



Audit Report



OIG-09-025

PRIVATE COLLECTION AGENCIES: Diversified Collection Services, Inc., Needs to Improve Compliance with FMS's Debt Compromise Requirements

January 8, 2009

Office of
Inspector General

Department of the Treasury

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Abbreviations

Diversified	Diversified Collection Services, Inc. (of Lathrop, CA)
DMS	Debt Management Services
FMS	Financial Management Service
OIG	Office of Inspector General
PCA	private collection agency
TOP	Treasury Offset Program
Treasury	Department of the Treasury

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*The Department of the Treasury
Office of Inspector General*

Judith R. Tillman
Commissioner
Financial Management Service

We audited compliance by Diversified Collection Services, Inc. (Diversified), a private collection agency (PCA) under contract with the Financial Management Service (FMS), with requirements for debt compromise.¹ Our objective was to determine, for compromises on delinquent federal nontax debt, whether Diversified is

1. following PCA contract requirements, including (a) attempting to collect the full amount due before considering a compromise and (b) compromising at authorized levels; and
2. documenting each compromise adequately, providing proper justification, and retaining evidence for the required period.

Our audit of Diversified is part of a series of planned audits of PCAs and FMS's oversight of debt compromise. Appendix 1 contains a description of our objective, scope, and methodology.

In brief, we found that Diversified was not following some PCA contract requirements and FMS policy, including documentation provisions for debt compromise. We are making two recommendations to address these matters.

¹ A compromise plan is a payment agreement that allows the debtor to satisfy a debt by paying an amount less than the total balance due, typically in a single payment.

Background

As the federal government's financial manager, FMS implements the government's delinquent debt program, collecting an annual average of more than \$3 billion in delinquent debt over the last 4 fiscal years through two main activities, the Treasury Offset Program (TOP) and the Cross-Servicing Program.

Through TOP, delinquent debtor records referred by federal program agencies and states are matched against files for federal payments, such as income tax refunds, federal employment salary payments, and Social Security benefit payments. When a match occurs, the payment is intercepted and offset up to the amount of the debt.

Cross-servicing is the centralized debt collection process for managing delinquent debts referred from federal program agencies through a variety of debt collection mechanisms, such as issuing demand letters, executing repayment agreements, referring accounts to TOP for administrative offset, referring debts to the PCAs, and reporting debts to credit bureaus.

The FMS Debt Management Services (DMS) provides federal agencies with debt collection and management services. DMS leads the development and implementation of governmentwide debt management policies. It accomplishes its mission of improving the quality of the federal government's financial management in part by increasing the collection of delinquent debt owed to the federal government and by providing debt management services to all federal agencies.

Once DMS determines that debtors cannot be located or are unwilling to resolve debts in an acceptable manner, the debts may be sent to the PCAs, which are private sector companies that specialize in collecting delinquent debt. PCAs attempt to find and contact debtors by searching various databases, making telephone calls, and sending collection letters. Once debtors are located and contacted, the PCAs encourage them to satisfy their debts.

On March 12, 2007, DMS awarded a Treasury debt collection contract to Diversified, to increase the recovery of, and to resolve,

nontax federal debts.² The contract is a renewable 1-year contract with four 1-year options available. Diversified also provided debt collection services under a prior contract with FMS.

For the 12 months ended January 31, 2008, FMS referred \$777 million to Diversified, which collected \$18 million and administratively resolved \$63 million. During the same period, Diversified processed 103 compromise agreements for which the forgiven amount was in excess of \$2,000. The total amount forgiven for the 103 compromise agreements was \$1.7 million.

Debt collection efforts are governed by various federal and state laws, including the Debt Collection Improvement Act of 1996 and the Federal Claims Collection Standards. Appendix 3 contains a brief summary of federal debt collection laws, regulations, and guidance. DMS's Private Collection Division monitors PCA activities.

Finding and Recommendations

FMS Should Ensure Diversified's Enhanced Compliance With PCA Contract Requirements and Policy for Debt Compromise

Diversified was not following some PCA contract requirements and FMS policy, including documentation provisions for debt compromise, as discussed below. Appendix 2 provides a summary of our results on a case-by-case basis for the 14 cases in our sample, randomly selected from a universe of the 103 compromise agreements that had an active status during the audit period and had amounts forgiven greater than \$2,000.

² A debt may be administratively resolved for a variety of reasons. For example, collection efforts may be discontinued because of a debtor's death, disability, or bankruptcy or because a debtor entity has gone out of business. A debt may also be resolved if the debtor pays or otherwise satisfies the delinquent debt in full, pays the amount of a compromise reached, or enters into a repayment agreement under terms acceptable to the creditor agency.

