JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS
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Report

TO: Members of the Judicial Council

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DATE: April 25, 2008

SUBJECT: Franchise Tax Board Court-Ordered Debt Program's Request for Concurrence to Use Available Funds (Action Requested)

Issue Statement

On August 31, 2007, the Judicial Council approved the Franchise Tax Board's (FTB's) utilization of $1.5 million from the Franchise Tax Board Court-Ordered Debt Court Collection Account (CCA) reserves for fiscal year 2007–2008 to continue the Court-Ordered Debt Expansion (CODE) Project. The CCA is a continuous appropriation fund and can be used only to enhance the FTB Court-Ordered Debt Program (FTB-COD Program) for the benefit of the superior courts and counties.

To prevent the immediate cancellation of the CODE Project, which would result in the noncompliance of mandatory provisions of Senate Bill 246 (Stats. 2004, ch. 380), the FTB requests that the Judicial Council concur in its request to the State Department of Finance to use the additional available funds in the CCA (approximately $4.3 million) to support the CODE Project as follows:

- FY 2007–2008: Based on actual revenues through January 2008, FTB is requesting an additional $1 million to complete phase I of the CODE Project, in addition to the $1.5 million approved by the Judicial Council in August 2007.

- FY 2008–2009 and FY 2009–2010: Based on revised revenue projections, FTB is requesting $3.3 million to complete phase II and phase III of the project, which encompass the development and implementation of technological enhancements to accept collection referrals from the 58 courts and counties and the critical external reporting and Web-based self-service features of the CODE Project.

Background

The FTB-COD Program began as a small pilot program in 1995. In August 2004, SB 246 made the FTB-COD Program permanent and required the FTB to expand its capacity to accept cases from all 58 courts and counties. The FTB-COD Program currently works with collection programs in 37 California superior courts and counties to pursue collection of some of the most delinquent and aged accounts. Currently, the FTB-COD Program is authorized to charge up to 15 percent of the revenue collected to offset the administrative costs of the program. While the remaining 85 percent is sent directly to courts and counties for deposit into local and state funds, the 15 percent charged by the FTB-COD Program is retained in the CCA. In the event the cost to operate the FTB-COD Program is less than 15 percent, the difference between the actual cost and 15 percent of revenue remains in the CCA and can be used only to support the program for the benefit of the courts and counties. No state General Funds are used to pay for FTB-COD Program expenses.

SB 246 amended Revenue and Taxation Code section 19280 to require the FTB-COD Program to accept collection referrals from the 58 superior courts and counties. The bill also required the Judicial Council and the FTB-COD Program to jointly seek whatever additional resources were needed to accommodate referrals from the courts and counties.

In January 2006, the FTB began the CODE Project, a four-fiscal-year technology project to design, develop, and implement an improved system for the primary purpose of supporting the FTB-COD Program and to expand its capacity to collect delinquent court-ordered debt for all 58 courts and counties.

The CODE Project is scheduled to be released in three phases. Phase I will meet the mandatory legislative requirements of SB 246, allowing the FTB to accommodate all 58 counties. Phase II and phase III are scheduled to be developed as parallel but separate efforts. Phase II adds required collection functionality, and phase III provides external reporting capabilities and debtor self-service Web features.

The FTB-COD Program's revenue projection for FY 2007–2008, as outlined in its Feasibility Study Report (FSR) 05-01, was overestimated—largely because the baseline year used by the FTB, FY 2004–2005, now appears anomalous compared to collections in other years.

In FY 2005–2006, the FTB-COD Program's revenue declined by $9 million dollars. Revenue will not achieve the projected levels originally estimated.

For FY 2007–2008, the FTB anticipated spending $12.6 million for the FTB-COD Program and the CODE Project. In order to meet this goal, the FTB would need to collect $84 million dollars ($12.6 million is 15 percent of $84 million). However, actual revenue through January 2008 indicates that the FTB-COD Program will collect $69.5 million dollars in FY 2007–2008, $14.5 million less than originally projected.

<u>Recommendation</u>
Staff of the Administrative Office of the Courts (AOC) recommends that the Judicial Council:

1. Support the Franchise Tax Board Court-Ordered Debt Program's request to the Department of Finance to use the additional available funds in the Court Collection Account (approximately $4.3 million) in order to support the technology project known as Court-Ordered Debt Collections Expansion (CODE) in FY 2007–2008, FY 2008–2009, and FY 2009–2010. The breakdown by fiscal year is:

    - FY 2007–2008: The FTB is requesting an additional $1 million to continue phase I of the CODE Project, in addition to the $1.5 million approved by the Judicial Council in August 2007.

    - FY 2008–2009 and FY 2009–2010: The FTB is requesting $3.3 million to complete phase II and phase III, the development and implementation of technological enhancements to accept collection referrals from the 58 courts and counties and the critical external reporting and Web-based self-service features of the CODE Project.

2. Direct AOC staff to formally inform both the Franchise Tax Board and the Department of Finance of the council's decision regarding this matter.

<u>Rationale for Recommendation</u>
Revenue and Taxation Code section 19280(b) specifies that the Judicial Council and the Franchise Tax Board shall seek whatever additional resources are needed to accept referrals from all 58 courts or counties. The Judicial Council's support of the FTB-COD Program's request to the Department of Finance for these appropriations from the CCA will further the FTB-COD's ongoing efforts to collect delinquent court-ordered debt statewide. Since its inception in 1995 through January 2008, the FTB-COD program has collected more than $372

million in fines, fees, assessments, and restitution fund fines on behalf of courts and counties.

Both the FTB and the Judicial Council agree that the CODE Project represents the current agreed-upon solution to the mandatory requirements of SB 246. The CODE Project is being managed within budget and is on schedule for timely implementation. However, the FTB's current revenue shortfall is the result of overestimated revenue projections based on FY 2004–2005, which was an anomalous year compared to collections in other years. Therefore, the 15 percent administrative fee cap based on the actual anticipated revenue of $69.5 million for FY 2007–2008 ($14.5 million less than originally projected) does not allow for adequate cash funding to complete the project. The FTB submitted a letter to the Department of Finance (DOF) requesting a General Fund loan to cover any additional deficit from 2008–2010. The DOF denied this request.

If the FTB is not able to use the additional $1 million of the CCA in FY 2007–2008, it will result in the immediate cancellation of the CODE Project. Canceling the CODE Project would result in the FTB being out of compliance with the legislative mandates of SB 246 to accommodate all 58 courts and counties. Courts and counties that are not yet participating in the FTB-COD Program would not be able to participate. Nearly three years of work and more than $4 million spent for the new CODE system development would be lost. Courts and counties would lose the money and time spent modifying their current systems to interface with the CODE system. Because phase III provides for debtor self-service, if not implemented, this self-service workload would be shifted back to the courts, the counties, and the FTB, increasing in-house workloads and resulting in increased program costs to the courts, the counties, and the FTB.

The current balance in the CCA is approximately $4.3 million. The FTB requests that the balance in the CCA be used to complete the development and implementation of technological enhancements to accept referrals from the 58 courts and counties and the critical external reporting and Web-based self-service features of the CODE Project.

With the Judicial Council's support of this request, the planned expansion via the CODE Project will remain on schedule. Canceling the CODE Project would result in a loss of revenue and increased program costs to the courts, the counties, and the FTB and would require the approval of the DOF.

The requested utilization of the $4.3 million balance from the CCA is based on the expected revenue shortfall for FY 2007–2008. Should an unexpected rise in collections provide the necessary revenue stream to support both the program and project costs, the amount FTB would utilize from the CCA would be reduced accordingly.

Alternative Actions Considered

Terminate CODE Project after phase I, December 2008

An alternative is to conclude the CODE Project after phase I in December 2008. This alternative requires CCA funding through December 2008 and Department of Finance approval. It meets the mandatory requirements of SB 246 but negatively affects the courts and counties since failure to complete the development and implementation of technology to accept collection referrals from all 58 courts and counties will result in a loss of revenue, reduced collection efficiencies, and increased collection costs. In addition, failure to implement the critical and external reporting and Web-based self-service features of the CODE Project would not allow debtors the ability to view account information, make payments, or set up installment agreements via the Internet, resulting in deflected and increased workloads and costs to the courts, the counties, and the FTB. Because of current system limitations identified in the CODE Project FSR, existing clients would face case referral limits, resulting in a loss of revenue. This alternative is unacceptable because it does not meet the requirements of SB 246 nor does it provide for the critical remaining system functionality.

Delay project until revenue streams improve

A second alternative is the immediate termination of the project and its restart when revenue growth is able to provide funding for both program and project costs. This option would require approval from the Department of Finance. This alternative does not meet the requirements of SB 246. New client participation would not be available and current client services would be limited because of current system billing capacity issues. For example, existing clients would face case referral limits, resulting in a loss of revenue. The counties and courts would be adversely affected since the money and time spent modifying their current systems to interface with the CODE system would be lost. This alternative would place the FTB out of compliance until a new system is implemented and would increase the overall costs of the project because of restart activities. This alternative is unacceptable because it does not meet the mandatory requirements of SB 246.

Comments From Interested Parties

None.

Implementation Requirements and Costs

None.