MANAGEMENT OBJECTIVE(S)

To collect all revenues due in a timely and efficient manner.

BACKGROUND

There are two levels of revenue management in the State. The Legislature must design the overall revenue structure for the State. The Legislature's objectives are to identify all available revenue sources and design a structure that distributes the revenue burden in an equitable and fair manner. Once those decisions are made, state entities must design procedures to implement the Legislature's revenue structure. State entities may also be responsible for collecting taxes or fees resulting from federal government mandates. Revenue management at the state entity level is the focus of this module.

Revenue management is one of the most important functions of governments, but is one of the least written about subjects in the field of public financial management (Allan, p. 1). Revenue management is the process of being accountable for the revenues that each entity is responsible for collecting.
The primary revenue sources of the State (in descending order) are:

- Taxes (sales, motor fuel & vehicles, natural gas & oil production, franchise, etc.)
- Federal financial assistance
- Licenses, fees, & permits
- Interest and investment income
- Lottery proceeds
- Other (land income, sales of goods & services, etc.)

Taxes historically make up about half of state revenues. The vast majority of taxes are collected by the Comptroller of Public Accounts with just a few other agencies collecting the remainder.

The type of revenue affects the processes and controls needed to manage it. For example, license fees require inventory controls over the actual license documents in order to ensure that fees are collected for all licenses issued. On the other hand, taxes and federal revenues do not require any inventory controls.

The amount of revenue is also important in determining the process to manage collections. The Comptroller collected over $17 billion in taxes in fiscal year 1994 and needs a very sophisticated management process to control the timely and efficient collection of these taxes. However, if an entity's only revenue is a few hundred dollars from sales of copies, the process should be simple and easy to administer. It is important that the process does not cost more than the revenues managed.

There could also be large amounts of cash receipts that do not represent revenue to the entity, such as taxes collected for and distributed to local governments. The principles of revenue management should also apply to these receipts.

Useful Materials

The Comptroller's Annual Cash Report breaks out taxes by the following types:

- Sales
- Oil production
- Natural gas production
- Motor fuels
- Motor vehicle sales/rentals & manufactured housing sales
- Franchise
- Cigarette and tobacco
- Alcoholic beverages
- Insurance occupation
- Utility
- Inheritance
- Hotel and motel

The Annual Cash Report also gives several breakdowns of revenues as well as other cash transactions. The breakdown used in this module is the top revenue types according to the Annual Cash Report. The additional types of revenue listed in the Annual Cash Report, but included in "other" in this module, are:

- Interest and investment income
- Contributions to employee benefits
- Sales of goods and services
- Land income
- Settlements of claims

The Annual Cash Report also provides detail by agency, fund, and Transaction (T) codes. The three thousand (3000 through 3999) "T" codes indicate revenue accounts.

The SAO in-house Comprehensive Analysis for Efficiency program (CAFE) can also provide detail information on revenues, as well as a number of other topics. CAFE provides access to information from several different data bases. Revenue information can be obtained from the Uniform Statewide Accounting System (USAS) or the Comprehensive Annual Financial Report (CAFR). Information for several fiscal years is available by agency, fund, "T" code or financial reporting account number.

DEFINITIONS
(in alphabetical order)

Disputed taxes are assessed taxes that the taxpayer disagrees with.

Electronic funds transfers (EFT) is a way of moving money between bank accounts instantaneously through electronic instructions and messages.

Federal financial assistance/revenue represents the monies paid to the State by the federal government to finance programs.

Good faith effort indicates that the taxpayer tried to comply with the tax law but did not pay the full tax owed for some reason.

Lockboxes are mailboxes designated for the collection of cash, used to speed deposits to a central bank account.

Lock bags are bags that can be locked; used for transporting cash.

A **Phone bank** is a telephone line that goes to a group of telephones, so that a caller can get through to an employee more quickly.

Voluntary compliance refers to taxpayers complying with tax laws on their own without any intervention by the taxing authority.

Waiver rates indicate the percentage of penalties for late taxes that is dropped or forgiven.

OVERVIEW OF THE PROCESS

The basic phases of the revenue management process are:

- **Develop a plan to collect revenues in compliance with legal authority or obligation to collect revenue.**
- **Identify and develop methods to obtain the information needs of the revenue management process (see Information Management module).**
- **Provide information to enable payers to know when, where, how, and how much to pay.**
- **Process dollars as quickly as is practical while providing adequate controls to safeguard receipts (see the Cash Management module).**
- **Ensure that all amounts due are collected (this means that collected dollars represent the correct amount due and that unpaid amounts are collected).**
- **Record and report revenue transactions.**
- **Monitor and evaluate the revenue management process (see Performance Measurement module).**

The complexity of the revenue collection function is evident from the number of processes involved in the collection of revenues (Allan, p. 2). The number of related or overlapping modules in this manual also indicates the complexity or scope of the process.

PROCEDURES

Suggested procedures, organized according to the elements of a finding, are listed below. They should be expanded or tailored to fit the specific entity being reviewed.

Note: The following procedures and the process described above are normative, rather than prescriptive. That is, they represent "average" or baseline thinking since they assemble information which repeatedly appeared in the various resources used to prepare this module. Do not be too hasty or literal in applying a given criterion or procedural step to a specific entity. While omissions or variations may be *obvious*, judgment must still be used to determine whether such omissions or variations are *significant*.

Review criteria:
General criteria

General criteria applicable to the revenue management process are as follows:

The primary objective of any revenue management process is to collect what is owed. As with any process, accomplishing this in an effective and efficient manner is important so that resources are not wasted. Other benefits of an efficient revenue management process include (Allan, pp. 1,2):

- improved cash management (including an improved cash flow, more accurate cash forecasting ability, and greater interest earnings)
- greater budgetary control and ability to complete projects timely
- improved creditworthiness and reduction in borrowing cost

As noted earlier, the type of revenue will have an impact on the nature of the procedures used to effectively and efficiently collect the amount due. However, all revenue management plans should:

- be formal, written, and supported by top management
- include the nature and location of the revenue process in the organization structure
- treat all payers consistently

Formal, written plans help ensure everyone understands and agrees with the procedures. Training of staff is also enhanced where procedures are clearly documented. Therefore, formal plans lower the risk that the procedures will not accomplish the goal or will not be performed as intended. However, management actions speak louder than words and written procedures too. If executive management demonstrates that procedures are not important, the procedures will not be important to the staff either.

The location of the revenue management function in the organization can demonstrate how important the function is to management. The importance of the function should probably vary with the size and complexity of the revenues collected. The type of revenue can determine the nature of the collection function. For instance, since driver's license fees often require the payer's physical presence, it makes sense for collection points to be decentralized. In other cases, a centralized collection function may be more beneficial. (See the Organizational Structure module for more information.)

The process should strive for consistent treatment of payers. The State has lost court cases where taxpayers showed that tax laws were applied differently to different industries. Consistency is probably hardest to maintain for tax revenue due to the number and significance of administrative decisions in applying the laws. Entities administering tax laws often need data bases of prior decisions to help ensure consistency. However, even those collecting licenses and fees should consider this issue. Usually the fee is the same for all applicants but could be based on other variables, such as the size of the business applying.

Additional insight and information on revenue management can be found in the *Audit Materials Package - Statewide Audit.* The Internal Control Structure Questionnaire - A/R - Cash Receipts has questions that indicate policies or controls that could be appropriate for revenue management systems.

Accounts receivable are an integral part of revenue management. The Receivable module may need to be considered along with this module.

Specific criteria

The criteria related to the basic phases of the revenue management process are as follows:

Develop a plan to collect the revenues in compliance with the entity's legal authority or obligation to collect revenue.
State entities' authority to collect revenues come from various legal sources. Revenue statutes can be specific to the type of revenue or to the entity. Normally, each type of tax is set up by a specific statute. Many statutes that set up entities will also authorize certain revenues such as license or permit fees. Fees can also result from federal mandates.

The revenue management plan developed should comply with legal requirements but be reasonable too. For example, some legislation calls for a fee to "cover the costs" of the related service. In these cases the cost of the service needs to be determined in order to determine the fee. However, the sophistication of the calculation should depend on the amounts of the related revenue. That is, a highly sophisticated cost accounting system should not be implemented in order to capture the true costs of copies so that fees can recover the exact costs. Generally, a reasonable approximation based on copier lease and supply costs would be sufficient.

If a fee is intended to support operations of a licensing entity, a simple calculation of the budget divided by the estimated number of licensees may be sufficient. If the entity's fund balance is decreasing, the fee needs to be raised (or expenditures reduced). On the other hand, a large surplus would indicate that the fee is too large to just cover costs. However, expecting the entity to operate without any reserves is probably not reasonable.

On the other hand, some legislation requires numerous administrative decisions and/or regulations to determine the appropriate method of applying the law. This is especially true in tax laws where a general requirement has to be implemented for many industries. This often requires many interpretations of the legal requirement as it applies to various businesses or industries. The Comptroller has two committees which deal with tax issues and questions that have not already been anticipated and covered by administrative rules.

Identify and develop methods to obtain the information needs of the revenue management process (see Information Management module).

The process should capture the information management needs to make decisions related to the revenue process or related processes. The information should be timely and in a readily useable format. One very important aspect often neglected is the data needed to evaluate the process. See the discussion under the "monitor and evaluate" phase of this module and the Performance Measurement module for more information.

Provide information to enable payers to know when, where, how, and/or how much to pay.

The type and extent of information needed to educate payers is determined primarily by the type of revenue. The type of revenue will determine things like the number and locations of the payers, as well as how complicated compliance will be. Therefore, the discussion in this section is divided by types of revenue.

Taxes

In order to collect taxes quickly and accurately, the State needs to ensure that taxpayers have the information they need to voluntarily comply with tax law. Since voluntary compliance is the least costly method of collecting taxes, this is a very important aspect of the tax revenue process. To the extent practical, the population of taxpayers should be identified to ensure that they all receive the information they need. Taxpayers need to know:

- which taxes apply to them
- which forms to file
- how to complete the forms
- how to compute the amount owed
- where and when to file/pay

Very few taxes are actually collected directly from the taxpayer/general public by the State. In most cases, taxes are collected by retailers (ie: sales taxes, motor fuel taxes, and motor vehicle taxes) at the point of sale. Other taxes are collected by local governments (counties and cities). In these cases, the actual taxpayer does not need extensive information. The retailers or local governments are the "taxpayers" who must understand the forms to file and the amount to pay. Other taxes, like franchise taxes, are paid directly by companies that need to understand the requirements.

Due to the complexity of some taxes, taxpayers should have access to additional resources to answer their questions. This can be accomplished in several ways:

- phone banks operated by knowledgeable employees
- publications that address common or timely issues/questions
- mailouts to specific groups affected by an issue/question
- training for taxpayers provided by knowledgeable employees
- on-line data bases

This communication is especially important for new taxes or changes in existing taxes. If the affected taxpayers can be notified in advance, they can comply, thus saving the State the cost, in both dollars and time, of collecting unpaid taxes.

It is important that communications with taxpayers be complete and understandable. The more complex the tax, the more significant this becomes. In some cases, it may be advisable to get input from several divisions, tax practitioners, and/or taxpayer groups affected.

Easy-to-understand forms are an important way to help taxpayers voluntarily comply with tax laws. Forms should be consistent for all taxes to the extent practical, so that taxpayers paying more than one tax don't have to become familiar with more forms than necessary. Reviews of tax forms can help ensure user-friendly and consistent forms.

Federal financial assistance
A state entity collecting federal revenues needs to understand the requirements associated with the federal money/program. The payments of federal funds (draw downs) are covered by the Cash Management Improvement Act (CMIA). The CMIA limits draw downs and requires interest payments where the funds are drawn down before they are needed or interest earnings where funds are not drawn timely. The CMIA can be found in the Statewide Audit's *Federal Reference manual*.

There are other general compliance requirements that apply to most federal grants and specific compliance requirements that apply to individual grants. These requirements cover program income, if applicable. The state entity is responsible for ensuring compliance with program requirements when federal funds are passed on to other entities/subrecepients. The Statewide A-128 Financial and Compliance Audit fulfills the State's audit compliance requirements for federal financial assistance.

Licenses, fees, & permits
The applicant/payer of these fees needs to know the license/permit requirements and where to apply. These fees usually affect a very specific group. If someone is considering gong into a field that requires a license, he/she needs to know of that requirement. Information can be distributed through professional groups or industry publications. Normally, the amount collected will be the correct amount since the fee is set. However, this could be a factor if the fee is based on a contingency such as size of operations.