Inadequate Documentation of Steps in Collection Process

Before compromising a debt, the contract requires a PCA to take the following steps, in order: (1) attempt to collect the full amount in one payment, (2) attempt to collect the full amount in multiple payments, and (3) attempt to collect a partial payment amount in one or multiple payments.³ The PCA is also required to include in its system a separate justification for being unable to collect in accordance with each applicable step. If the PCA is unsuccessful in these efforts, it may then attempt to negotiate a compromise payment amount with the debtor.

In all 14 of the debt compromise cases we reviewed, Diversified did not document step 3 (attempt to collect a partial payment) in accordance with contract requirements. Without documentary evidence of its efforts to establish partial payment agreements instead of compromise agreements in these cases, Diversified has not provided assurance to FMS that the \$238,000 in compromised debt should have been forgiven. In addition, Diversified did not document steps 1 and 2 in one case until after the decision to compromise had been made.

Without proper documentation by a PCA, a reviewer would not be able to determine whether the PCA adhered to the requirements of the contract and acted in the best interests of the government.

In a written response to this finding, Diversified agreed with the specific findings in step 3 (attempt to collect a partial payment amount in one or multiple payments) as noted in appendix 2. Additional information provided by Diversified for the case where we found that documentation was not adequate for the other two steps did not change our finding. As discussed earlier, the debt collector's notes should include documentation of each step addressed prior to reaching a compromise agreement.

³ In a partial payment agreement, the government suspends active collection while the debtor makes payments toward the balance due. Unlike a debt compromise, a partial payment agreement does not release the debtor's obligation to pay the full balance of the debt; the debt will remain in TOP so that the debtor's federal payments may be offset and applied to the debt balance.

Missing Compromise Agreement Letter

The contract states that, after reaching an agreement with the debtor, the PCA is to send a DMS-approved compromise agreement letter to the debtor confirming the payment arrangement to which the debtor has agreed.

The file for 1 of the 14 Diversified cases we examined lacked a compromise agreement letter. There was no indication in the collector's notes from Diversified's system that a letter had been sent to the debtor. As a result, the debtor did not have documentation confirming the payment arrangement and it would be difficult for Diversified to settle any dispute that might arise. Diversified acknowledged that it did not send a compromise agreement letter to the debtor and stated that this was an error on its part.

Recommendations

We recommend that FMS take action to ensure that Diversified

1. conducts additional training or takes other corrective action to ensure that its employees properly document the steps taken prior to compromise, and
2. sends and retains copies of compromise agreement letters in each case where a compromise is reached.

Management Response

FMS concurred with our recommendations. The DMS Private Collection Division held a Debt Collection Forum for representatives of each of the five PCAs under the current contract, including Diversified. Payment agreement standards and documentation requirements were a major focus. DMS plans to verify that each PCA has conducted additional training and may travel to PCA sites to train collection staff. In addition, as part of its annual compliance reviews, FMS will continue to review PCA files to ensure that letters detailing the terms of the compromise agreements were sent to the debtors.

OIG Comment

We believe that the actions taken or planned by FMS address the intent of the recommendations.

* * * * *

We appreciate the courtesies and cooperation provided to our staff. If you wish to discuss this report, you may contact me at (202) 927-6512 or Maria V. Carmona, Audit Manager, at (202) 927-6345.

Michael J. Maloney
Director, Fiscal Service Audits

Our audit objective was to determine if, for compromises on delinquent federal nontax debt, private collection agencies (PCA) under contract with the Financial Management Service (FMS) were

1. following PCA contract requirements, including (a) attempting to collect the full amount due before considering a compromise and (b) compromising at authorized levels; and
2. documenting each compromise adequately, providing proper justification, and retaining evidence for the required period.

This report provides the results of our review for Diversified Collection Services, Inc. (Diversified), one of the PCAs with which FMS has contracted for debt collection services. We previously issued reports on two PCAs⁴ and plan to report on other PCAs and FMS's administration of the program at a later date.

We began our fieldwork for the overall audit in February 2008 and completed it in June 2008. Our work was performed at the FMS's offices in Washington, DC. This included reviewing Diversified records that were sent to FMS.

To accomplish our objective, we reviewed applicable laws and regulations. We also considered policy guidance given to the PCAs by FMS. This included both current and prior versions of PCA contract documents and FMS policy issuances, such as the Private Collection Agency Policy & Procedures Manual and technical bulletins.

We considered how FMS monitors PCA activity, reviewing the compliance checklists completed by FMS and supporting documentation obtained by FMS as it oversees the PCAs. We also reviewed the most recent compliance report for each of the PCAs under the prior contract.⁵

⁴ The two reports, issued on September 26, 2008, are "Pioneer Credit Recovery, Inc., Needs to Improve Compliance with FMS's Debt Compromise Requirements," OIG-08-043, and "Linebarger, