluded by July 1, 2006.

Item Four (4)

In the future, the Council will, in accordance with Minnesota Statues, notify the Governor of members who miss three (3) consecutive meetings.

Council President Kevin Lindsey to provide a response to this issue.

Chapter Three (3): Administrative Expenditures

Item Five (5)

<u>Duplicate Payment Issue</u>***: Original invoices are required by the Administration Department for processing. However, under emergency situations, when speedy actions are needed, the Council has sent a faxed copy of the original invoice to the Department of Administration to process. Subsequently, the original invoice is also sent. On two occasions, as a result of this practice, payment errors were made that led to overpay-ments; payments that were later corrected.***

It is acknowledged that the specifics of the payment schedule for Kathie Battle, MLK Program Coordinator, were not strictly adhered to. The $7,000 contract called for payments to be made in the following order:

- ***$2,000 to be paid initially, and***
- ***Four (4) monthly payments of $1,250.***

However, monthly invoices submitted ranged from $1,200 to $1,800. But the total never exceeded the agreed upon total contract sum of $7,000.

It should be noted that this audit contains an error regarding the number of transactions tested and the number of transaction that were not in compliance. Originally, it was cited that ten (10) of fourteen(14) transactions were not in compliance. The audit team changed the number of transactions that were not in compliance to one (1) – not ten (10).

The Council incurred obligations of $7,000 with Concordia University for the rental of Ginglehoff Auditorium for the annual MLK event. There is a long standing arrangement between the University and the MLK Commission regarding this event. This amount exceeded the Department of Administration's limit of $5,000 as a result of incurring expenses that were greater than anticipated.

The Council will continue to work to resolve these issues, particularly the invoice and contract issues associated with the Dr. Rev. Martin Luther King Holiday Celebration. More specifically, concerted efforts will be made to ensure properly authorized contracts, the receipt and review of invoices, and that all transactions are in compliance with the Minnesota Local Purchasing Authority Guidelines.

In addition, the Council will consult with the Department of Administration to ensure that all legal requirements are understood and met. Currently the Council is in discussions that will result in its service level agreement being amended. It is anticipated that these changes will more clearly delineate the roles of the Council and the Department of Administration.

Item Six (6)

The Council will continue to work with the Department of Administration to ensure appropriate code utilization and that timely payment of expenditures will be made.

It should be noted that the Council does not have access to MAPS. As a result, Council staff has a limited but evolving role in the code entering process. The Department of Administration essentially transcribes the submitted codes which are entered in to MAPS. The number of codes to be utilized by the Council have recently been expanded from three to four codes.

Chapter Four: Grant Revenues and Expenditures

Item Seven (7)

The Council will continue to work with the Minnesota Department of Education to resolve the $51,000 repayment issue associated the "Clearinghouse of Best Education Practices Grant. Efforts will be made to secure a letter from MDE indicating the successful resolution of this issue within ninety (90) days.

Item Eight (8)

The Council, through the Minnesota African American Tobacco Education Network (MAATEN), is developing an agreement with Minnesota Partnership for Action Against Tobacco (MPAAT) that will ensure compliance with contract specifications that require the provision of $72,000 in documented in kind services over a three year period. This process will be completed in the next thirty (30) days.

Item Nine (9)

The Council adhered to all state policies and procedures when state revenues were used. However, no process regarding this issue has been recommended for the handling of non-state revenues. In this respect, the Council will continue to work with the Department of Finance to establish an acceptable process for recording the receipts and disbursements for the annual Dr. Martin Luther King Jr. Holiday Celebration.

While cited as a partially resolved audit issue, the specific issue regarding the appropriate reporting of non-state revenues (receipts and disbursements) was just

raised in this audit. What was raised in the most recent audit is the issue of "not depositing about $29,000 in the state treasury or recording activity in MAPS."

It should be noted that these charitable funds have been directly sent by donors to the Saint Paul Foundation; who in turn submit quarterly reports on receipts and disbursements to the Council. Without these tax-exempt funds, there would be no MLK celebration. This is state activity that is directed/overseen by the Governor's Commission on the Dr. Rev. Martin Luther King Jr. Holiday Celebration – not the Council on Black Minnesotans. Decisions are made by the Commission as a whole and not by Council staff. In regards to depositing and handling tax deductible funds, whatever depositing-expenditure process that is developed for the Department of Corrections Education Foundation should be appropriate for the Commission.

#2

Calling All New Careership Applicants

If you or someone you know:

-have some college and five or more years of work experience and/or a history of involvement in a community-based organization;
-have skills that would add to the effectiveness of community development locally and/or have an interest in community leadership as evidenced by past participation in community activities;
-have direct experience working with or advocating for the interests of communities of color;
-have a sincere interest in considering a career in the community development industry; articulates career interests that match the human resource needs of local community development corporations;
-are willing and able to make a 12 month part-time work and training commitment to the Careership program; and
-are willing to learn new skills and perform tasks or duties offered by host community development corporation Careership assignments.

Background:

The Careership is a mid-career apprenticeship program designed to train new leaders, particularly people of color, for professional positions in the community development field. The program was designed by a diverse group of CDC staff and other community development stakeholders. The group's premise was that there are many talented, capable individuals in communities of color with transferable work skills and that those persons, with some discrete community development work experience and training, could become competitive candidates for openings in CDCs and other community development agencies in a relatively short time period.

LISC implemented the program by partnering with Metropolitan State University's Center for Community Based Learning. Metro State brought its experience in working with mid-career adult learners. The Center for Community Based Learning brought its experience of working with nonprofit, community based organizations. In addition, Metro State's student population included much higher participation from communities of color than other local colleges and universities.

There have been two phases of the Careership Program. The first was a pilot phase funded by a national consortium of funders called the National Community Development Initiative's Human Capital Development Initiative. Because the Careership program had produced tangible and positive results in its first three years, the Family Housing Fund and the Otto Bremer Foundation made funding commitments in early 2002 to expand and continue the Careership program through 2004. Fundraising is underway for a future years.

Careership apprentices work 15 hours per week, for one year, for a host organization and are paid a $10,000 work stipend (over the course of the year). Hosts have been nonprofit community development organizations, government development and housing funding agencies, public housing agencies, and consultants who work with nonprofit housing developers and managers, and private foundations who fund affordable housing. Careership apprentices are matched with host organizations that match their career and learning goals and usually have the opportunity to interview 2-3 possible hosts. Host organizations are also invited to interview a number of apprentices and agree to host the person who they feel will be the best match for their work and environment. In addition, each apprentice receives a education stipend of $1,000 to pursue education and training that helps them achieve their career goals. Lastly, each apprentice also attends a monthly seminar. The seminar covers the history and strategies of community development and the challenges and opportunities of working in low income communities and communities of color. Participants receive three college credits for completing the community development seminar requirements.

Program summary and results:

An overall summary of Careership statistics and demographics to date is as follows:

Applicants:

- 163 persons have applied for the Careership program.
- An average of 3 organizations have volunteered to host each Careership participant (approximately 42 organizations in an unduplicated count) and some organizations have volunteered, and hosted participants, multiple times.

Careership Participants:

- 44 persons have been selected and 36 have completed their Careership education and work requirements (8 participants were selected but did not finish their Careership term).
- Careership participants have been hosted by 35 different organizations including nonprofit developers, a housing funder, a housing consultant, and four government agencies.
- The race or ethnicity of the Careership participants is: 22 African Americans (50%), 4 American Indian (9%), 7 African immigrants (16%), 6 Asians (Hmong) (14%), and 5 Latino (11%)
- The gender of the group is: 19 men (43%) and 25 women (57%).

A list of all persons who have completed their Careership is attached. The list includes each participant's Careership host and their current employment.

An overall summary of the Careership program results to date include:

- Of the 36 persons who have completed their Careership work and education requirements, 28 or ***78% have secured employment in community development.***
- Of the 28 participants that secured employment in community development, 13 ***(46%) secured or were promoted to positions with nonprofit development organizations that are partners of LISC***; 2 (7%) secured positions in government agencies that play a direct role in funding affordable housing and community development projects; 8 (29%) secured positions with nonprofit organizations that are part of the broader spectrum of community development including real estate, employment and training, self sufficiency services, and youth development; and 5 (18%) secured positions in the for profit industries that support and partner with community development organizations.
- 3 participants secured their first full-time, professional position after completing the Careership program.
- 7 participants had the opportunity to take and complete the 4 week DTI Project Development Program or the National Development Council's Housing Development Finance Program.
- 2 participants completed and 1 made progress in completing a graduate degree in community economic development after completing the Careership program.
- 1 participant completed and 6 made significant progress in completing undergraduate degrees after starting and completing the Careership program.
- 1 participant was elected to local government public office (for the first time) after completing the Careership program.

- 1 participant was asked to serve in a voluntary position with a state advisory board that oversees a business development loan and grant program after completing the Careership program and another serves on the board of directors of a CDC.
- 1 participant was asked to serve in a voluntary position with a state advisory board that oversees a business development loan and grant program after completing the Careership program.

How to apply or get more information:

The Careership is a partnership of Twin Cities Local Initiatives Support Corporation (LISC) and Metropolitan State University's Center for Community Based Learning. LISC is a Twin Cities based, nonprofit, financial intermediary that provides technical and financial assistance to nonprofit community developers (primarily real estate developers). Please call Barbara Jeanetta at 651-265-2293 (or email at bjeanetta@liscnet.org) for more information or an application.

Applications will be accepted throughout 2005. Interviews will be scheduled in October or November 2005 and candidates will be selected in November and December 2005 for a January 2006 program start date.

The Careership -- **a mid-career apprenticeship opportunity in Community Development**
Prospective Applicant Data Sheet

Please indicate the phone numbers, mail and e-mail addresses where you would **prefer** to be reached:

Name ____________________ **Phone** ____________

Address ______________________________

____

Fax ______________ **E-mail** ______________

Work:
Please describe your current work and summarize your previous work experiences:

____

____

____

Education:
Do you possess a high school diploma? _____
Have you or are you currently attending college? _____ College: ______________
Have you completed a college certificate and/or degree? ____ Major(s): ______________
A graduate degree? _____ If yes, please describe: ______________

Please describe other key training or educational experiences:

____

____

Service/Volunteering:
Please describe any key community service or volunteer experiences you have had in recent years (including the names of notable organizations with whom you have worked):

____

____

____

Skills:
What do you consider your strengths and most important skills?

____

____

____

Return this form (or a resume) to: Barbara Jeanetta, Twin Cities LISC, 570 Asbury Street, Suite 207, St. Paul 55104 or by fax 651-649-1112. You may also scan this form and e-mail it to bjeanetta@lisc.org. Please call 651-265-2293 with questions or concerns.

4

3/05

3/15/06

Rebecca Johnson
Internship Hours

Mondays:	1:15 pm to 7:15 pm (6 hours)
Tuesdays:	7:00 am to 7:00 pm (12 hours)
Wednesdays:	OUT
Thursdays:	7:00 am to 5 pm (10)
Fridays:	7:00 am to 7:00 pm (12)

Since the first three months of classes will be held on the second Tuesday of the month, the day of our regular Board meetings, I will not take comp time for time spent at the board meeting.

April to December, the classes will be held on the first Tuesdays of the month. On these days, I will make up the extra hours during the pay period.

J44.

Memo

To: Lester R. Collins

From: Nedra Henson

CC: Rebecca S. Johnson, Carol Washington, Roger Banks

Date: February 24, 2005

Re: New hours for Careership

Good Morning,

Per our office meeting my new hours will be Monday through Friday, 7:00 a.m. -3:30 .pm. and every first Tuesday of the month I will be completely out of the office to fulfill my Careership requirements as contracted.

Sincerely,

Nedra Henson

Nedra Henson,

Purpose: Nedra's Schedule
Source: Lester Collins

STATE OF MINNESOTA
COUNCIL ON BLACK MINNESOTANS
#4
Wright Building • Suite 426
2233 University Avenue • St. Paul, MN 55114 • (651) 642-0811 • 643-3580 FAX

July 24, 2000

Mr. Bobby J. Champion
Office of the Attorney General
525 Park Street, Suite 200
St. Paul, Minnesota 55103-2106

Dear Mr. Champion:

Thank you for your help in getting the Council's bylaws straightened out. At its last meeting, the Council adopted the bylaws with the changes that you suggested.

Since then, another question has come up having to do with compensation of Council members under Minn.Stats. Section 15.0575, subd. 3. That section provides that full-time employees of the state or of political subdivisions of the state are not eligible for the standard $55 daily compensation for time spent on "board activities," but also provides that such members may suffer no loss in compensation or benefits as a result of their service on the board. The Council has as many as four members who might be covered under this prohibition, but we have been paying all members $55 for each meeting they have attended.

I enclose a copy of two recent articles from the Pioneer Press that deal with this issue. One article announces that the State Council on Asian-Pacific Minnesotans has been improperly paying its members who work for the state, and that those members need to pay back their accumulated stipends. The other article concerns a controversy over similar payments made by the State Gambling Control Board, which apparently feels that its members who might have received payments prohibited by Section 15.0575 should not have to pay them back, because all of the meetings and functions for which the payments were made took place on the employees' vacation or unpaid personal time. The article also notes that the matter has been referred to the Attorney General's Office for guidance.

In our Council's case, all functions for which members have been compensated in recent years have taken place either on weekday evenings after 5 p.m. or on weekends. We believe that the Gambling Control Board's argument against reimbursement applies just as well to our circumstances, but we don't know how likely it is that their argument will prevail.

We also recognize that the situations of different Council members might result in different treatment under the same rules. In our case, Member A is a full-time administrator at a MnSCU campus, Member B is an instructor at a different MnSCU campus who works under nine-month contracts that have been renewed each year, Member C is a full-time employee of Hennepin County, and Member D is a full-time employee of a project that is funded by the Minneapolis Youth Coordinating Board, which is an agency of the City of Minneapolis.

So what should we do about the $55 payments to these four Council members? Should we stop making the payments to these members until the question concerning the Gambling Control Board is resolved? Should we advise these members that they might have to pay back compensation that they have already received? Or should we advise the Council membership of the nature of the problem, and leave it up to them as to whether they continue to receive payments, with the understanding that they might have to pay them back, depending on your office's resolution of the question raised by the Gambling Control Board?

The next meeting of the Council is scheduled for Tuesday, August 8. How likely is it that you will be able to provide some authoritative guidance on these questions by then? Is it likely that an answer to the Gambling Control Board's question might be forthcoming soon? Finally, what kind of additional information might you need in order to consider these questions?

I'd appreciate any advice that you can provide on this situation. Please call me soon with your initial thoughts.

Very truly yours,

Lester R. Collins

Lester R. Collins
Executive Director

Enclosure

cc: Taye Reta

St Paul Pioneer Press 7·14·00

GAMBLING CONTROL BOARD

Group disputes alleged fund misuse: The Gambling Control Board is contesting a report released Thursday by the legislative auditor that alleges three board members were inappropriately paid daily allowances from September 1996 through May 2000.

The report recommends that the board members repay $3,245 they received for attending board functions. State law prohibits government employees from receiving the payment if they are reimbursed from another source, which board officials say they were not.

One board member used vacation time to attend board functions. Another used unpaid personal time. The third has retired and couldn't be reached. Two were county employees; one was a city employee.

"It's our belief that the intent of (the statute) is to prevent employees of the state or political subdivisions of the state from 'double dipping' at taxpayer expense," executive director Harry Baltzer wrote in response to the audit. "We believe these board members have met that test and were paid and accepted per diem in good faith."

The case was referred to the attorney general's office, which will decide whether to pursue reimbursement from the employees.

— ASSOCIATED PRESS

ASIAN-PACIFIC COUNCIL

Audit finds mismanagement: The Council on Asian-Pacific Minnesotans improperly administered grants and made daily allowance payments to ineligible council members, according to a legislative audit released Thursday.

In some cases from July 1, 1996, through June 30, 1999, the council also used unspent grant money for other projects without specific approval, the audit concluded.

"For one grant, the council charged unallowed or questionable costs to the grant," the audit said.

The council used $4,393 from a federal AIDS grant to cover statewide costs unrelated to the project. An employee who didn't work on the project also was paid $1,436 from the grant.

The audit recommended that the council repay the grant account for unallowed costs and work with other state agencies to resolve remaining balances from other old grants, which the council has since done.

Another problem uncovered by the audit was inappropriate expense payments totaling $3,135 to three council members, who claimed the allowances even though their status as state employees made them ineligible.

Executive Director Illean Her said the council wasn't aware until this year that its statute was amended in 1996 to prohibit payments to those employees. One has repaid the amount he received and the other two are setting up schedules to repay the money.

The council, established in 1985, advises the governor and the Legislature on issues important to Minnesota's estimated 140,000 Asian-Pacific Islanders, representing more than 40 ethnic groups.

— ASSOCIATED PRESS

Minnesota Session Laws

Minnesota Session Laws - 2001

Key: ~~language to be deleted~~ new language Change language enhancement display.

Legislative history and Authors

CHAPTER 61-H.F.No. 525

An act relating to state government; revising conditions under which public employees receive daily payments for service on boards and councils; requiring groups to adopt standards for daily payments; amending Minnesota Statutes 2000, sections 15.0575, subdivision 3; 15.059, subdivision 3; and 214.09, subdivision 3.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. Minnesota Statutes 2000, section 15.0575, subdivision 3, is amended to read:

Subd. 3. [COMPENSATION.] (a) Members of the boards ~~must~~ may be compensated at the rate of $55 a day spent on board activities, when authorized by the board, plus expenses in the same manner and amount as authorized by the commissioner's plan adopted under section 43A.18, subdivision 2. Members who, as a result of time spent attending board meetings, incur child care expenses that would not otherwise have been incurred, may be reimbursed for those expenses upon board authorization.

(b) Members who are ~~full-time~~ state employees or ~~full-time~~ employees of the political subdivisions of the state ~~may~~ must not receive the daily payment~~, but they may suffer no loss in compensation or benefits from the state or a political subdivision as a result of their service on the board~~ for activities that occur during working hours for which they are compensated by the state or political subdivision. However, a state or political subdivision employee may receive the daily payment if the employee uses vacation time for board activities. Members who are ~~full-time~~ state employees or ~~full-time~~ employees of the political subdivisions of the state may receive the expenses provided for in this subdivision unless the expenses are reimbursed by another source. Members who are state employees or employees of political subdivisions of the state may be reimbursed for child care expenses only for time spent on board activities that are outside their ~~normal~~ working hours.

(c) Each board must adopt internal standards prescribing what constitutes a day spent on board activities for purposes of making daily payments under this subdivision.

Sec. 2. Minnesota Statutes 2000, section 15.059, subdivision 3, is amended to read:

Subd. 3. [COMPENSATION.] (a) Members of the advisory councils and committees ~~must~~ may be compensated at the rate of $55 a day spent on council or committee activities, when authorized by the council or committee, plus expenses in the same manner and amount as authorized by the commissioner's plan adopted under section 43A.18, subdivision 2. Members who, as a result of time spent attending council or committee meetings,

#5

STATE OF MINNESOTA
COUNCIL ON BLACK MINNESOTANS
Wright Building • Suite 426
2233 University Avenue • St. Paul, MN 55114 • (651) 642-0811 • 643-3580 FAX

May 18, 2002

Ms. Tina Jackson
740 North Lexington Parkway
St. Paul, MN 55104

RE: **Council on Black Minnesotans Per Diem Reimbursement Request**

Dear Ms. Jackson:

On July 26, 2001, I sent a letter to you regarding reimbursement of per diem paid you during the time period to June 2000. This letter is a friendly reminder to that effect.

Pursuant to Minn. Stat. § 3.9225, subd. 1 (2000), compensation of Council members is governed by Minn. Stat. 15.0575 (2000). For your convenience, copies of the statutes are enclosed. Section 15.0575 prohibits full-time employees of the state or a political subdivision of the state from receiving per diem compensation. It is my understanding that you are a full-time employee of the Minnesota State Colleges and Universities and thus were ineligible to receive per diem due to your full-time state employment.

I am enclosing a statement relating to the reimbursement amount. Please do not hesitate to contact me about this reimbursement request at 651-643-3015. I would be glad to discuss any concerns or questions that you may have and would certainly consider any additional information you may have if you question the amount or believe that you were not a full-time state employee during the relevant time period.