Lottery proceeds
These payers need to know where and how to play. Since the collections are made by retail establishments, there could be a need for training of retailers to ensure the correct amounts are collected and remitted. However, the simplicity of the games and charges is the primary method of ensuring against errors due to a lack of understanding.

Other
Most other income is between specific parties who need to understand the transaction cost/contract. There may be a need for informing perspective

payers/buyers of the availability of the goods or service. For example, the Texas Department of Criminal Justice needs to let perspective customers know about the goods and services they have for sale.

Process dollars as quickly as is practical while providing adequate controls to safeguard receipts (See the Cash Management module).
The primary objective in processing collected revenues is to make the funds available for investment or expenditure as quickly as practical. There are many ways to do this, including:

- separating the dollars from the documentation, thus allowing the deposit of the money before the processing of the documentation is complete
- prioritizing receipts and processing the large dollar amounts first
- requiring large payers to file through electronic fund transfers (EFT)
- increasing staff during peak periods (including mail opening as well as receipt processing) by hiring temporary workers or reassigning staff
- staggering due dates to level out the inflow of funds, thus eliminating peak periods where the receipts cannot be processed timely
- using lockbox systems for decentralized receipts

The larger the dollar amounts involved, the more important rapid depositing is. The interest earned on one day for small deposits may not cover the costs of depositing a day sooner. Generally, if deposits were made one day faster, the additional interest would equal one day's average receipts times the current interest rate. That is, if an entity collected approximately $100,000 per work day ($25 million annually if open 250 days), the additional interest at five percent would be $5,000. Obviously, that would not justify adding an employee to process the deposits a day quicker. However, at five percent, yearly deposits of $18 billion would result in $3.6 million more in interest if the deposits could be made one day earlier and $150,000 if deposits were made one hour earlier. Adding staff in these instances may be appropriate.

It is important to remember that revenue is not normally collected/deposited evenly. Procedures, such as depositing large dollar receipts first, may make these simple calculations overstate possible increases in interest. Also interest will not increase if the timing of disbursements moves up to match the faster availability of funds.

One limiting factor in speeding deposits can be maintaining adequate controls. The revenue process should also ensure the security of the funds. The benefits of faster depositing should be weighed against any loss in security. After all, earning more interest on less money may be a bad idea. "Because of the high risk inherent in handling cash, the segregation of duties, rather than operational efficiency, should guide the operations of the revenue collections office" (Allan, p 38).

Physical security should limit access to the processing area(s) to only those employees needing access for the performance of their jobs. This may be accomplished with locked doors or a counter that separates the payer from the employee. Safes or vaults (whose combinations are known only by those employees that need to know) should be used to temporarily store cash until it is deposited. Other security measures could include video monitors and alarms. Physical security should also be provided over revenue forms such as receipt books, licenses, permits, etc. All physical security measures should be balanced against the dollars at risk.

Segregation of duties and reconciliations of deposits to original receipt and/or other records are the primary controls to prevent/detect thefts within the cash processing system. The segregation of cash handling and reconciliation duties helps ensure that the reconciliations are meaningful.

Generally, receipts should be controlled by two or more persons until the payment is recorded. All payments should be recorded immediately upon receipt or as close thereafter as practical. Once the payment is recorded, reconciliations of recorded and actual cash can detect missing monies. However, if one person controls the payment before it is recorded, he/she could misappropriate it and not record the payment. In this case, a reconciliation of recorded receipts to deposits would not detect the theft. Having two persons present reduces the risk because there is less likelihood of theft without collusion. This is the basic principle behind two employees opening the mail.

In some cases, there is no need for a second employee because the payer is the second person in control of the cash until it is recorded. This assumes the payer will receive a cash receipt (can also be a cash register tape) for his/her payment before leaving.

The original recording of the revenue (cash receipts, mail logs, etc.) should be segregated from the processing/depositing function. The reconciliation function (both between the original record and the deposit records/ledgers and the ledger and bank account) should be performed by someone without responsibilities in the receiving or processing functions.

The use of “lock bags” for transporting deposits helps establish responsibility and protects the employee making the deposit, if he/she is independent of the cash receiving function and does not have a key to the bag. The lock bags do not stop a robber from cutting open the bag to get to the funds. However, if the undamaged bag is “short” cash, the funds were likely shorted before being put into the bag.

Additionally, no one employee/section should control the “service” paid for (including establishment or removal of a liability) and the collection of the related money. This includes automated access to records such as receivables, billings, etc.

A basic underlying feature of most control systems over revenue is that the payers will complain if they do not receive what they paid for. Therefore, if an employee takes money and does not process the license for example, the applicant will demand to know what happened to his/her license. The same is true for revenues associated with permits, publications, etc., where the payer would complain if he/she did not receive the purchased item. Likewise, the payer would complain if he/she continued to get notices of payments due (taxes, sales of goods, etc.) after he/she had paid.

However, if the same employee has control of the license, permit, or accounts receivable records, then the employee could take the money and provide the service. In this case, the payer would not complain.

It is important to note that there can be compensating controls where the ideal segregation of duties does not exist. This could be because it is not practical (too few employees for two to be assigned to mail opening each day) or because the faster receipt of the dollars outweighs the control (auditors collecting taxes due at the end of the audit). Some examples of compensating controls to help ensure that the funds make it to the Treasury or bank are:

- active oversight by employees in a “pool” or open work area
- records outside the mail opener’s control (license inventory, A/R, etc.)
- review of audit working papers and independent contact with the taxpayer.

There is additional discussion of controls for each revenue type under the next phase of the revenue management process.

Ensure that all amounts due are collected (this means that collected dollars represent the correct amount due and that unpaid amounts are collected). Procedures to ensure that all amounts due are collected can either be at the point of collection or post collection. If practical, it is generally more efficient to establish controls at the point of collection rather than after collection.

The applicable procedures/controls are dependent on the nature of the revenue being collected. Therefore, the discussion in this section is divided by types of revenue.

