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Collecting Delinquent Revenue from Debtors' Federal Tax Refunds

By Kevin R. Appel

What if states and local governments could collect delinquent tax obligations by deducting them from federal tax refunds? Currently, thirty-six states and the District of Columbia participate in the Federal Offset Tax Program, which permits states to collect past-due child support and state income tax obligations from debtors' federal income tax refunds. If this program were to be expanded to include all delinquent state and local government tax obligations, it could facilitate the collection of millions of dollars in delinquent revenue by states and local governments.

On July 28, 2005, Representative Mike Turner (R-OH) introduced a bill to do just that in the 109th Congress. The bill, HR 3498, was co-sponsored by Representatives Tom Davis (R-VA) and Jim Moran (D-VA). It has been referred to the House Governmental Reform Committee, chaired by Davis, and to the specific Subcommittee on Federalism and the Census, Chaired by Turner. On its way to becoming permanent law, the bill would also have to pass through the House Ways and Means Committee.

HR 3498 would amend the Internal Revenue Code to allow state govern-

ments to collect all past-due, legally enforceable tax debts from debtors' federal income tax refunds. Even more importantly, from the viewpoint of localities confronting decreasing revenue sources, the bill would also enable local governments to collect legally enforceable tax debts owed to the locality from federal tax refunds.

Under the program proposed in Congressman Turner's bill, states will serve as the clearinghouse for their respective local governments (e.g., through the state taxing authority). The Federal Offset Tax Program is currently administered so that all data and funds are sent electronically between the states and the federal government, minimizing the administrative burden. The 37 jurisdictions already participating in the Federal Offset Tax Program have computer programs in place that can also be used to process claims of local governments.

To participate in the program, a local government would have to certify to the state that the delinquent tax debts claimed are in fact past due and are legally enforceable and that a good faith effort has been made to notify the tax debtor and provide an opportunity to resolve the delinquency. On behalf of the local government, the state government would then notify the Internal Revenue Service (IRS) of the tax debt. The IRS would reduce the tax debtor's federal tax refund up to the amount of the debt and pro-

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Tools for Encouraging Prompt Payment

- Pre-printed return envelopes
- Penalties, late fees, and interest charges
- Discounts for prompt payment
- Prepayments of taxes
- Deposits
- Making payment options as convenient as possible for the customer (e.g., accepting payments by credit card, automatic ACH debts, 24 hour drop box, internet, phone, etc.)
- Installment payment plans

Source: *Collecting Delinquent Revenues* (GFOA publication) 1995.

Treasury Management Sessions at GFOA's Annual Conference

The upcoming GFOA conference in Montréal, Canada, on May 7-10, 2006, will offer attendees sessions on innovative practices in cash management and investing. Conference registrants can attend the following sessions.

On Guard: Protecting Against Check and Electronic Payment Fraud. Does your government have adequate security measures in place to avoid becoming a victim of payment fraud? This session will highlight tools and techniques to help your government prevent payment fraud associated with paper checks and electronic payments, incorporating the guidelines from the new GFOA recommended practice, "Electronic Commerce and Cash Management." This session will cover fraud-prevention tools such as account reconciliation, ACH blocks and filters, positive pay, and paper check security features.

Pay Up! Tools and Techniques for Collecting Delinquent Revenues. Looking for ways to increase your revenue collection rate? In this session, leading practitioners will share proven technologies and techniques for collecting delinquent revenues. Speakers will highlight tools such as high-tech scanners for finding delinquent taxpayers and parking ticket amnesties, and suggest tips and traps based on their experience.

Peaks and Valleys: Optimizing Funds with Cash Flow Forecasting. Effective cash flow forecasting is a critical component of a public investment program, as it provides an estimate of how much money is available for investing for given period. Cash flow forecasting can also help your government meet its liquidity needs without short-term borrowing or prematurely cashing in long-term investments. This session will introduce key concepts and techniques of cash flow forecasting and highlight useful software tools. Speakers will incorporate the guidance in the new