Thank you in advance for your prompt attention to this reimbursement request. Please make your check in the amount of $385.00 payable to the State of Minnesota and return it to my attention at the address for the Council listed above. If you cannot pay the full amount at this time, please call me so that we can discuss payment options.

Sincerely,

Lester Collins
Executive Director

STATE OF MINNESOTA
COUNCIL ON BLACK MINNESOTANS
Wright Building • Suite 426
2233 University Avenue • St. Paul, MN 55114 • (651) 642-0811 • 643-3580 FAX

July 26, 2001

Ms. Dianne Binns
525 Portland Avenue South
Minneapolis, MN 55415

RE: **Council on Black Minnesotans Per Diem Reimbursement Request**

Dear Ms. Binns:

Pursuant to the Legislative Auditor's Review on State-Paid Per Diems dated March 1, 2001, a copy of which is enclosed for your convenience, I am writing to request reimbursement of $605.00 per diem compensation you received for time spent on Council on Black Minnesotans during the time period to June 2000.

Pursuant to Minn. Stat. § 3.9225, subd. 1 (2000), compensation of Council members is governed by Minn. Stat. 15.0575 (2000). For your convenience, copies of the statutes are enclosed. Section 15.0575 prohibits full-time employees of the state or a political subdivision of the state from receiving per diem compensation. As indicated in the Legislative Auditor's report, it is my understanding that you are a full-time employee of the Minnesota State Colleges and Universities and thus were ineligible to receive per diem due to your full-time state employment.

Please do not hesitate to contact me about this reimbursement request at 651-643-3015. I would be glad to discuss any concerns or questions that you may have and would certainly consider any additional information you may have if you question the amount or believe that you were not a full-time state employee during the relevant time period.

Thank you in advance for your prompt attention to this reimbursement request. Please make your check in the amount of $605.00 payable to the State of Minnesota and return it to my attention at the address for the Council listed above.

Sincerely,

Lester Collins
Executive Director

LRC:rsj
Enclosures

cc: Christie Eller, Attorney General's Office

STATE OF MINNESOTA
COUNCIL ON BLACK MINNESOTANS
Wright Building • Suite 426
2233 University Avenue • St. Paul, MN 55114 • (651) 642-0811 • 643-3580 FAX

May 18, 2002

Mr. Les Green
25447 Pleasant Road
St. Cloud MN 56301

RE: **Council on Black Minnesotans Per Diem Reimbursement Request**

Dear Mr. Green:

On July 26, 2001, I sent a letter to you regarding reimbursement of per diem paid you during the time period to June 2000. This letter is a friendly reminder to that effect.

Pursuant to Minn. Stat. § 3.9225, subd. 1 (2000), compensation of Council members is governed by Minn. Stat. 15.0575 (2000). For your convenience, copies of the statutes are enclosed. Section 15.0575 prohibits full-time employees of the state or a political subdivision of the state from receiving per diem compensation. It is my understanding that you are a full-time employee of the Minnesota State Colleges and Universities and thus were ineligible to receive per diem due to your full-time state employment.

I am enclosing a statement relating to the reimbursement amount. Please do not hesitate to contact me about this reimbursement request at 651-643-3015. I would be glad to discuss any concerns or questions that you may have and would certainly consider any additional information you may have if you question the amount or believe that you were not a full-time state employee during the relevant time period.

Thank you in advance for your prompt attention to this reimbursement request. Please make your check in the amount of $385.00 payable to the State of Minnesota and return it to my attention at the address for the Council listed above. If you cannot pay the full amount at this time, please call me so that we can discuss payment options.

Sincerely,

Lester Collins
Executive Director

STATE OF MINNESOTA
COUNCIL ON BLACK MINNESOTANS
Wright Building • Suite 426
2233 University Avenue • St. Paul, MN 55114 • (651) 642-0811 • 643-3580 FAX

May 18, 2002

Ms. Valerie Geaither
1406 Hall Curve
Minneapolis, MN 55411

RE: Council on Black Minnesotans Per Diem Reimbursement Request

Dear Ms. Geaither:

On July 26, 2001, I sent a letter to you regarding reimbursement of per diem paid you during the time period to June 2000. This letter is a friendly reminder to that effect.

Pursuant to Minn. Stat. § 3.9225, subd. 1 (2000), compensation of Council members is governed by Minn. Stat. 15.0575 (2000). For your convenience, copies of the statutes are enclosed. Section 15.0575 prohibits full-time employees of the state or a political subdivision of the state from receiving per diem compensation. It is my understanding that you are a full-time employee of the Minnesota State Colleges and Universities and thus were ineligible to receive per diem due to your full-time state employment.

I am enclosing a statement relating to the reimbursement amount. Please do not hesitate to contact me about this reimbursement request at 651-643-3015. I would be glad to discuss any concerns or questions that you may have and would certainly consider any additional information you may have if you question the amount or believe that you were not a full-time state employee during the relevant time period.

Thank you in advance for your prompt attention to this reimbursement request. Please make your check in the amount of $165.00 payable to the State of Minnesota and return it to my attention at the address for the Council listed above. If you cannot pay the full amount at this time, please call me so that we can discuss payment options.

Sincerely,

Lester Collins
Executive Director

State Council on Black Minnesotans Report
Response to a Request from the Minnesota Human Rights Commission: Documentation on Legislative/Community Agenda Issues & Conditions

(08-13-04)

Issues and Conditions Impacting Persons/Families of African Heritage

The State Council on Black Minnesotans is a research, policy and action driven organization. It uses data/information in both a proactive and reactive manner when addressing issues affecting the African American and African communities of Minnesota. To achieve its mission the Council uses both primary and secondary research strategies. A principal source of information for the Council, in addition to written reports containing primary and secondary information, comes from Council members and staff attending community forums, presentations and conferences.

For the year 2002, the Council determined that the three issue areas of: 1) Health Disparities, 2) Education and 3) Employment were the areas that would comprise its organizational priorities and receive the bulk of its attention.

During 2003 and 2004, using community forums and special meetings, the following issue areas, in lexical order, were identified as organizational priorities; areas that would become the core of the Council's legislative agenda for 2003 and 2004:

1. **Families and Children issues** – particularly Out of Home Placement Care and Child Protection Issues
2. **Criminal Justice and Corrections** – with a particular focus on Racial Profiling/Police Misconduct., incarceration rates and equity within the judicial system.
3. **Education** – focus was to be placed on student performance outcomes, disciplinary policies, the administration of the educational system, parental involvement in educational processes and cultural competency.
4. **Health Disparities** – the Council continues its focus on the issue of health disparities. Teen pregnancy and STD prevention, tobacco usage and smoking prevention, and health conditions associated with environmental conditions, particularly environmental racism and its correlates.

Demographic Information

Besides monitoring and utilizing information associated with specific substantive issue areas, the Council has had to remain knowledgeable about selected demographic characteristics associated with the status of persons and families of African descent on the local, state, and national level. This includes data on population levels and distribution, income and earnings, housing and homeownership, etc.. Most of this data is derived from the U.S. Census and specific reports generated by research entities such as the Minnesota Department of Planning and the Minnesota Board on Aging. An environmental scan conducted for the Kellogg Foundation by the St. Paul/Ramsey County Children's Initiative, while dated, presents a comprehensive picture of the needs and issues of families and children in the St. Paul area.

This report, however, has as its primary focus delineating resources and documentation associated with the Council on Black Minnesotans' four priority areas for the years 2003 - 2005:

1. **Families and Children – Out of Home Placement Issues.**

   Considerable documentation exists in this substantive area. Those public agencies, namely the MN Department of Human Services and Hennepin and Ramsey counties Departments of Human Services/Child Protection have developed and issued reports on the status of out of home placement and the racial disparities associated with this process. Our most recent involvement with DHS, aside from meeting with the Commissioner, includes the review of the agency's five year plan that was submitted to the federal government in August; "Minnesota's Child and Family Service Plan, 2004-2009" A major study on racial disparities in out of home placement, commissioned by Racial Disparities Task Force of DHS, is near conclusion.

   The MN Department of Human Services issued a report to the 2002 Minnesota Legislature entitled "Study of Outcomes for African American Children in Minnesota's Child Protection System". It contains a fairly comprehensive analysis of the disparities associated with out of home care.

   Research and position papers have been and continue to be developed by area academicians including Dr.Samuel Meyers of the University of Minnesota's Hubert H. Humphrey Institute; Dr.Glenda Rooney and Dr. Nancy Rodenberg of Augsburg College; and Dr. William Allen of the University of Minnesota; all members of the Commission on Minnesota's African American Children (COMAAC – staffed by Council staff). Research on other associated topics, particularly kinship care has been conducted by Dr. Priscilla Gibson of the Department of Social Work, University of Minnesota.

   The Council also relies heavily on reports generated by the Children's Defense Fund. They include "Kids Count", the " School Readiness Report" and other special reports.

   Because of the size of these documents, they and other similar size reports/studies, have not been reproduced for this submission. They can, however, be ordered from CDF or secured through websites.

2. **Criminal Justice and Corrections Issues**

   Significant local research has been conducted that had **Racial Profiling** as its focus. As a result of legislation enacted in 2000, a study was commissioned to determine the status of racial profiling in Minnesota. Sixty-five law enforcement agencies throughout the state volunteered to participate in the study - which was conducted, analyzed and reported on by two organizations - the MN Council on Crime and Justice and the Institute on Race and Poverty of the University of Minnesota. The study concluded that "race has been a significant factor in traffic stops. There is a summary of this research and its recommendations on-line as well as data reports reflecting survey outcomes from each of the individual agency survey participants. Both the police departments of Minneapolis and Saint Paul conducted their own racial profiling studies prior to the legislative study commissioned in 2001. The results of the previous studies, with similar conclusions, are also on-line. And, the Mayor of the City of Minneapolis has recently created a task force to conduct and oversee the conduct of follow-up research on this issue.

The **cultural competency of peace officers** in Minnesota has been called into question. This issue is closely associated with the practice of racial profiling. The educational efforts of the MN Peace Officer Standards and Training Board (POST) to develop culturally competent officers was also the subject of the above mentioned legislation. This agency's website contains the training records of most police officers in Minnesota. The Peace officers participation in classes addressing the issues of cultural competency and racial profiling has been summarized and submitted in this package of documentation.