Taxes

Taxes are generally controlled post-collection, since it is impractical to provide individual attention to each taxpayer for each return. Procedures helping to ensure that all taxes due are collected are divided into these primary processes:

- penalties for non-payment
- audits of returns

- hearings for disputed taxes
- enforcement/collection of known unpaid amounts
- identification of taxpayers who did not file returns

Penalties for non-payment help ensure taxes are paid. Penalties and interest should be high enough to be an incentive for taxpayers to voluntarily pay. For this to occur, the penalties and interest must significantly exceed what the taxpayer would earn by not paying. This means penalties and interest should be higher than the short-term loan rate. Failure to maintain this ratio can provide the delinquent taxpayer with an interest-rate subsidy and could result in more late payments (Allan, p. 99).

The penalties can be dropped/waived where it is determined that the taxpayer made a “good faith” effort to pay the correct amount. However, high waiver rates could be an indication of too complex a tax structure and/or inadequate education of taxpayers. Inadequate waiver policies could also affect the waiver rate, by not providing proper controls to ensure valid and consistent waivers of penalties.

Audits of tax returns identify unpaid taxes and also encourage voluntary compliance. The audits should concentrate on high dollar and high risk returns while not totally excluding the bulk of returns. The randomness of audit selection has the most impact on voluntary compliance. That is, if taxpayers think they may get audited, there is an incentive to pay the correct amount to avoid possible penalties and interest.

Several strategies can help to focus the audit function, including auditing:

- all returns over a certain dollar amount
- taxpayers who have significantly underpaid before
- taxpayers whose returns show a significant decrease in tax liability from prior periods
- taxpayers whose returns are indicated by automated edits (such as calculation errors or larger than “normal” percentages of certain expenditures/deductions)
- new taxpayers
- randomly selected returns

No one of these options will give adequate coverage by itself. However, a mix of these procedures can provide coverage focused on both maximizing collections and voluntary compliance. These options should be supplemented with tips or other leads that indicate that taxes have not been paid.

The hearing process for disputed taxes (redeterminations) should be sufficient to provide:

- consistent access by all taxpayers
- independent evaluation of opposing positions
- adequate time for taxpayers to support their position

- timely processing of cases

The last two objectives above are somewhat contradictory. The primary result should be that the process itself does not overly delay the disposition. Procedures should be in place to ensure that taxpayers do not have an incentive to protest amounts other than for legitimate disputes. For example, if the interest does not accrue on amounts in dispute, then it is to the taxpayers benefit to keep the amount in the hearing process (earning the taxpayer interest), even if the taxpayer does not actually believe that he/she can win the dispute.

Enforcement/collection of known unpaid amounts should concentrate on collecting the most dollars practical while maintaining the good will of the citizens (Allan, p. 91). Procedures to accomplish this include:
- processing the high dollar accounts first
- segregating the accounts and applying more aggressive procedures to priority accounts (i.e., field visits for high dollar accounts and phone calls for low dollar accounts)
- using low-cost contacts before high-cost procedures (i.e., form letters, then phone calls, then field visits)

The last procedure above may not be effective for accounts where collection on initial contact is unlikely. Generally, the cost of a contact method mirrors the method's effectiveness. That is, the lower the cost, the less effective the contact. Therefore, using less effective contact methods could significantly increase the collection time and may not be the best approach for large dollar accounts.

Since the enforcement of tax liabilities is basically a receivable function, review the Receivables module for additional guidance.

Identification of taxpayers who did not file returns is necessary to ensure that everyone pays their fair share and to encourage voluntary compliance. Non-filers can be taxpayers who do not file for all applicable taxes due to lack of knowledge or for other reasons. However, much of this activity could relate to the "underground economy." This refers to financial activity, such as cash payments or payments between individuals, that is not recorded or reported.

Taxpayers who stop paying can be identified by comparisons of prior and current payers. The primary method for identifying non-filers who have never paid a particular tax is to compare filers with data bases from industry groups or other organizations.

The data base used would depend on the tax. For example, for a tax on a certain industry the list of filers might be compared to subscribers to or advertisers in an industry publication. Sales tax might be tested by comparing filers from a certain city to the businesses included in the business section of the phone book. Additional comparisons might include data bases of licensees, vendors, payers of other taxes, payers in multiple other states, the Internal Revenue Service, the

Secretary of State, the Texas Employment Commission, and the Small Business Administration.

The difficulty in identifying non-filers is in determining sources for effective comparisons. Obviously, automated data bases are necessary since most taxpayer lists would be too lengthy for manual comparisons. Additionally, comparisons based on names (such as from phone records) can create many false leads due to differences in the name used in the data base and on the tax return. It may take significant resources to prove that an identified potential non-filer actually should have filed. A well publicized non-filer identification function may have more impact by encouraging voluntary compliance than by identifying actual non-filers.

Federal financial assistance can be maximized by:

- being aware of the available federal programs and applying for all applicable federal assistance
- claiming all allowable costs, including all allowable indirect costs
- filing for reimbursement/drawing federal funds timely (see cash management discussion above)

Licenses, fees, and permits are normally controlled at the point of collection. The use of prenumbered forms is the primary controlling procedure for these revenues. Comparing the prenumbered licenses or permits issued to the collected fees can provide assurance that all fees are accounted for. The payer will demand a license/permit in return for the payment, so each license/permit issued should be represented by a receipt. The prenumbered form for other fees is usually a prenumbered receipt and works the same way.

It is important that the control over the prenumbered forms be segregated from the collection of the money. An employee who can provide a license without it being recorded could divert the funds without it being detected. Inventory records should be maintained to ensure that all prenumbered forms can be accounted for. (See the Inventory module for more information.)

There could also be a need to identify persons or businesses operating without a required license. If this is the case, the basic process discussed earlier in this section, under identification of taxpayers who did not file a return, would generally apply. Again, the problem would be identifying an efficient identification process/source.

Lottery proceeds are controlled similar to licenses in that tickets are basically prenumbered and individually accounted for. Due to the large number of tickets and sales locations, the controls are highly automated and track individual tickets to the location and time of sale. The Lottery commission receives an annual audit from a CPA firm.

Other revenues may be controlled at the point of the transaction by prenumbered forms or post transaction through verification of compliance with contracts or other agreements. The prenumbered forms may be sales invoices or receipt forms and work basically the same as licenses/permits. Land and investment type income can be controlled through schedules of expected receipts based on contracts.

Record and report revenue transactions

Consistent and accurate records ensure that management and state leaders have appropriate information to base decisions on and enables the State to report financial activity based on Generally Accepted Accounting Principles (GAAP).