Performance Benchmarks				
Public Investor Performance Indexes				
The Public Investor 10-bill index				
	Index Value	Quarterly/Monthly Return Annualized	Annualized Returns Since	
			Jan. 1, 2005	Jan. 1, 2004
Jan. 1, 2005	280.0364	1.93%(Q)r	1.23%r	1.16%r
Jan. 1, 2006	288.3628	3.99%(M)r	2.97%r	2.10%r
Feb. 1, 2006	289.2715	3.85%(M)r	3.04%r	2.17%r
Mar. 1, 2006	290.1812r	3.84%(M)r	3.10%r	2.23%r
April 1, 2006	291.2818	4.65%(M)	3.20%	2.32%
		4.11%(Q)		
The <i>Public Investor</i> 10-bill index consists of 10 hypothetical Treasury bill investments, with an average maturity of approximately 80 days. Every other Thursday, a T-bill matures and proceeds are reinvested alternately in three-month and six-month T-bills. This rolling index provides a benchmark for evaluating cash management portfolios with biweekly payment and payroll requirements. The original value of the index was 97.6765 on July 1, 1984.				
The money market fund index				
	Average Return	Annualized Return	Returns Since	
		Jan. 1, 2005	Jan. 1, 2004	
Jan. 1, 2005	1.46%r	0.76%	0.82%	
Jan. 1, 2006	3.51%r	2.47%	1.29%	
Feb. 1, 2006	3.74%r	2.56%	1.36%	
Mar. 1, 2006	3.87%r	2.64%	1.43%	
April 1, 2006	4.04%	2.73%	1.50%	
The money market fund index is the simple average of <i>Money Fund Report Averages</i> TM seven-day money market fund indexes, as reported for the two weeks closest to the end of each month. The annualized return is calculated using these rates for a four-week period centering on the first of each month. The results should simulate returns from passive investment in an average money market fund.				
S&P Rated LGIP Index (March 24, 2006)				
	7-day yield	30-day yield	Maturity (Days)	
	4.38%	4.35%	27	
This index is comprised of local government investment pools that are rated AAAM or AAM by Standard & Poor's and represent pools that strive to maintain a stable net asset fund.				
Key Rates: Cash Markets				
Rate	3/31/06	Year Ago		
Fed funds	4.88	2.76		
CDs: Three months	4.93	3.05		
CDs: Six months	5.07	3.34		
BAs: One month	4.79	2.83		
T-bills: 91-day yield	4.50	2.80		
T-bill: 52 week yield	4.84	3.41		
Commercial paper, dealer-placed, 3 months	4.91	3.00		
Bond Buyer 20-bond municipal index	4.53	4.61		
Tax-exempt notes	3.52	2.55		

GFOA recommended practice "Use of Cash Flow Forecasts in Operations."

Comparison Shopping: Advice on How to Procure Banking Services. Governments rely on many different service providers to carry out their financial operations, but none is more important than their depository bank. It follows, then, that selecting a bank warrants careful planning and consideration. This session will walk

through the process of procuring banking services, including developing an RFP, evaluating responses to the RFP, conducting credit analysis on banks, and transitioning to a new bank. Speakers will also show how to evaluate the relative benefits and costs of paying for services through direct fees, compensating balances, or a combination of the two.

There is still time to register for this year's annual conference at www.gfoa.org/conference/2006. ☘

Panel of Economists

Risks to Current Economic Expansion

This month *Public Investor* asked its panel of economists what they see as the biggest risks to the current economic expansion. We also asked the panel how long they expect the current expansion to last.

Lacy Hunt of Hoisington Investment Management considers the greatest risk to the current economic expansion is a decision by the Fed to tighten monetary policy too much and for too long a duration. Hunt adds that a great deal of monetary restraint is already in place. For example, short-term interest rates have risen sharply, total reserves of depository institutions have contracted by a near record pace in the past twelve months, the M2 money stock has decelerated to the slowest pace in ten years, and the yield curve has flattened significantly.

Carl Tannenbaum of LaSalle Bank ABN/Amro puts moderating housing prices, high oil prices, and the potential for geopolitical trouble at the top of his list of risks to the current expansion. If these risks are handled well, he expects the expansion to last another several years.

John Silvia of Wachovia Securities considers the U.S. dollar to be the greatest risk to the current expansion. He expects the expansion to peak in the second half of 2007.