The Council attempts to react to policy situations and challenges as they arise. For example, a critical issue confronting our communities is currently being considered by the Minnesota Supreme Court. A final hearing on the issue of **"Criminal Accusation Information on the World-Wide Web"** is scheduled to be held on September 21, 2004. This hearing has as its basis the final report of the Minnesota Supreme Court Advisory Committee on Rules of Public Access to Records of the Judicial Branch. If the principal recommendation of the body is adopted, it will have very serious ramifications for the Black population, and other populations of color, in Minnesota. The names of individuals who have not been convicted of a crime – so much for the presumption of innocence will be placed on the world-wide web for "information harvesters" to do what they will with the information. Such criminal justice information on the web has historically been used to restrict opportunities for populations of color regarding their employment and housing accommodations- while promoting fear and misleading and manufactured generalizations – and while filling the financial coffers of "information harvesters".

The above is an example of a process used by the Council to review, monitor and analyze (e.g. research) proposed changes in legislation and other forms of policy that are under consideration. These types of activity are considered to be mini-research efforts and there are many of them.

A very valuable set of information has been created by the state judiciary. A database, developed in about 2001, covers the judicial experience of individuals of color in Minnesota from arrests through dispositions and includes financial information. Because of the lack of resources, judicial staff have been unable to analyze and report on the data contained in this new information system. Only a set of preliminary reports have been released and they are on the court's website .

The research conducted by the African American Men's Project of Hennepin County provides some insight regarding the status of young African American men in relation to the police and the judicial and corrections systems. Their research is on their website.

3. **Education Issues**

Students of African heritage enrolled in the public school systems (k-12) throughout the state are experiencing very serious disparities in most performance areas – including drop-out and graduation rates, performance on standardize math and english tests, the application of discipline practices, indicators of poverty and parental involvement. Reports substantiating these conditions abound. They include reports generated by the Department of Education (formerly the Department of Children, Families and Learning) and school districts throughout the state, particularly the Minneapolis and Saint Paul school districts - where the vast majority of students are students of color.Reports and studies released by the Children Defense Fund are also very relevant to this issue.

A recent report - "2004 State of Students of Color"- released by the Minnesota Minority Education Partnership reveals that "low performances on standardized tests in the elementary and secondary grades, poor high school graduation rates and low college attendance rates among minority students is a persistent problem in Minnesota"

Comparatively speaking, selected indicators reveal that over the past few years access to higher education opportunities for students of color have decreased. The above cited report emphasized that "we are losing students of color at every step of the way from elementary to high school, to college and to higher level degrees". It went on to suggest that "Minnesota is putting its social and economic future at risk as a result of not developing the talents of our state's fastest growing communities." This situation is acerbated by the proportional growth in "minority" student enrollment. A decade ago students of color represented 1 in 10 of K-12 student enrollments in public schools. Today, it is closer to 1 in 5.

Racism and discrimination continue to be a part of the lives of students of color at all levels of their educational experiences. For example, the Minneapolis NAACP et al successfully brought suit to address public schools educational inequities. In the higher educational arena, for example, two studies were commission that delineated the status of discrimination and racism at Saint Cloud State University.. The Nichols Report and the report by the U.S.Equal Employment Opportunity Commission in 2002 both acknow-ledged problems associated with racism and discrimination. In the EEOC report it was asserted that "Overall, the evidence indicates that the University suffers from a severe lack of credibility with regard to diversity issues".

The Citizen's League has traditionally been a valuable resource in both the educational research field and research in other substantive areas. This includes a report entitled "A Failing Grade on School Completion". - an analysis on the school dropout issue.

4. Health Disparities

The Office of Minority and Multicultural Health of the Minnesota's Department of Health has become the primary source on information associated with the status of health disparities in Minnesota. A good reference document is the agency's recent report to the Minnesota Legislature. Evaluative reports which delineate the status of funded grantee programs and the status of the agency and its operations are also available.

Reports on the health status of populations of color at the municipal and county level are available. Both the Health & Family Support Services Department of Minneapolis, through is health disparities efforts and the Health Department of Hennepin County, particularly through its SHAPE project, provide health profiles for both African and

African American populations. Similar reports are available from the St. Paul/Ramsey County Department of Public Health

Comparative data at the national and state level is available from the Kaiser Family Foundation.

5. Other Issues and Conditions

Frequently, the Council is requested to provide technical assistance and research assistance to community-based organizations and agencies. For example, the Council was requested to provide an analysis of the Tax Accelerated Zone Policy (slum prevention legislation) and its impact on Black residents of the cities of St. Paul and Minneapolis. It was feared that this policy was being used to promote gentrification in these cities.

Council staff has also been asked to conduct an analysis of the extent to which African Americans benefited from the Minneapolis Empowerment Zone program. This required analyzing U.S. Department of Housing and Urban Development program performance reports and audits. Local reports, including organizational minutes, and data systems review were used to determine the extent to which board members exhibited inappropriate behavior (e.g. conflict of interest) and whether or not the data collection and reporting system used was conducive to determining the extent to which African Americans benefited from this program.

The Empowerment Zone project highlights one of the major constraints faced by the Council when attempting to conduct research on the conditions faced by, or that affect, African and African American populations. Unfortunately, the research efforts of most governmental agencies do not involve the systematic collection of data using Race or Ethnicity as variables. And, even if "race data" is collected, it is in a form that does not allow for the differentiation between the status of African and African American populations. The Council is unable to effectively address its mission and charge without this type of information

Council on Black Minnesotans Staff Report: The Council's Linkages with Constituents

(October 11, 2005)

The State Council on Black Minnesotans addresses the need for people of African heritage to fully and effectively participate in and equitably benefit from the political, social and economic resources, policies and procedures of this state. Developing and maintaining linkages with and for the Council's constituents is central to accomplishing the above mentioned goals. According to the "Twenty-Sixty-Twenty Report" developed in 2004 for the Office of the Governor, nearly 19 percent of the agency's resources are expended for this function.

The Council has multiple constituencies. First, it has a target population constituency comprised of African Americans, Africans and the impoverished. Associated with this constituency are a set of individuals and organizations with which we have forged some strong linkages. A principal role played by the Council is in educating client constituents regarding issue and conditions affecting them and working toward the resolution of these conditions.

Minnesota's fast growing Black population is the Council's primary client constituency and is the State's largest non-European ethnic/cultural group. In 2000, according to Tom Gillaspy, the State Demographer, there are from 172,000 to 200,000 residents who are Black Minnesotans – more than triple the state's Black population in 1980.

The Council's primary client constituency also includes one of the largest African immigrant populations in the United States. The vast majority of the Council's client constituencies, nearly 92%, are residents of the Twin Cities Metropolitan Area. Smaller Black communities can be found in and near Rochester, Duluth, St. Cloud, Mankato, Moorhead and Worthington. Currently, rapid Black population growth is taking place in such Greater Minnesota counties as Carlton, Isanti, Chisago and Crow Wing.

Overall, the client populations served by the Council are disproportionately impoverished and have experienced a multitude of complex and inter-related problems; social, political and economic. These conditions are both caused and acerbated by a lack of equal access and opportunity and institutional and individual racism. The Council was created to address the disparities associated with these conditions and be an instrument for creating institutional and social change.

There is also a "public policy-makers & administrators" constituency. This includes an institutional constituency of health and human service and research organizations with similar functions, values, concerns, target populations, and/or objectives. Within this context, the Council educates and advises local and state policy makers regarding issues and problems affecting persons of African heritage. The Council also educates and trains policy administrators and implementers on issues and conditions confronting our primary client constituents. These constituents are provided education and training services that range from one-on-one meetings to community forums and dialogues.

Council on Black Minnesotans
Summary of Linkages to Constituents

What follows is a selected summary of linkages that the Council has developed and maintained with governmental, non-profit and community based individuals and institutions.

Governmental Linkages

African National Linkages:

- Collaborated with local Sudanese to arrange meetings and engagements for Dr. Machar, a leader of the **Sudanese Liberation Army**, with MN governmental leaders, Stand for Africa, KMOJ and Insight News. Goal was to promote investments in Sudanese infrastructure and to familiarize Minnesotans regarding conditions and opportunities in The Sudan.
- Arranged meetings between MN state dignitaries and governmental representatives from **Ghana**.

Federal Linkages:

Senate and House Linkages

- Advocated for change in **Temporary Status Policy** for persons from Liberia and Sierra Leone with representatives from Senators Coleman and Dayton's offices
- Supported research by the **U.S. Center Disease Control** proposed for North Minneapolis Black community.
- **Mark McClean, CMS Director (Medicare Part D)** – Collaborated with health professional organizations, Metropolitan Area Agency on Aging and senior serving non-profit health and human service agencies to promote information and outreach regarding pharmaceutical benefits.

State Linkages:

Department of Human Services Linkages:

- A coalition comprised of members from **COMAAC, the Children's Defense Fund, Our Children Our Future and Black Family/Children Ombudsperson** met on several occasions with Commissioner Goodno and his predecessor to discuss out of home placement policies and practices.

- **Reviewed DHS Five Year Plan**, in collaboration with COMAAC, prior to its submission to Washington D.C. Recommended that the best practices and procedures presented in the American Indian Child Welfare Act be used when dealing with African American children.

- Participated as member of the department's **Advisory Task Force on African American Disparities** (out of home placement). Reviewed and participated in the design, implementation and recommendations of a study conducted by the University of Minnesota. Committees to monitor and develop state policy and monitor and evaluate policy outcomes were created.
- **Collaborated with Our Children Our Future, African American Ombudsman for Children and Families and COMAAC** on "background check legislation" with DHS Assistant Commissioner Sutton and legal staff . Legislative committees accepted the recommended changes.
- Collaborated with several organizations, including **Affirmative Options and MN Welfare Rights** organization to support expanding educational benefits and opportunities for MFIP recipients.

Department of Veteran Affairs Linkages:

- Collaborated with department staff, members of the legislature and CBM member Clarence Jones in the passage of a **Minority Veterans Outreach Bill.**
- Participated in and supported the **Veterans Day event at Sabathani Community Center.** Gov. Pawlenty made a presentation.
- Collaborated with representatives, primarily Dave Hall, from the **MN Black Veterans Organization** and Sam Grant (Metro State University) to restructure and reinvigorate this organization. Interns were assigned to an economic development project with the CDC of the veterans organization.