GAAP reporting uses basically the same principle for all types of revenues. Revenues are normally recorded when earned, available, and measurable. Taxes are recognized when they are due to be paid to the State. Federal assistance is earned when the related program expenses are made, thus creating receivables for draws not made or deferred revenues for advances. Usually, license and fee revenue is recognized when received.

Monitor and evaluate the revenue management process (see Performance Measurement module)

Monitoring and evaluation are needed to ensure that entity goals are being met. Benchmarks that define compliance with goals are necessary to evaluate the results of procedures.

Collection costs are often overlooked in the evaluation of the revenue collection function. Recording cost information over time is essential to determine how well the revenue management process is performing. An accurate accounting for costs of collection requires the identification of direct and indirect costs associated with the revenue management function (Allan, pp. 111-112) .

Another important measure of the success of the collection function is the amount and length of time that accounts receivable are outstanding. Accounts receivable are tracked through the use of an accounts receivable aging analysis, which measures the time accounts have remained unpaid since the revenue became due. An important statistic is the average number of days that accounts receivable are outstanding. The information can be used to determine if and where problems exist in the accounts receivable system. The results can measure revenue enforcement efforts by comparisons to standards such as past performance, objectives, or similar entities (Allan, pp. 115-116).

An evaluation of collection rates and trends in those rates is also useful. This type of information can indicate the need for corrective budgetary actions (increased fees or reduced spending) or more aggressive collection policies. The most important aspect of collection ratios is the trend. The following are examples of comparisons that can be made (Allan, pp 116-117):

- this month’s collections compared to last month’s collections

- this month's collections compared to the same month's collections last year
- this year's collections-to-date compared to collections-to-date at the same time last year
- this year's collections-to-date compared to the amount anticipated or budgeted-to-date

Benchmarks

Examples of types of benchmarks for each phase of the revenue management process include:

- *educate payers through making relevant information available*
  - number of calls taken by the phone bank
  - time taken to answer calls to the phone bank
  - percentage of questions answered on first contact
  - percentage of additional collections resulting from audits where payer made "good faith" effort (penalties/interest waived)
- *process dollars and documentation as quickly as practical*
  - number of tax returns processed
  - number of days/hours to deposit (normally three days maximum per state requirement)
  - percentage of dollars deposited within X period (first hour/day)
- *collect all amounts due*
  - number of audits completed or calls made
  - percentage of audit coverage in taxpayers and dollars
  - amount collected over costs of audits (by division/field office/auditor)
  - percentage of disputed cases ruled in favor of payer
  - percentage of cases in dispute over X days old
  - percentage of accounts receivable dollars over X days old
  - amount collected over costs of identifying non-filers

Performance evaluations sometimes need to be completed at more than one level. For example, the cost of the audit function must be weighed against the benefit derived. Active evaluation of the audit function in total is a vital part of this evaluation. However, analysis by region/office, type tax, etc., may also provide needed information. This second level of analysis may reveal that more audits/auditors in a certain region and fewer in another region could increase the collections while not affecting the costs. When determining the benefit derived, be sure to consider all benefits. For instance, the audit function may encourage voluntary compliance in addition to whatever additional dollars it collects.

Care has to be taken in the development of performance measures to ensure that they do not provide incentives for conduct that does not support the entity's objectives. For example, if the performance measure of tax auditors or field offices is how much additional tax they assess, the incentive could be to assess taxes that they know are not owed. These taxes would be protested and won by the taxpayer, requiring more resources in the redetermination process and harming taxpayer relations. However, the auditor or field office may be rewarded because they exceeded the expected performance or assessed more taxes than other auditors/field offices. In this case, actual taxes collected and/or number of successful appeals may be more appropriate measures.

Assess Condition: Determine the actual process used

Conduct interviews, observe operations, and identify and collect available documentation in order to gain an understanding of the entity's actual revenue management process and controls. Included in the actual process are both official/unofficial and formal/informal processes and controls. An official process may exist even if it is not documented. More information is provided in the automated *Project & Procedures Manual (PPM)* and standard programs and questionnaires are available in the *Audit Materials Package - Statewide Audit*. Possible procedures include, but are not limited to:

- Determine where the revenue management process resides in the entity, who participates in the process, and how the participants are selected.
- Obtain and review any manuals, policies, and forms that could document any phase of the revenue management process, including its relationship to entity goals, objectives, strategies, and plans.
- Determine if and how management consciously selects and employs the assumptions, criteria, methods, processes, and techniques used in the revenue management process. Obtain and review available documentation on the assessment of risks, costs, and benefits.
- Determine the kind and frequency of monitoring over the revenue management process and how monitoring information is communicated to appropriate personnel for action.
- Complete appropriate programs and questionnaires from the statewide materials package.

Note that for large, sophisticated systems, a separate understanding may need to be documented for each phase of the revenue management process.

The *Audit Materials Package - Statewide Audit* contains questionnaires and programs that can aid in gaining an understanding of the revenue management process. The Internal Control Structure Memo contains a generic program for evaluating control systems. The first section is dedicated to gaining an understanding. Procedures include:

- identifying weaknesses noted in prior audits
- completing/updating the related control structure questionnaire
- completing/updating flowcharts and/or narratives
- considering general and application EDP controls
- considering the affect of the entity’s control environment

Entity permanent files should contain prior audit findings and dispositions in section **PF-1.**

The Internal Control Structure Questionnaire - A/R - Cash Receipts has information on revenue management polices and procedures. The questionnaire is organized in the following management objectives, with questions under each objective that indicate policies or controls that could be appropriate:

Accounting System Policy -

1. Reported revenues represent earned funds. Other income is properly recognized, recorded, and classified.
2. All revenue earned during the year (period) is recorded and included in the financial records/statements.
3. All revenues are properly classified and described in the financial records and are reported in the proper period. Revenues are presented in the annual financial report (AFR) in accordance with Comptroller's reporting requirements.
4. Significant receivables which should be written off are not included and allowances for doubtful value are adequate.
5. Input into the system is accurate, authorized, and complete.