Gary Thayer of AG Edwards & Sons states that the biggest risk to the current economic expansion would probably be from the Fed raising rates too far causing a sharp decline in the housing market. If the Fed does not raise rates too far, the current slowdown may only be a pause in the expansion, and the economy could continue to grow several more years. ☘

Databank

	Current Period	Previous Period	Year Ago
Economic Growth			
Real GDP growth	IV Q '05	III Q '05	Year Ago
Annual rate, constant dollars	1.6%	4.1%	3.3%
Retail sales	Feb	Jan	Year Ago
\$ billions	362.29	367.18	339.52
Industrial production index	Feb	Jan	12 mo. chg.
Change, monthly and annually	0.7%	-0.3%	3.3%
Leading indicators index	Feb	Jan	6 mo. chg.
Change, monthly and annually	-0.8%	1.2%	1.0%
New housing starts	Feb	Jan	Year Ago
Thousands of units, annualized	2,120	2,303	2,228
Purchasing Management Index	Feb	Jan	Year Ago
Nat'l Assoc. of Purchasing Management	56.7	54.8	55.6
Inflation			
Consumer price index	Feb	Jan	12 mo. chg.
Change, monthly and annually	0.1%	0.7%	3.6%
Producer price index	Feb	Jan	12 mo. chg.
Change, monthly and annually, seasonally adjusted	-1.4%	0.3%	3.7%
GDP price deflator	IV Q '05	III Q '05	Year Ago
Annual rate	3.3%	3.3%	2.7%
Unemployment rate	Feb	Jan	Year Ago
BLS	4.8%	4.7%	5.4%
Other			
Money market fund maturities	Mar 21	Feb 21	Mar '05
Average portfolio maturity (<i>Money Fund Report Averages™</i>)	37 days	40 days	37 days

Interest Rate Outlook

The *Public Investor's* panel of eminent institutional economists projects interest rates for the first day of each forecast month. Averages are the midpoints between the arithmetic mean and the median of individual projections. The low and high individual forecasts illustrate the range.

Rate	May-06 Average (Low-High)	July-06 Average (Low-High)	October-06 Average (Low-High)
Fed Funds	4.8 4 ³ / ₄ -4 ³ / ₄	5.0 4 ³ / ₄ -5	5.0 4 ³ / ₄ -5
30-day prime bank (CD)	4.8 4 ³ / ₄ -4 ⁷ / ₈	4.9 4 ³ / ₄ -4 ⁷ / ₈	4.9 4 ⁷ / ₈ -5
3-month T-bill yield	4.7 4 ⁵ / ₈ -4 ³ / ₄	4.8 4 ³ / ₄ -5	4.8 4 ³ / ₄ -5 ¹ / ₈
5-year Treasury note	4.7 4 ⁵ / ₈ -4 ³ / ₄	4.7 4 ⁵ / ₈ -4 ⁷ / ₈	4.8 4 ³ / ₄ -5
30-year Treasury bond	4.8 4 ⁵ / ₈ -4 ⁷ / ₈	4.9 4 ⁵ / ₈ -5	5.1 4 ³ / ₄ -5 ¹ / ₄
Consensus Index*	100%	100%	100%

* Consensus index is the percentage of responses within 75 basis points (0.75 percent) of the average interest rate. Index measures the extent of panelists' agreement. If all forecasts are within ³/₄ percent of the various averages for a given month, the consensus would be 100. If all responses fall at the extreme ends of a wide range, the index is 0.

Interest rate forecast panelists

John Silvia	Wachovia Securities
Carl R. Tannenbaum	LaSalle Bank ABN/Amro
Gary Thayer	AG Edwards & Sons, Inc.