Department of Health Linkages:

- **Office of Minority and Multicultural Health** – By statute, the Council represents the African and African American communities on the Health Disparities Advisory Group. Made presentation as a panel member at the agency's annual event along with Rep. Jim Abeler.
- Collaborated with the **Department's Rural Health Advisory Committee and Community Health Advisory Committee as a member of the Health Aging Work Group.** Purpose of this body is to advise the Governor on strategies for Minnesota seniors, particularly for Part D of Medicare.
- Collaborated with Pete Rode of **the MN Depart of Health's "Student Survey project"** and made suggestions regarding additional questions that might be included in the survey and the status of health among Minnesota students.
- Collaborated with a group of individuals and organizations to promote the passage of the **Cigarette Tax Bill** in the most recent legislative session.

Minnesota State Judiciary Linkages:

- **Public Trust and Confidence Committee** – Work with the judiciary to create and promote cultural competency and to promote a positive image for the judicial system through-out the state. Sponsored an information sharing community forum at the

Minneapolis Urban League to introduce the community to the new judiciary data collection and reporting system – and associated reports.

- **Minnesota Supreme Court - Supreme Court Advisory Committee on Rules of Public Access to Records of the Judicial Branch**. Testified twice against having arrest records placed on the court's web site where information harvesters could exploit this data. The court eventually supported our position.
- Collaborated with the judiciary committee that promotes greater cultural competency among judges through training – particularly in the area of out of home placement of children for reasons of abuse and/or neglect.

Minnesota Human Rights Commission Linkages:

- The Council has formal representation from the Commission on its Board – Melane Miles.

- Have collaborated with the **Commissioner, Velma Korbel**, in an effort to promote greater cooperation between councils of color and to deal with the issues of racial profiling and health disparities.

Metropolitan Linkages:

- Collaborated with **Peter Bell, Metropolitan Council President**, to make presentation on Metropolitan Government at the Council on Black Minnesotans Policy Training Day on the Hill.
- Testified before the **Council on the 2030 Plan** and on the need for revising its information gathering strategies and methodologies.
- Testified in response to a **demographic data presentation** made before the Metro Council by Metro Council staff.
- Collaborated with **Metro Transit Authority** staff to review proposed changes in bus service for North and South/Central Minneapolis and areas of St. Paul. Some recommendations were accepted. Some services were restored.

<u>County Linkages</u>

- **Ramsey County MFIP project**. Worked with a community-based group, including Mary K. Boyd and Kwame McDonald, to study and develop solutions to identified issues and problems. Made recommendations to and received funding for a "Navigators Project" from Ramsey County Commissioners.
- **Hennepin County SHAPE project**. Comprehensive research project designed to delineate health status and conditions facing communities of color in Hennepin County. Made suggestions for modifying data collection strategies regarding racial/ethnic/cultural data.
- As part of a collaboration that included the MN **African American Tobacco Education Network, Blue Cross Blue Shield and Smoke Free**, council staff testified before

Hennepin and Ramsey County Commissioners on "second hand smoke issues. Both bodies passed an ordinance making specific working areas "smoke free".

- A collaboration that included representatives from Augsburg College, the University of Minnesota, Children Defense Fund, and Hennepin County Public Defenders Office made a presentation to Hennepin County Commissioners on **Out of Home Placement Research.** County set up a task force to examine and develop policies in this area.

Municipal Linkages:

- **The Minneapolis Mayor's Committee on Racial Profiling Research**. A collaboration was formed that included representatives from municipal, county and state law enforcement agencies and representatives from Minneapolis communities of color and American Indians to oversee the design and implementation of s study to determine the impact of police policies and practices on racial profiling outcomes. Project is in the data analysis stage.
- **Municipal ordinances for Police/INS separation**. In collaboration with a number of organizations, the Council was successful in having an ordinance passed in both Minneapolis and Saint Paul. Currently, council staff is in collaboration with organizations in the cities of Richfield and St. Louis Park to secure the passage of similar ordinances.
- Testified before the **Minneapolis City Council** on the issue of **background checks for renters** and the disparate impact that city policy has on populations of color and the poor. Humphrey Institute study indicates that the costs for background checks for racial minorities is three to four times the costs associated with individuals of European Descent.
- Collaborated with the **City of Saint Paul** to examine the impact of **Accelerated Tax Zone policy** on Black property owners. Hearings on the issue were sponsored by the African American Leadership Council of St. Paul. Commissioner Susan Haigh from Ramsey County was also involved in this project.
- As part of a collaboration that included the **MN African American Tobacco Education Network, Blue Cross Blue Shield and Smoke Free**, council staff testified before the City Councils of Minneapolis and Saint Paul on "second hand smoke issues. Both bodies passed an ordinance making specific working areas "smoke free".
- Participated as a consultant to the **Minneapolis Police Community Relations Council**, providing technical assistance regarding the design and utilization of the Police Incident Survey for the Federal Mediation process.
- Participated with the **Minneapolis Department on Health and Family Support**, other health providers and advocates, in the development of an Urban Health Agenda.
- Collaborated with Chief McManus, Lt. Aradondo, Sgt. Christensen, Our Children Our Future, Rep. Keith Ellison, Ann Hill and other COMAAC representatives on police out of home policies and practices. African American children are disproportionately represented among out of home placement youth. Several changes have been made regarding how the police respond to the placement of children in abuse/neglect situations with relatives and friends.

Community-Based Linkages

Communication Linkages:

- Council developed a "Question of the Week" on issues affecting Africans and African Americans for KMOJ Radio and Insight News.
- Participated on a regular basis on the "Al McFarlane Show" to discuss issues important to the African and African American communities in the Twin Cities Metropolitan Area.
- Collaborated with Jewish Community Action to produce and present a television production on immigrant rights and police separation ordinances.
- Collaborated with the St. Paul N.A.A.C.P. and taped several television programs on issues affecting the African American populace.
- Published several position papers on tobacco issues; including one on a tobacco tax increase. This was done in collaboration with the MN African American Tobacco Education Network.
- Worked with Insight News and the Spokesman and Recorder to have articles on the 2003 Racial Profiling Study published.
- Several programs were taped and presented on Minneapolis Cable Channel. These programs were part of an Urban League Pipeline series and were moderated by Council staff.

Community Organization Linkages:

- **African American Leadership Council of St. Paul**. This is a federation of Black individuals and organizations that have as their focus developing and maintaining communication within the Black community of Saint Paul and engaging in projects that impact their communities.
- **African American Leadership Summit and Coalition of Black Churches of Minneapolis**. The purpose of this organization is similar to the St. Paul Council. It explores and monitors issues that impact the Black communities of Minneapolis. The area of education is of particular interest to this body. It co-sponsored the Black Educational Conference held at Augsburg College and is currently involved in the Minneapolis Public Schools Facilities Reutilization Project.
- **African American Adoption Agency**. Staff serves as board member.
- **Center for Urban and Regional Affairs,** University of Minnesota. Collaborated on the University's Northside Project, community mobilization and training, and community-based participatory research project. The goals is to make these processes more inclusive and responsive to the needs of African American and African communities
- **Empowerment Zone Program**. Was called upon by community residents to explore and evaluate the Federal HUD Audit and Empowerment Zone information system with the goal of determining the extent to which Black families, individuals and communities of targeted areas of Minneapolis benefited from the resources of the Empowerment Zone Program.

- **University of Minnesota/Minneapolis Public Schools Research on the Sexual Perceptions and Experiences of Elementary School Children.** Was called upon by educators and parents in North Minneapolis to examine a survey instrument and protocol develop by University researchers . Project was found to be age inappropriate and to have violated IRB protocols for both the University and the Minneapolis Public Schools.
- **Collaborated with Stand for Africa and C-PAM** to increase employment opportunities for African Immigrants. We were successful passing legislation that would reduce testing barriers that would lead to the certification of foreign trained nurses.
- **Council on Crime and Justice.** CBM Council staff serves on this agency's Institutional Review Board which oversees the proposed research to be conducted by this agency. Agency has conducted considerable research in the area of criminal justice issues. CBM staff also sits on the agency's community Task Force on Corrections and Criminal Justice Research. Along with the Institute on Race and Poverty, this agency was responsible for analyzing and reporting on the outcomes of the State-wide Racial Profiling Study.
- **Transportation Access Alliance.** Worked with the Minneapolis Urban League, MICAH, the Institute on Race and Poverty (Myron Orfield) to promote transit issues. Worked with representatives from the MTC to reinstitute previously eliminated bus service.
- **Minneapolis Urban League.** The CBM Council is a co-sponsor to the league's Pipe Line, a community forum series on issues affecting Black Minnesotans. These events are held on at least a monthly basis. Many of these events are facilitated/moderated by Council staff. This includes political candidates forums.
- **Saint Paul Urban League.** Worked in partnership with this organization to promote healthy choices among African American Youth. Funded by the Office of Minority and Multicultural Health, this was a STD/HIV prevention program that was designed to educate the youth regarding health issues and to empower then through policy and legislative advocacy training.
- **The Institute on Race and Poverty.** Under the leadership of both john powell and Myron Orefield this agency has collaborated with CBM staff. Collaboration involves the issues of racial profiling research, equitable distribution of metropolitan resources, education and transit/transportation.
- **Environmental Justice Advocates of Minnesota.** CBM was a founding member of this organization which has as its focus pollution, environmental hazards, environmental racism and other issues. Its membership is made up of representatives from the State Legislature, the Sierra Club, neighborhood associations and other environmentally oriented groups. This alliance was successful in having the MN Utilities Commission approve the conversion of electrical energy generation plants in Minneapolis and St. Paul from coal to another fuel source.
- **Under the auspices of the Citizens League** Council staff has participated in research projects. The most recent being an analysis of barriers and issues associated with improving the linkages between high school and higher education for students of color.
- **Life Source. (Organ Donation Program from Africans and African Americans)** CBM staff has provided representation to this group. Goal is to learn from the Black community, develop their trust, and develop program strategies to significantly increase organ donations among African Americans and to insure that research conducted is culturally appropriate.

Sixty Percent Category (In Priority Order)

Function 2: Conducting Research

Both primary and secondary research is performed. Primary research is conducted to identify issues for legislative/policy agenda. Secondary research focuses on Education, Criminal Justice, Family and Children and Health issues and racial disparities/disproportionalities. Use research information to monitor the status of Africans and African Americans in Minnesota and promote improvements in identified status.

Activity A - Issue identification research is conducted at community meetings and forums.

Activity B - Monitor and assess research conducted by local, state, and federal agencies and organizations.

Activity C - Informal research is conducted at planning, development and operational meetings by staff and Board.

Function 2 – Costs:	Staff	Operations $	Total	% of Budget
	$30,846.00	$ 5,220	$36,066.00	12.79

Function 3: Council Promotes Cultural and Economic Development

Cultural Development - Present and participate in cultural events and activities to promote cultural identity and understanding. Promote cultural competency and inclusion. Address racism, racial disparities and disproportionalities.
Economic Development - Monitor and assess economic development programs designed to impact our target populations. Conduct and review research on the economic status of Africans and African Americans.

Activity A – Educate target populations regarding issues and conditions affecting them.

Activity B – Collaborate with and educate policy makers and implementers with the goal of increasing cultural competency and understanding and promoting a decrease in individual and institutional racism

Activity C – Assist target populations, agencies and organizations to increase their capacities to deal more effectively with cultural issues and racial disparities

Activity D - Promote and preserve cultural identity through providing and participating in "cultural" events in the African and African American communities.

Function 3 – Costs:	Staff	Operations $	Total	% of Budget
	$30,540.00	$ 4,640	$35,180.00	12.48

Function 4: The Council manages stakeholder relations and public inquiries.

Stakeholder relations are fostered and managed through serious collaborative participation in stakeholder organizations and activities.

The Council acts as a facilitation and mediation tool and responds to inquiries regarding the Council and specific substantive issues areas affecting persons of African heritage.

Activity A - The Council sponsors community forums and dialogues.

Activity B - Works with community media to insure wide distribution of relevant information.

Activity C - Responds to requests for information on issues affecting Africans and African Americans.

Activity D - Provides information referral services

Activity E - Develops and supports programs that and facilitate and promote African and African American Relations.

Function 4 – Costs:	Staff	Operations $	Total	% of Budget
	$12,718.00	$ 2,900.00	$15,618.00	5.54

Function 5: Council sets strategic direction and operational plans.

These activities are conducted by the Council's Board of Directors. In addition, the Council participates on Advisory Boards and Commissions that perform these tasks.

Activity A - Council Executive Committee and Board meetings

Activity B – Conduct community forums and dialogues to develop legislative/policy agenda and target populations, community & constituency priorities and operational plans.

Activity C – Office of Minority and Multicultural Health and other health disparities/disproportionalies focused organizations

Activity D - Criminal Justice and Racial Profiling issues

Function 5 – Costs:	Staff	Operations $	Total	% of Budget
	$9,742.00	$ 2,332.00	$12,074.00	4.28

Function 6: The Evaluation Function.

Council develops performance targets and measures, monitors and manages performance. A major function of the Council is to monitor and evaluate the performance of local, state, regional and federal governmental units and assess the impact of their policies and program activities on populations of color.

Activity A – Assists in the development of performance objectives for our institutional and organizational constituencies.

Activity B - Develop performance objectives and targets for the Council and Council programs

Activity C – Promotes responsibility and accountability.

Activity D – Works to insure that resources are equitably distributed to African Americans, Africans, other populations of color and American Indians

Activity E - Works to reduce disparities and disproportionalities

Function 6 – Costs:	Staff	Operations $	Total	% of Budget
	$5,813.00	$ 870.00	$6,683.00	2.37

Function 7: Financial Management Functions

Activity A – Develops and maintains budgets through involvement of Executive Director and staff, Council Treasurer, Executive Committee and Council Directors

Activity B – Council reports and analyzes financial performance

Activity C – Council audits financial reports.

Function 7 – Costs:	Staff	Operations $	Total	% of Budget
	$30,089.00	$ 5,220.00	$35,309.00	12.52

Function 8: Human Resources Management Functions

Activity A - The Council manages personnel resources. Through the Executive Director, the Council determines organizational structure and authority delegation.

Activity B – The Council recruits and hires employees

Activity C – The Council retains and develops employees and manages employee performance.

Activity D – The Council pays, rewards and recognizes staff.

Activity E - The Council manages contracts and other agreements. More specifically, the Council supervises and manages the Coordinators of the Dr. Martin Luther King Jr. Celebration, the African American Tobacco Education Network and the African American Teen Pregnancy and STD/HIV Prevention Project.

Function 8 – Costs:	Staff	Operations $	Total	% of Budget
	$23,849.00	$ 5,568.00	$29,417.00	10.43

Total – Sixty Percent Category

	Staff	Operations $	Total	% of Budget
	$143,597.00	$ 26,750.00	$170,347.00	60.37

Lower Twenty Percent Category

Function 9: Management of Operational Functions

Council establishes information management direction and architecture strategy. It developed a Strategic Information Resource Management Plan (SIRMP) and a Comprehensive Database System Plan. And, using standard operational procedures and activities, it performs the following activities.

Activity A – Council procures and manages goods, services, and systems.

Activity B – Council manages and disposes of assets.

Function 9 – Costs:	Staff	Operations $	Total	% of Budget
	$55,611.00	$ 9,964.00	$65,575.00	23.26

*** Note: This report is based on a staff survey that was conducted to determine each staff member's level of involvement across functional areas being addressed.

The dollar amounts and percentage levels are over as a result of rounding the calculations:

Budgeted Amount	Calculated Amount	Overage
$ 282,000 (100%)	$ 288,250 (102.19%)	$ 6,250 (2.19%)

Council on Black Minnesotans – 1980 to 2003
Matrix: Annual Budget by Population Levels by Staff FTE - % Change & Ratios

YEAR	ANNUAL BUDGET	% CHANGE	BLACK POPULATION	% CHANGE	PER CAPITA EXPENDITURES RATIO	FULL TIME STAFF	STAFF TO CONSTITUENCY RATIO
1980	$ 80,000	-	54,000		$ 1.48	2.5	21,600
1981	80,000	0.0%				2.5	
1982	80,000	0.0%				2.5	
1983	99,055	19.24%				3.0	
1984	118,375	19.50%				3.0	
1985	117,357	- .86%				3.0	
1986	126,680	7.94%				3.0	
1987	148,042	16.86%				3.0	
1988	168,700	13.95%				3.0	
1989	181,535	7.61%				3.0	
1990	180,823	- .39%	96,000	77.78% (1980 X 1990)	$1.88 – +27.03% (1980 X 1990)	3.0	32,000 - +48.15% (1980 X 1990)
1991	176,000	- 2.7%	100,083	4.25%	$ 1.76	3.0	33,361
1992	195,000	10.80%	105,930	5.84%	$ 1.84	3.0	35,310
1993	300,426	54.06%	111,611	5.36%	$ 2.69	3.5	31,889
1994	292,538	- 2.63%	117,597	5.36%	$ 2.49	3.5	33,600
1995	281,221	- 3.87%	123,112	4.69%	$ 2.28	3.5	35,174
1996	249,849	- 11.16%	128,257	4.18%	$ 1.95	3.5	36,645
1997	434,010	73.71%	134,151	4.60%	$ 3.24	6.0	22,359
1998	431,000	- .69%	141,192	5.25%	$ 3.05	6.0	23,532
1999	565,449	31.19%	148,596	5.24%	$ 3.81	4.0	37,149
2000	373,865	- 33.88%	172,000	15.75% 79.17% (1990 X 2000) 218.52% (1980 X 2000)	$ 2.17 - +15.43% (1990 X 2000)	4.0	43,000 - + 34.38% (1900 X 2000)
2001	323,000	- 13.61				4.0	
2002	313,000	- 3.10				4.0	
2003	318,230	1.67				4.0	

YEAR	ANNUAL BUDGET	% CHANGE	BLACK POPULATION	% CHANGE	PER CAPITA EXPENDITURES RATIO	FULL TIME STAFF	STAFF TO CONSTITUENCY RATIO
1980	$ 80,000	-	54,000		$ 1.48	2.5	21,600
1990	180,823	- .39%	96,000	77.78% (1980 X 1990)	$1.88 – +27.03% (1980 X 1990)	3.0	32,000 - +48.15% (1980 X 1990)
2000	373,865	- 33.88%	172,000	15.75% 79.17% (1990 X 2000) 218.52% (1980 X 2000)	$ 2.17 - +15.43% (1990 X 2000)	4.0	43,000 - + 34.38% (1900 X 2000)

L = Lester R = Roger		Purpose						Status	
Date	**Event/Organization**	**Purpose**	**Planning/Product Development**	**Implementation/ Presentation**	**Training/ Education**	**Collaboration/ Support**	**Networking/ Celebration**	**On-Going**	**Completed**
R	Transportation Pipeline Follow-uo Meeting		X			X		X	
L & R	African American Men's Project - Child Support Forum				X	X			X
7/22/05 R	Mid West Regional Hearing, National Commission on the Voting Rights Act				X		X		X
7/23/05 L	MN Reparations Campaign		X	X		X		X	
L	Street Outreach Theater					X	X		X
7/26/05 L & R	CBM Executive Committee Meeting		X					X	
7/27/05 R	Dialogue on Africa – Dr. Ali Khalif Galaydh			X	X	X			X
L & R	African American Racial Diaparities Advisory Committee		X	X				X	
7/28/05 L	African American Adoption Agency		X			X		X	
7/29/05	African American Tobacco Education Network Retreat		X	X		X			X
L	Millions More March at New Salem Baptist Church			X		X		X	
7/30/05	Millions More March Leadership Meeting			X		X		X	
L & R	Office of Minority & Multicultural Health/Healthy Start Forum on Infant			X		X			X

L = Lester R = Roger		Purpose						Status	
Date	**Event/Organization**	**Purpose**	**Planning/Product Development**	**Implementation/ Presentation**	**Training/ Education**	**Collaboration/ Support**	**Networking/ Celebration**	**On-Going**	**Completed**
	Mortality								
8/1/05 R	Medicare Justice Coalition Forum			X		X			X
R	Insight News/KMOJ Show at North High – Organ Donation Issue				X	X	X		X
8/3/05 L	Transportation Collaboration		X			X		X	
R	INS/Police Separation Ordinance – Richfield		X			X		X	
8/5/05 R	Jewish Community Action Staff		X			X		X	
8/6/05 L	MUL Family Day						X		X
8/8/05 R	HENNEPIN County Public Health Protection Assessment Team & Environmental Health Unit	Community based Participatory Research		X	X	X		X	
R	Alan Page – Supreme Court – Policy Event	Discussion sponsored by the Citizens League			X				X

July 18 - July 24

July 2005						
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31						

August 2005						
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Monday, July 18

5:30pm 6:00pm MN HispanicLeadership wards - College Scholarships (Harriet Island - 200 Justus OHAGE BLVD.)

Tuesday, July 19

:30pm 8:00pm Safe Return Initiative - from Penitentiary to Community Transition (STP Student Center - UMN 22017 Buford Ave.)

Wednesday, July 20

9:00am 5:00pm Safe Return Initiative - From Penitentiary to Community Transition - Domestic Violence (UMN STP Saint Paul Student Center - 2017 Buford Ave.)

Thursday, July 21

12:00pm 1:30pm Demographic Brown Bag - Barbara Ronningan "What's Happening to MN Schools?" (Lady Slipper Room - Centennial Bldg)

2:00pm 4:00pm Transportaton Pipeline Follow-up Meeting (MUL????)

5:30pm 7:00pm Mn Hispanic Leadership Awards - College Scholarships (Harriet Island - 200 Justus Ohage Blvd)

6:00pm 8:00pm African American Mens Project - Child Support Forum (MUL)

Friday, July 22

11:00am 7:00pm MidWest Regional Hearing, National Commission on the Voting Rights Act - Public Testimony heard from 6-7pm (Dorsey & Whitney - 50 South 6th Street - Suite 1500)

Saturday, July 23

11:00am 1:00pm Reparations Education Session (Zion Baptist Church - on Elwood)

Sunday, July 24

July 25 - July 31

July 2005						
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August 2005						
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28	29	30	31			

Monday, July 25

Tuesday, July 26

2:00pm 2:00pm CBM Executive Committee Meeting (DELasalle High School)

Wednesday, July 27

11:30am 1:30pm Dialogue on Africa - Dr. Ali Khalif Galaydh of HHH Inst. (MN Council on Non=Profits)

1:00pm 3:00pm African American Disparities Advisory Committee - DHS (DHS - 444 Lafayette - room 3E/F)

Thursday, July 28

Friday, July 29

7:00am 8:00am Pick up Bev Propes for MAATEN Retreat - 7:45 AM (1141 Thomas North - 612-529-8136)

8:00am 5:00pm African American Tobacco Education Network (Chaska)

7:00pm 9:00pm Channel Afrique (Doubletree Park Place Hotel - 1500 Park Place - Dover Resturant)

7:00pm 9:00pm New Salem Baptist Church Event

Saturday, July 30

9:00am 10:30am Millions More March - Brother Jason Mohamud (MUL)

10:30am 12:00pm Office of Minority & Multicultural Health/Healthy Start - Infant Mortality Forum (HQB/MLK Center STP)

Sunday, July 31

August 01 - August 07

August 2005						
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September 2005						
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Monday, August 01

9:30am 12:00pm Medicare Justice Coalition Forum - Celebrating 40 years of Medicare (Plymouth Creek Center - 14800 34th Avenue North - Plymouth)

11:00am 1:00pm Insight News/KMOJ Show at North High School - Organ Donation Issue - Life Source (North High School - Mpls)

Tuesday, August 02

7:00pm 8:30pm Night Out Celebration (Neighborhood - Powderhorn Park)

Wednesday, August 03

2:00pm 4:00pm Transportation Pipeline Followup Group (MUL)

6:30pm 8:00pm INS POLICE SEPARATION ORDINANCE - RICHFIELD (Woodlake LUTHERAN CHURCH - 76th & Oliver)

Thursday, August 04

Friday, August 05

10:30am 12:00pm Jewish Community Action/At Home Fdn. - Louisa Hext (Starbucks at the Strip Mall)

Saturday, August 06

Sunday, August 07

August 08 - August 14

August 2005						
S	M	T	W	T	F	S
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

September 2005						
S	M	T	W	T	F	S
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	

Monday, August 08

12:00pm 2:00pm HC Public Health Protection Assessment Team & Environmental Health Unit - Community Based Paticipatory Research (HC Health Services Bldg. 525 Portland Ave. Conference Room 111)

5:00pm 8:00pm Alan Page - Supreme Court - Policy & a Pint Event - Citizens League (Solera - 900 Hennepin Avenue)

Tuesday, August 09

9:30am 10:00am

5:30pm 8:30pm CBM Board Meeting (CBM)

Wednesday, August 10

12:00pm 1:30pm Juvenile Justice Policy - Disproportionate Contact Committee - Bill Collins (STP Police Department - Gardener Meeting)

00pm 2:00pm Black Seniors Issues with Wilder People (Gambles Skogmo) (STP - 650 Marshall - Room 104)

Thursday, August 11

11:30am 1:30pm Shannon Institute - Ronnie Brooks (Mai Village stp)

Friday, August 12

8:00am 8:30am Transportation of Tyler & Madison - Grandkids to Linden Hills Park (Linden Hills Park for Bus at 8:30)

8:30am 10:00am Senate Discussion of Auditors Report on the Sec. of State (Capitol # 107 - Elections Com. Wiger)

10:00am 12:00pm COMAAC (CBM)

12:00pm 2:00pm DHS Racial Disparities Task Force - State Policy & Practices Committee (CBM)

Saturday, August 13

12:00pm 4:00pm Festival for Fathers (North Commons Park)

12:00pm 4:00pm IGBO Celebration (St. Thomas University)

Sunday, August 14

The State Council on Black Minnesotans
Applicants for the Council Board – Survey

1. **Name:** ____
   Last First MI

2. **Address:** ____

3. **Length of Residence in Minnesota - Years:** ______ **Completion Date:** ___________

4. **Phone #'s: Home** ____________ **Work** ____________ **Cell** ____________

5. **E-mail Address:** ____

6. **Ethnicity/Nationality: African American** _____ **African** _____ (Specify Country) ________________________

7. **Education/Training:**

Institution/School	Years	Degree or Certification	Major/Primary Focus

8. **Employment History:** (From the Most Current to the Least Current)

Place of Employment	Years	Job Title	Job Duties/Functions

9. **Knowledge of Council on Black Minnesotans (Purpose & Past Activities)**

Very Low	Somewhat Low	Moderate Knowledge	Better than Average	Very High
Comments:				

10. **What are the Three (3) Main Skills that you bring to the Council?**

1.
2.
3.

11. **Major or Most Significant/Relevant Community Involvement Activities**

Name of Organization	Where? (City/State)	How Long (In Months)	Role (What did they do?)
Comments:			

12. **What are the Three (3) Most Important Issues Facing Africans/African Americans in Minnesota?**

1.
2.
3.

13. **What is Your Availability and Time Commitment?**

Available for:

_____ **a.** **Board Meetings (0nly) – Once a month on every 2nd Tuesday – 5 to 9 PM = Four Hours per Month**

_____ **b.** **Board Meetings & Committee Meetings (Average - additional 2 hours/Month) = Six Hours per Month**

_____ **c.** **Board , Committee and Community Meetings (Average – additional 2 hours/Month) = Eight Hours per Month . This is the ideal level.**

14. **If not Selected for the Board at this time, would you consider serving on one or more of the Board's Committees?**

Yes ___ No ___ (If Yes – which Committee(s)?)

_____ **African/African American Community Relations**
_____ **Economic Development**
_____ **Education**
_____ **Family & Children Issues**
_____ **Health**
_____ **Housing**
_____ **Information Systems/Technology**
_____ **Legislation, Policy & Advocacy**

IIB

The Excellence Report

The State of Minnesota's Drive to Excellence

A monthly update on Minnesota's Drive to Excellence **March 2006**

This issue:

Sub-Cabinet Q and A:

Human Services Commissioner Kevin Goodno

What are your thoughts on Minnesota's Drive to Excellence overall?

The strength of Drive to Excellence is its underlying philosophy – to make government work better for the citizens it serves. This effort has given us an opportunity to assess state services and see if there is a better way to do business. We know that centralizing everything isn't the answer, just as decentralizing everything isn't the answer. The challenge is how to strike the right balance. We need to continually ask ourselves which services can best be provided at an enterprise level and which are more effectively provided at an agency level.

Commissioner Kevin Goodno

What is your involvement with the Drive to Excellence?

I've been involved in this effort since it was in the formative stages and I'm currently on the Governor's Drive to Excellence Sub-cabinet.

How has your agency been involved in Drive to Excellence thus far?

The commitment of our staff has been critical to this project. Literally hundreds of Department of Human Services (DHS) employees have put in countless hours on nearly all of the projects while keeping up with their other duties. Many of these employees would not ordinarily have the opportunity to participate in a statewide effort of this kind. At various times it has been both difficult and energizing for staff. DHS is known for best practices in many of the areas the Drive to Excellence has focused on, so it is gratifying for them to share their expertise.

What do you see as the primary benefits from the Drive to Excellence?

The key benefits are in those areas where we are able to make a difference for citizens as well as for our business partners. The License Minnesota project, which is

Sub-Cabinet Q&A
Please see Page 2

From the Director

We must, indeed, all hang together or, most assuredly, we shall all hang separately.
– Benjamin Franklin

By Kathy Sibbel
DTE Program Director

Last month, the Excellence Report noted that the Department of Transportation (Mn/DOT) and the Office of Enterprise Technology (OET) announced a joint pilot project for developing and implementing the State's federated model of information technology service delivery. Now, I'll explain what this "federated model" is all about.

The federated model embodies the Drive to Excellence enterprise goal of delivering effective, efficient and economical government. Currently, many State agencies are operating in a relatively autonomous manner, getting the job done, but not necessarily in an optimal manner. Moving to a more enterprise or "whole state" approach allows agencies to increase results and eliminate redundancies.