Control Procedures-

1. Written procedures exist for handling accounts receivable, credit memoranda, and uncollectible accounts.
2. There is an adequate segregation of duties between divisions/persons responsible for credit/collection, shipping, billing, cash receiving, and posting to the accounting records.
3. There is a reconciliation of recorded deposits to original control records by an independent employee and reviewed by a supervisor in a timely manner.
4. Initial cash receipts records are created immediately upon receipt and checks are restrictively endorsed.
5. Revenue transactions with third parties are evidenced with issuance of a receipt.
6. There is adequate physical security over undeposited receipts. Cash receipts are deposited in a timely manner.
7. Written approvals are necessary for any adjustment credits or write-offs of uncollectible accounts.
8. Personnel periodically confirm receivables by confirmation with debtors.
9. Subsidiary ledgers of receivables are regularly reconciled to the general ledger control records.

After your understanding is documented in either flowcharts or narratives, consider having client staff review the working paper. This can help ensure you have correctly understood the process.

If significant controls over the revenue management process are edit checks or other automated controls, you may want to also gain an understanding of the controls over the EDP resources. Your assessment of the control system could change if access to the automated controls are weak, allowing the controls to be bypassed within the automated system.

The significance of EDP to the revenue management process and the project objective will determine how much of an understanding is needed in these areas. This understanding should consider the general controls over the overall automated systems as well as controls specific to automated systems applicable to the revenue management process. The statewide materials package contains programs and questionnaires for the following EDP general controls:

- access
- system design, development, and maintenance (SDDM)
- computer operations
- physical security

There is also a generic questionnaire for application controls.

The control environment can have a positive or negative effect on the control systems as they actually operate. Controls, both manual and automated, that look good "on paper" can be ignored or otherwise rendered ineffective if the atmosphere/environment is not conducive. Likewise, weak controls can be informally supplemented when the atmosphere/environment emphasizes caution. An understanding of the environment in which the controls over the revenue management process operate may be necessary depending on the objectives of the audit. The statewide materials package includes a Control Environment Risk Assessment. The control environment is defined as:

- management philosophy and operating style
- organizational structure
- governing board/commission's audit committee
- methods of assigning authority and responsibility
- management control methods
- internal audit function
- personnel policies and practices
- external influences

Depending on the type of revenue and the scope of the audit, there may be a need to also gain an understanding of any or all of the following related internal control structures:

- receivables
- inventories
- cash management
- performance measures

All of these areas have modules within the *Methodology Manual*. The statewide materials package also has programs and questionnaires for inventories and receivables.

In addition to gaining an understanding of the actual process, also try to find out:

- how the participants view the actual process
- what parts of the process they see as successful or unsuccessful and why
- what they think is important about the process and why

This information may help identify causes and barriers.

"Red Flags"

General:
Many times fraud starts out as a one-time "borrowing" to meet an immediate need. However, when the missing funds are not discovered, the process is repeated. Soon the theft becomes a part of the employee's "operating income" and he/she cannot do without it. This often occurs in small entities or accounting sections where everyone trusts everyone else because they are "good" people.

Having the same employee make deposits and pick up bank statements allowed her to steal over $90,000 over 2-3 years from a state university. Although management noticed the bank statements were altered, they accepted the employee's explanation that the bank's computer records were wrong. That the bank had altered the statements due to construction in the area having caused lost transactions. The employee was believed because she was an outstanding member of the community and long-time employee.

The following are some of the more common problems noted at state entities in previous audits.

Control environment weaknesses:

- One person controlling the entity or revenue management process
- No emphasis placed on controls/monitoring of revenue process

EDP weaknesses:

- Controls can be circumvented because access not limited or access logs not reviewed

Following are common weaknesses listed by type of revenue:

Taxes-

- Weak education of taxpayers (hard to define direct benefits of taxpayer education process since impossible to tell how many taxpayers would have paid without it, but it probably impacts voluntary compliance more than any other process)
- Lack of adequate monitoring tools/performance measures to ensure audit/enforcement functions are as effective as could be
- Lack of effective non-filer identification function

Federal Revenue-

- Not actively seeking/being unaware of all federal funds available
- Not aggressively claiming indirect cost
- Not adequately monitoring spending and/or matching and allowing funds to lapse

Licenses, Fees, & Permits and other-

- Lack of segregation of duties, especially between cash handling and service provided
- Lack of controls over inventories of license/permit documents or receivables

Some common problems in revenue collection for all governments are (Allan, pp. 7,8):

- slow processing of receipts
- slow deposit of receipts
- slow billing
- lack of incentive to pursue collections
- weak enforcement of revenue laws
- determining what is owed
- poorly trained staff
- lack of internal controls
- poor records management

Determine the strengths and weaknesses of the actual process

Using the tailored criteria, the understanding of the entity's process gained above, and the procedures in this section, analyze the actual process to determine if it:

- is designed to timely and efficiently collect all revenues due in a way that supports the entity's mission, goals, and objectives (management objective this module, page 1)
- has controls that provide reasonable assurance that the process will work as intended
- is implemented and functioning as designed
- is actually achieving the desired management objective(s)

Suggested procedures for each of these four analysis steps are detailed below. In executing these procedures, remember to identify and analyze both strengths and weaknesses. As a general guide, "yes" answers on the statewide materials' control questionnaire indicate strengths and "no" answers indicate weaknesses. However, the significance of the strengths and weaknesses have to be determined for the particular entity's process.

Identify and review the steps in the actual process to determine if the process is designed to timely and efficiently collect all revenues due in a way that supports the entity's mission, goals, and objectives. Possible procedures include, but are not limited to:

- Determine if all major steps in the criteria are included in the actual process. If steps are missing, determine if their absence is likely to have a significant negative effect on the revenue management process at the entity you are reviewing.
- Determine if all the steps in the process appear to add value. If there are steps that do not appear to add value, try to get additional information on why they are included in the process.

- Review the order of the steps in the process to determine if it promotes productivity.
- Review the level of technology used in the process to determine if it is up-to-date and appropriate to the task. Automated tracking and reconciliations, electronic filing and electronic funds transfers are examples of technology uses to enhance revenue management. Besides computer, electronic, communications, and other mechanical technology, you should also consider what kinds of management technology are used (Gantt charts, process maps, decision matrices, etc.). See the appendix to the module on Problem-Solving and Decision-Making for more information.