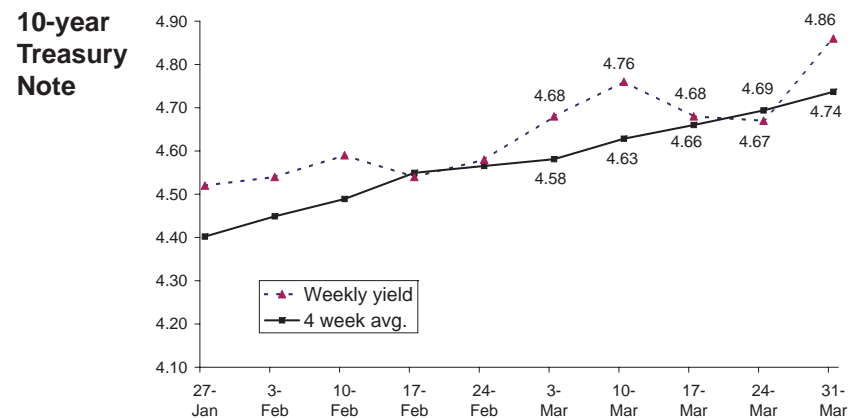
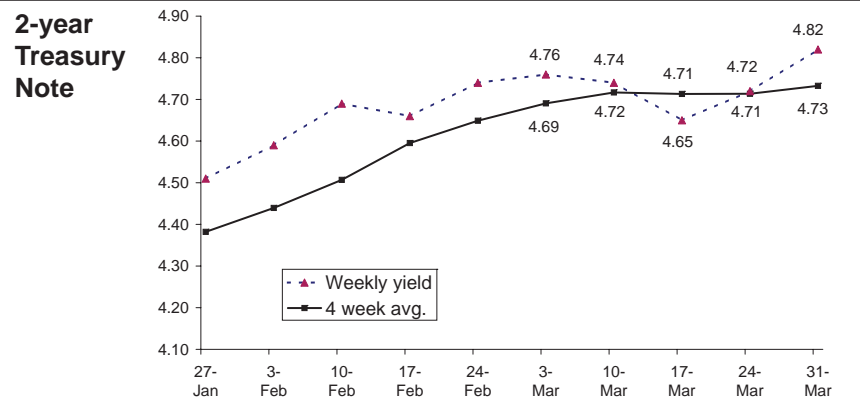
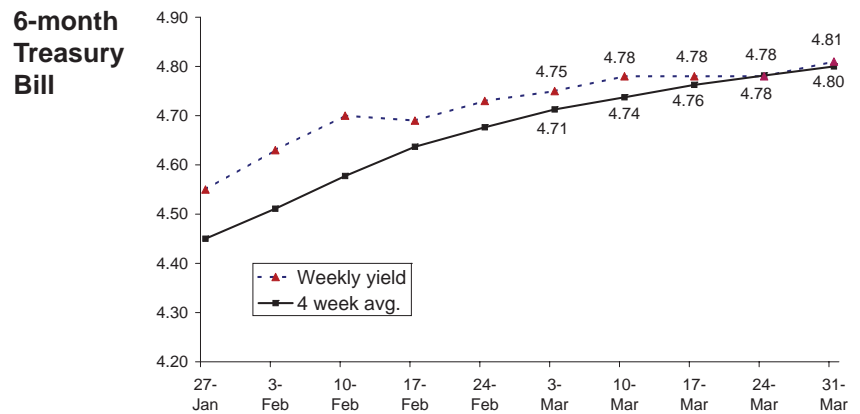
Fair Debt Collection Practices Act

While governments are not covered by the Fair Debt Collection Practices Act, they should operate within the guidelines set forth by the act. The act places restrictions on collection practices and strives to protect the debtor's privacy. Guidelines governments generally follow are presented below:

- Limit communication with debtors. Collectors must limit the number of daily telephone calls to debtors and must call the debtor between 8 a.m. and 9 p.m. based on the debtor's time zone. Additionally, collectors cannot contact debtors at a place known to be inconvenient for the debtor. For example, the collector should not contact the debtor at his place of employment if the debtor's employer prohibits the debtor from receiving such communication.
- Limit communications with persons other than the debtor. Collectors may not communicate with others in connection with the debtor except for spouses, parents or legal guardians if the debtor is a minor, attorneys, and administrators of the debtor's estate.
- Avoid harassment and abuse. Collectors must be courteous at all times and avoid the use of threats to the debtor's person, property, or reputation.
- Avoid false or misleading representations. Collectors must not falsely imply that the debtor has committed a crime. In addition, collectors must not threaten the debtor with actions that they have no intention of carrying out.
- Provide written validation of the debt. Collectors must be able to prove that a debt is owed.

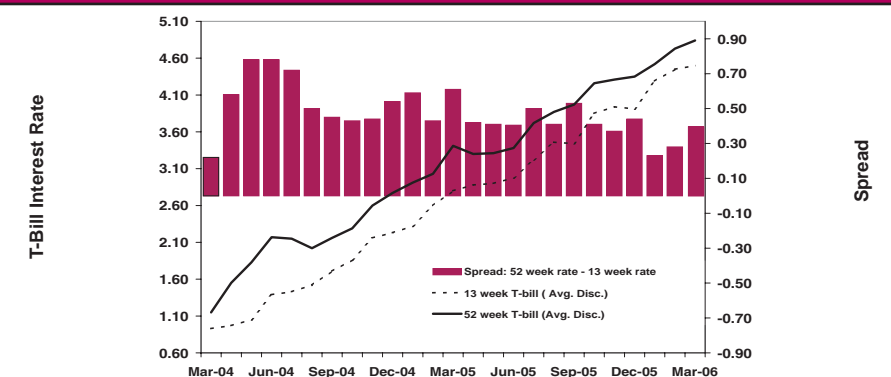
Source: *Collecting Delinquent Revenues* (GFOA publication) 1995.

Moving Averages



Public Investor's four-week moving averages are calculated as a simple average of Friday closing yield quotations for the most recently offered six-month Treasury bill (discount basis), two-year Treasury note, and 10-year Treasury note. Moving averages are used by analysts to monitor trends and trend changes. Generally, interest rates are increasing (prices falling) when the moving average yield is rising and the current rate exceeds the moving average. Conversely, current yields below a declining moving average are associated with lower interest rates (high prices on fixed-income securities). Some market timers buy (or sell) longer maturities when current market yields fall below (or penetrate above) their moving averages.

Relative Yield Value Chart



Collecting — *continued from page 1*

vide it to the state; the state would then forward funds to the local government. Both the IRS and the state government would be able to collect fees to offset the cost of their services. In the event that there are insufficient tax return funds to pay all debts, the IRS, federal agencies and state governments will be paid before the local governments.

In processing claims, the IRS will ensure that the tax refund offset would not exceed the tax debt of any individual. When a refund is offset, the IRS will provide to the state the tax debtor's name, taxpayer identification number, address, and the amount deducted. The IRS also will notify each person whose tax refund was offset and explain why it was offset.

The bill's concept has been publicly supported by the Association of Public Treasurers of the United States and Canada, the Government Finance Officers Association, the Federation of Tax Administrators, the National Association of Counties, the National Association of County Treasurers and Financial Officers, and the Conference of State Court Administrators.

How The Expanded Federal Offset Tax Program Would Work

1. Local government certifies to its state that the delinquent tax debts claimed are in fact past due and are legally enforceable and that a good faith effort has been made to notify the tax debtor to give them an opportunity to resolve the delinquency.
2. State government notifies the Internal Revenue Service (IRS) of the tax debt.
3. IRS reduces the tax debtor's federal tax refund up to the amount of the debt and sends it to the state (less a fee for IRS services).
4. State sends funds to the local government (less a fee for the state's services).

Recommended Practices for Accounts Receivable Collection

- ❑ All accounts receivable should be recorded in a manner to permit an analysis of the aging of such receivables (e.g., <30 days, 30-60 days, etc.).

For Accounts that Become Past Due:

- ❑ The initiating department should have specified practices that ensure proper delinquent notice is provided to customer and continued service is restricted (unless continuation of service is required by law or resolution) until such accounts are current.
- ❑ Such practices should specify the threshold and materiality of a delinquency for which further collection efforts would be pursued (e.g., >180 days and over \$25).
- ❑ To facilitate such collection efforts, departments shall establish information criteria as part of the initial credit application process with the customer (e.g., bank account #, social security # or driver's license #, Federal ID #, etc.).
- ❑ Utilization of collection agencies should be performed utilizing all federal and state notice requirements and in a manner in which the entity receives all of its receivable owed.

Bad Debt Expense:

- ❑ The determination of the need for an allowance for doubtful accounts should be based upon an established method (e.g., the percentage of receivable method).
- ❑ The computation of an allowance for doubtful accounts should be performed at least annually based upon the aging of such receivables and recent history of write-offs at fiscal year-end, with any material changes reported to appropriate officials.
- ❑ For write-offs of delinquent balances, subject to state laws, thresholds should be established to permit the timely write-off of immaterial balances (e.g., balances <\$25 and >180 days delinquent) upon appropriate authorization.
- ❑ For balances greater than established threshold (e.g., >\$25), collection efforts should be performed for a period equivalent to the statute of limitations or sooner if bankruptcy has been discharged for account, business no longer exists or individual is deceased, at which point such amounts will be written-off upon appropriate authorization.
- ❑ For any account written-off, such customer information should be retained for as long as practically feasible in automated system capacity in order to have continued enforcement of service denied on credit until previously written-off balances have been paid. Many states have restrictions for certain types of revenues that cannot be written-off (e.g., property taxes), therefore policy should appropriately differentiate between various allowable practices for different revenues.

Adapted from "Revenue Policy: Accounts Receivable Controls," GFOA Recommended Practice (2003).

Collecting — continued from page 1

Proponents of HR 3498 urge interested states and local governments to let their representatives in Congress and the members of the relevant congressional committees know of the potential benefits of the bill.