The federated or enterprise model is depicted as a pyramid, which balances three ways of managing business *within the State:*

Agency Functions – At the top are the functions truly specific to an agency. For example, only the Department of Natural Resources

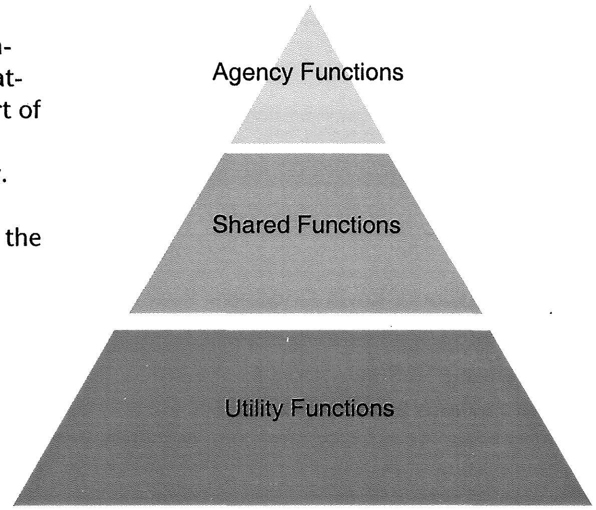
From the Director
Please see Page 2

From the Director: Toward a Federated Model

needs processes and systems for tracking the State's moose population. The agency is the subject matter expert, and this function is part of its core business. Therefore, all responsibility remains at the agency.

Utility Functions – At the base are the functions that are common to all agencies. Payroll is an example. All agencies need to provide payroll services, but should not be burdened with such operations as updating tax tables or generating W2 forms. This work can much more efficiently be provided by and managed by one entity. A comparison from daily life would be electrical power, which most people receive from a utility company (such as Xcel) rather than from operating their own generators.

Shared Functions – In the middle are common business and technology functions that are important to multiple agencies, but again are not their core business. Like a cooperative, the agencies have direct input into the service provided to them, via Service Level Agreements, but are not responsible for daily operations.
An example would be an enterprise grants management governance structure and application. Today, o 30 State agencies handle grants, e with their own processes. A shared service would provide a "Center of Excellence" resource, establish standard policies and procedures and maintain and operate a statewide system for tracking, monitoring and reporting all grants.



The enterprise model balances three ways of managing business

The ultimate goal of the federated model is to improve service to citizens by allowing agencies to focus on their critical missions, and optimize efficiencies through the use of common services. The OET governance structure further reinforces the concept: "(This model) recognizes that a thoughtful mixture of central, shared and agency responsibilities can be crafted to further the missions of government."

It is a cultural shift towards more collaboration and cooperation across all agencies and employees and is in the best interests of the citizens of Minnesota. Thank you to Mn/DOT and OET for being the forerunners in this effort.

Sub-Cabinet Q&A: Commissioneer Kevin Goodno

Continued from the front page

making it easier for people to get information about hundreds of different state licenses, is a good example. The IT standards project is a way for government to be more cost effective and without hindering an agency's ability to provide services.

What's on the horizon for the Drive to Excellence?

The basic premise of Drive to Excellence is sound and should continue to guide the projects and directions that unfold in the months ahead. I've been impressed with the energy that has been infused into this effort. The Department of Human Services will continue to remain an active partner in this work.

Project Highlights

Construction Codes: Designing business processes for the combined CCLD. Completing new functional team structure.

Licensing: Agency forums scheduled for March 20 and 23. Forums will explain the project's direction and share information among licensing agencies. Analyzing results of agency license questionnaire. Presented "License Minnesota" update to House Government Operations Committee.

Real Property: Published Request For Proposal (RFP) for prospective enterprise-wide real property management system. RFP responses due March 28.

IT Governance: Implementing new Technology Request System (TRS). Governor's Office approved Office of Enterprise Technology (OET) Governance Structure. Rolled-out OET Strategic Plan 2006. Completed and announced Project Management Core Standards of Practice Policy Directive, and Project Portfolio Management Policy Directive, and State Chief Information Officer Enterprise Policy Development Process.

Sourcing: Cell phone Request for Proposal responses closed February 21. Joint Sourcing and Information Technology Governance team evaluating RFP responses.

Forum Will Offer Overview for State Licensing Staff

The Drive to Excellence Licensing ·ering Team will hold an agency fo- n on March 20, and again on March 23, for licensing personnel from state agencies, boards, commissions and other interested state entities.

> **Agency Licensing Forum**
> **Monday, March 20, 1-4 p.m.**
> **Thursday, March 23, 8:30-11:30 a.m.**
> **Skjegstad Room**
> **Harold Stassen Building**
> **600 Robert Street, St. Paul**

The three-hour forum will provide an overview of the One-Stop Licensing project, a presentation on License Minnesota, a review of success stories and, then, breakout sessions for gathering information from the state's licensing professionals.

"The forum has a couple of purposes," says Marybeth Stoltz, Licensing Project Manager. "First, we want to let people know what is happening with the project. Second, we want them to know that we need their help."

Licensing personnel interested in attending can register online through the Drive to Excellence web site, www.excellence.state.mn.us by Tuesday, March 14. Parking is not permitted in the lot in front of the Stassen Building, but is available at the Centennial Ramp.

Parking permits for the Orange (visitors) level of the Centennial Office Building Ramp (enter from the north on Rev. Martin Luther King Jr. Drive) are available in advance at the Department of Administration Plant Management Division Office, Room G10, Administration Building, Sherburne and Cedar avenues.

Legislative Season Starts Out Strong

The House Government Operations Committee, chaired by Rep. Kathy Tingelstad, received an update on the Drive to Excellence at its February 16 meeting.

The 15 members of the committee listened intently as Program Director Kathy ˜ibbel provided an overview of the ve's successes, including a historic ..ew standards and lower prices for computer equipment, an amended Office Supply contract and the creation of the "License Minnesota" web site.

Licensing Project Manager Marybeth Stoltz of the Department of Labor and Industry continued, highlighting the new "License Minnesota" web site with its 25,000 visits since Dec. 15, the creation of a "one-stop-shop" information hub for every state-issued license, and the steering team's work toward placing all licenses online. She said there is a "huge opportunity for the state to provide a customer centric, online licensing transaction center for professional, occupational and business licensing and renewals, as well as third-party administration of professional exams."

Legislators from both sides of the aisle ,pressed eagerness at the opportunity ιο reduce costs, increase efficiency and create better services for its citizens. Some legislators expressed concern about the number of licenses required by the state. Stoltz, assured them that a Business Process Mapping Team was evaluating all licenses. She noted that the Department of Agriculture has already reduced the number of licenses it requires from 85 to 55. The bi-partisan support for the Drive to Excellence was once again in evidence, increasing the prospects for a bright session ahead.

Real Property Celebrates

The Real Property Project Team celebrated achieving a major milestone with the publication of the Request for Proposals (RFP) for an enterprise-wide real property management system. The RFP team, above, decompressed with a pizza party over lunch on Feb. 27. Pictured from left, standing, are Dick Post (Mn/DOT), Gene Peterman (Admin), Heidi Myers (Admin), Terry Palmer (Military Affairs), Craig Krook (Human Services), Chuck Irrgang (Historical Society), Mike Ryan (Office of Enterprise Technology), Lenora Madigan (Admin), Bev Kroiss (Admin), Janet Ekern (Mn/DOT), Kathy Sibbel (Drive to Excellence), Steve Gustafson (Office of Enterprise Technology), Ben Brandenburg (Admin); seated: Betsy Hayes (Admin), Nicky Giancola (Admin) and Mindy Fukushi (Drive to Excellence). Not pictured are Gene Barthel (Zoological Garden), Joe Miller (Corrections), Steve Musser (Veterans Homes Board, Jayne Rankin (Finance), Alan VanBuskirk (Human Services), Dave Olson (Natural Resources) and Mark Wallace (Natural Resources).

The Excellence Report

The Excellence Report is a monthly publication of the Drive to Excellence Program Office for individuals and organizations interested in this ongoing initiative to reform business and technical processes in the Executive Branch. More information is available online at www.excellence.state.mn.us. Comments should be addressed to excellence@state.mn.us.

This information will be made available in alternate format upon request by calling 651.201.2558.

Mission Statement

The mission of the Drive to Excellence is to enable the effective, efficient and economical delivery of state government services

Increased Quality

Increased Customer Service

Reduced Costs

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January 2006

Drive to Excellence

Goals and Implementation

The State of Minnesota's Drive to Excellence

www.excellence.state.mn.us

Goals

- Create more "one-stop shop" opportunities for easy citizen and business access to services
- Increase electronic delivery of government services
- Streamline government by creating shared services
- Optimize the size of state government by leveraging state worker retirements

With full implementation, overall savings could be as much as $570 million by 2011. Some of these savings will be reinvested.

Six Areas of Initial Reform

Information Technology Governance

The 2005 Legislature authorized the creation of a state technology agency and a cabinet-level state chief information officer, both firsts for Minnesota. As a result of the legislation, the new Office of Enterprise Technology, headed by the CIO, has expanded authority for managing the state's technology policy and infrastructure.

Purchasing

The State of Minnesota spends more than $1 billion a year on goods and services purchased from more than 25,000 vendors. During 2005, the state implemented "spend intelligence" software for analyzing purchasing and spending and developed standards for office supplies and personal computer equipment that will result in savings of up to 44 percent from previous contract prices.

Licensing

"License Minnesota," launched in mid-December, is a one-stop web gateway to 673 types of state licenses that are administered by more than 40 state agencies. The portal eliminates the need for citizens, professionals and business operators to know - or at least make an educated guess about - which state agency administers what license.

Construction Codes Consolidation

The Drive to Excellence has consolidated state construction code oversight and regulation from five agencies to one. The consolidation eliminates problems associated with fragmented jurisdictional authority, inconsistencies in rules and information and lack of coordination of state inspection efforts.

Grants Management

The state currently pursues, distributes and manages more than $1.1 billion of incoming grant money. The state also monitors the performance of approximately 7,000 organizations that receive $1.4 billion through 9,400 state grants. Unifying how these grants are processed will provide greater efficiencies and increased accountability.

Real Property Management

The state's 5,000 buildings and nearly six million acres of land are currently managed by 22 agencies. This uncoordinated approach to managing the state's property will be replaced by an enterprise governance structure that optimizes rent, repair, co-location, consolidation and maintenance.