Identify the controls over the process to determine if they provide reasonable assurance that the process will work as intended. These controls should be appropriate, placed at the right point(s) in the process, timely, and cost effective. Possible procedures include, but are not limited to:

- Draw a picture of the process, the controls, and the control objectives (see page 13 of the Introduction for an example). Flowcharts of the revenue management process can help identify inputs, processes, and outputs.
- Determine if the control objectives are in alignment with timely and efficiently collecting all revenues due in a way that supports the entity's mission, goals, and objectives.
- Identify the critical points of the process (i.e., those parts of the process most likely to determine its success or failure or expose the entity to high levels of risk) and the controls related to them. Remember that this includes both manual and EDP controls, as well as controls in related processes. Consider whether the controls are:
  - in the right location within the process (input, operations, output)
  - timely (real time, same day, weekly, etc.)
- Compare the cost of the control(s) to the risk being controlled to determine if the cost is worth the benefit. Consider if there may be a more efficient control that would provide the necessary assurance. This could be a manual instead of an automated control, or vice-versa.
- Determine what controls are in place for monitoring and evaluating the overall effectiveness of the revenue management process and making sure that changes are made in the process if it does not yield the desired results.
- Identify, describe, and assess the process used to gather input from employees who might reasonably discover flaws in the process.

Determine if the audit scope requires the knowledge of whether the controls are actually functioning as prescribed by management. Review observations, interviews, documentation, and other evidence and design specific audit procedures as needed to determine if the process and/or the controls have been implemented and are functioning as designed. Depending upon the objectives of the project, these procedures may include both tests of controls and substantive tests, more information on which is found in *The PPM*.. Additionally, the List of Tests of Controls - Cash receipts/Receivables and List of Substantive Tests - Revenues programs in the *Audit Materials Package - Statewide Audit* provide lists of possible tests.

Normally, only strengths would be tested to ensure they are working. However, there may be reason to test weak systems. Tests may identify receipts that cannot be accounted for or may give some assurance that the receipts can be accounted for, even though the system did not ensure this. However, a weak system may only allow tests to document that the recorded receipts are accounted for and not provide evidence that all receipts were recorded. The purpose of the tests should be determined before audit resources are used.
Possible procedures to test controls include, but are not limited to:

- Determine if any evidence of management override exists.
- Walk through the actual process, i.e., follow a transaction through the people and documents involved.
- Observe key points in the process, such as mail opening, depositing, reconciliations, physical security during processing, or physical security of computers.
- Sample items such as receipts, billings, or sales invoices and test for evidence that the controls were exercised on the sample items.
- Review reconciliations to ensure they actually bridge the appropriate information.
- Examine logs or other evidence of EDP controls.

Each procedure's results should be compared to the official process, especially noting differences in actual segregation of duties. If segregation of duties is negated during personnel's vacation, more extensive testing during that period may be called for. **It is important for the auditor to be skeptical of explanations given for apparent lapses in controls or records.**

Possible substantive tests include, but are not limited to:

- fluctuation analysis for reasonableness of revenue recorded
- comparisons to calculated revenue from:
  - changes in items such as licenses inventory
  - interest on investments
  - contract payments
  - independent data (i.e., number of gallons sold X tax rate compared to motor fuels taxes)
- confirm revenue with payer

Review and analyze any reports used by the entity to monitor the outcome(s) of the Revenue management process and/or any other information available to determine if the process is actually collecting all revenues due timely and efficiently. Possible procedures include, but are not limited to:

- Analyze these process reports over time for trends.

- Discuss any apparently significant negative or positive trends with management.
- Determine if and how management acts upon these trend reports and what changes, if any, were made in the process or controls as a result. Some process refinements, especially those affecting entity mission, goals, and outcome measures, may need to wait until the next appropriation cycle.
- Determine if significant steps of the process are not being monitored or if more effective monitoring tools could be used.

Determine causes

Determine what circumstances, if any, caused the identified weaknesses in the revenue management process. Note that causes are often hard to identify and/or directly associate with a weakness. Allocation of resources decisions must consider quantitative as well as qualitative factors. The practicality of determining an actual cause should be considered before spending resources in this area. Possible procedures include, but are not limited to:

- Determine if the participants in the revenue management process understand the entity's mission, goals, and values and support them through their management of revenue.
- Determine if the participants understand both the purpose of and their role in the revenue management process.
- Determine if the relationship between the revenue management process and other entity processes is clear.
- If the process occurs at multiple locations, determine the nature and scope of the communication and coordination among them.
- Determine if the revenue management process has adequate human, dollar, time, information, and asset resources. If they appear inadequate, determine if entity resources have been allocated according to the significance of the revenue management process relative to other entity processes.
- Determine if the entity has considered using alternative resources such as industry associations, non-profit organizations, academic institutions, or other governmental entities to meet its resource needs.
- Determine if resources available to the revenue management process have been allocated and used in a manner consistent with the importance of that resource to the revenue management process.
- If there are negative trends in the reports used to monitor the outcome(s) of the revenue management process, determine if these reports are communicated to and used by the appropriate parties to modify the process.

Determine what internal or external constraints or barriers, if any, must be removed in order to overcome these identified weaknesses. Possible procedures include, but are not limited to:

- Review the applicable entity, state, or federal laws or regulations to determine if any of them prevent the necessary changes from being made in the revenue management process.

- Determine if any key employees are unwilling to change the process and why they are unwilling.

Determine effect

Determine which weaknesses in the entity process are significant. Do not consider weaknesses that are minor or are compensated for by other controls. Possible procedures include, but are not limited to:

- Identify performance benchmarks (industry standards, historical internal data, other comparable entities, etc.) for the process in question and compare to actual performance. If the current process is not meeting benchmarks; determine, if possible, what is lost or what could be gained if the process could be changed to meet the benchmarks.
- Determine/quantify the impact of weaknesses in the current process. Impact can be measured by comparing the dollar cost, dollars lost, dollars at risk, impact on services, impact on citizens, impact on the economy, etc. Measurements can be quantitative, qualitative, or both.

Be sure that any quantification used actually applies to the impact of the control or phase being addressed. Following are examples of possible quantification errors to avoid:

- If the weakness is in the mail opening process, do not include federal funds in the dollars at risk. Federal funds are normally direct deposits and do not go through the mail opening process.
- If the weakness is in the revenue audit function, do not include collections from sources from other than audits.