Information on contacting members of Congress can be found on GFOA's Web site at <http://www.gfoa.org/flc>. The full text of the bill may be found at: <http://thomas.loc.gov> (enter "HR 3498" into the search box). ☞

Kevin R. Appel is the chief deputy treasurer and legal counsel to the Treasurer of Arlington County, Virginia. Reprinted with permission from "IRS Offset of Taxed Owed to State & Local Governments," State & Local Law News, Volume 29, No.3, Spring 2006. © 2006 by the American Bar Association.

Resources on Collecting Delinquent Revenue

- *Collecting Delinquent Revenues* (GFOA publication) 1995.
- Compendium of Local Government Collection Powers and Practices in the United States and Canada (Arlington County Treasurer's Office).
- Fair Debt Collection Practices Act. (<http://www.ftc.gov/os/statutes/fdcpa/fdcact.htm>)
- "Revenue Policy: Accounts Receivable Controls," GFOA Recommended Practice (2003). (http://www.gfoa.org/services/rp/cash/cash-accounts_receivable_policy.pdf)

Ask Public Investor

Is there a topic that you would like to know more about? Send us a quick email with a topic or question that you would like to see covered in *Public Investor*. *Public Investor* focuses on public cash management (i.e., collection, disbursement, and investment of public funds). Send topics to gmichel@gfoa.org.

Delinquent Revenue Collection Toolbox

- ❑ *Notices*—Written communication by the tax collector to inform the debtor that payment is overdue.
- ❑ *Telephone calls*—Personal contact via phone with the debtor.
- ❑ *Payment plans/promissory notes*—A payment plan that allows debtors to pay back their debt overtime.
- ❑ *Disconnection of services*—Disconnection of public utilities or other services provided to the debtor.
- ❑ *Lien on debtor's property*—In many jurisdictions the assessed tax constitutes or can constitute a lien on some or all of the delinquent debtor's property.
- ❑ *Distress*—The seizure of personal property to enforce the payment of taxes and its subsequent sale to the public if the taxes are not paid.
- ❑ *Levy/garnishment of cash/intangibles*—The seizure of cash or other intangibles from a person indebted to the tax debtor.
- ❑ *Legal process*—The use of the court system to enforce taxes as a personal obligation of the delinquent.
- ❑ *Sale of real estate tax liens (tax certificate/lien auction)*—The sale of the locality's lien on real estate so a tax debt is satisfied and the right to the debt is essentially transferred to a third party who may take steps eventually to foreclose that right.
- ❑ *Judicial sale of real property*—Actual sale of real property by public auction or otherwise for unpaid taxes owed on the property.
- ❑ *Collection agencies/outside attorneys*—The use of collection agencies and outside attorneys to assist in the collection of delinquent taxes; also other parties who may be called upon or used to collect delinquent accounts.
- ❑ *Summons*—The tax collector's authority to summon a taxpayer to appear before him and to ask questions under oath about the tax liability.
- ❑ *Withholding of permits/licenses*—The authority of the tax collector to withhold certain state or local licenses or permits due to unpaid taxes.
- ❑ *Padlocking*—The authority of the tax collector to forcibly close down a business due to unpaid taxes.
- ❑ *Withholding of motor vehicle registrations*—The authority of the tax collector to withhold vehicle registrations due to unpaid taxes.
- ❑ *Publishing names*—The tax collector's ability or obligation under law to make public a list of delinquent taxes as part of another collection action or as an independent means of collection.
- ❑ *Bonding*—Requirement of posting a bond either at the registration stage for certain taxes (such as trust taxes: food tax, sales tax, hotel tax etc.) or to fore-stall or avoid specific collection action.
- ❑ *Offset of amounts due*—Withholding of payments due from the locality for taxes owing to the locality and applying the withheld funds toward the tax debt.
- ❑ *Setoff of state tax refunds*—Withholding of state or provincial tax refunds or other payments from the state or province to the delinquent taxpayer because of debts owed to a locality.
- ❑ *Assessment of responsible officer*—The direct taxation of an officer or employee of a business for taxes the business was required to collect for the locality.
- ❑ *Write off of uncollected accounts*—The tax collector's authority to determine a tax is uncollectible and present the tax as such and remove it from his books.

Sources: Compendium of Local Government Collection Powers and Practices in the United States and Canada (Arlington County Treasurer's Office); *Collecting Delinquent Revenues* (GFOA publication) 1995.

Note: Many governments do not have the legal authority to use some of these delinquent revenue collection tools.