Develop recommendations

Develop specific recommendations to correct the weaknesses identified as significant in the previous section. In developing these recommendations, consider the tailored criteria, kind of process and control weaknesses identified, causes and barriers, effects, and additional resources listed at the end of this module. Possible procedures include, but are not limited to:

- Develop alternative(s) to address significant weaknesses. Alternatives can be developed by using:
  - the criteria contained in this module
  - general management principles
  - processes at comparable entities
  - solutions for removing barriers
- Compare the actual entity process to a recommended alternative process(es) and ensure that the significant weakness(es) have been addressed.
- Compare the cost/benefit of the alternative(s) to the current process.
  - Estimate the cost of the actual process and the alternative process(es) and compare.
  - Estimate the quantity and/or quality of services provided by the actual process and by the alternative process(es) and compare.
  - Identify the risks associated with the actual process and with the alternative process(es) and compare.
- Provide general guidelines as to the objectives each solution should meet; then the entity can tailor the solution to its specific situation.
- Provide specific information, if available, on how each recommendation can be implemented.

RESOURCES

Useful Materials

Additional information can be found in the following statewide financial reports:

- Comptroller of Public Accounts' *Biennial Revenue Estimate* contains information on forecasts of state revenue in total and by various breakdowns including state fund and revenue object code.
- Comptroller of Public Accounts' *Annual Cash Report* contains information on actual cash receipts in total and by various breakdowns including state fund and revenue object code.
- Comptroller of Public Accounts' *Comprehensive Annual Financial Report* (CAFR) contains information on the State's revenues on an accrual basis primarily in total and by GAAP fund type, with detail for some larger funds.

The Cash Management module contains lengthy lists of articles, periodicals, books, and professional organizations related to cash flow and cash management. While these resources could also impact portions of the revenue management process, they have not been repeated here.

Articles

Alm, James and William Beck. “Wiping the Slate Clean: Individual Response to State Tax Amnesties.” *Southern Economic Journal* 57:4:1,043-1,053 April 1991. Location:

Jamison, Conny M. “Collecting Delinquent Revenues: No Stone Unturned in the City of San Diego.” *Government Finance Review*. February 1991. Location:

Lewis, Richard F. “Delinquent Tax Collections: An Overview.” *Government Finance Officers Association of Texas Newsletter*. September 1989. Location:

Martin, Susan W. “Using Amnesty Information to Detect Tax Cheats and Improve Taxpayer Service.” *Government Finance Review*. October 1988. Location:

Nemes, Judith. “Automated Systems Can Help Dial Up more Claims Dollars.” *Modern Healthcare*. 20:38:45. September 24, 1990. Location:

O’Leary, Frank. “Automated Taxpayer Service: Simple and Convenient.” *Government Finance Review*. April 1990. Location:

Shear, Jeffrey. “New York City Unearths the Underground Economy.” *Government Finance Review*. June 1990. Location:

Thompson, Phyllis and Emil Hartleb. “Voluntary Compliance: The Secret to Effective Receivables Management.” *Government Finance Officers Association of Texas Newsletter*. March 1989. Location:

Books

Allan, Ian J. *Revenue Collection Administration - A Guide for Smaller Governments*. Government Finance Officers Association. 1993. Location: SAO Methodology Resource Files

City of Tulsa Treasury Division. *Revenue Management: A Proactive Revenue Collection System*. 1991. Location:

Davey, Patrick J. *New Patterns in Organizing for Financial Management*. 1983. Location: The University of Texas, Public Affairs Library (HG 4026 D34)

Federation of Tax Administrators. *The Use of Electronic Funds Transfer for State Tax Payments: A Report with Recommendations*. 1990. Location:

Mavrovitis, Basil P. *Cashflow, Credit, and Collection: Over 100 Proven Technics for Protecting and Strengthening your Balance Sheet*. 1990. Location: The University of Texas, Perry-Castaneda Library (HG 4028 C45 M228)

Select Committee on Tax Equity. *Rethinking Texas Taxes*. 1993. Location: SAO Library

Smith, Elton C. And Kenneth L. Evans. *A Handbook for Alabama Municipal Revenue Officers*. Location: The University of Texas, Public Affairs Library (HJ 9191 S647).

Texas Comptroller of Public Accounts. *Sources of Revenue Growth: A History of State Taxes in Texas, 1972-1995*. 1994 Location: Texas State Library (84 p: ill; 28 cm)

___. *Taxpayers' Rights, Remedies & Responsibilities*. 1994. Location: Texas State Library (7 p; 28 cm)

Data Bases

The Comprehensive Analysis for Efficiency (CAFE) data base contains various financial information including revenue totals by agency, fund, and object code or type revenue. The information can be viewed from the Statewide accounting system' historical data or the pior CAFR's. Ron Sassen (RCS/ 4758) is the SAO contact for CAFE.

The current Statewide accounting system, USAS, contains current information on revenues by agency, fund, and object code. USAS can be accessed by the SAO; contact Earnest Cuellar (EDC/ 3064).

Human Resources

The following staff members have specialized training or ongoing interest in revenue management:

SAO Employee(s)	Title/Function
Worth S. Ferguson, CPA	Module Writer/Editor
Linda Lansdowne, CPA John Swinton, MPAFF	Reviewers

Periodicals

Modern Healthcare
Published
Location:

Southern Economic Journal
Published monthly by
Location:

Wall Street Journal
Published daily by Dow Jones & Company
Location: SAO Library

Professional Associations and Research Entities

Government Finance Officers Association (GFOA)
Washington, D.C.
(202) 429-2750

Government Accounting Standards Board (GASB)
Norwalk, Connecticut
(203) 847-0700

Related Modules and Reports

Cash Management
Receivables
Inventories
Information Management
Performance Measures

SAO Report No. 2-299: *A Review of the Management Controls and Revenue Auditing Function at the Texas Alcoholic Beverage Commission*.

SAO Report No. 3-001: *Texas State Treasury Department - Review of the Revenue Auditing Functions*.

SAO Report No. 3-015: *A Review of the Comptroller's Revenue management Process.*

SAO Report No. 3-019: *Opportunities to Enhance the Administration of Taxes at the Texas Department of Insurance.*

SAO Report No. 95-018: *A Review of the Revenue Audit Function of the Texas State Treasury: The Tobacco Tax Revenue Process*.

SAO Report No. 95-030: *An Audit Report on the Comptroller's Tax Revenue management Process*.

Michigan Office of the Auditor General. *Performance Audit of the Single Business Tax Division - Department of Treasury*. May 1, 1988 through May 31, 1992.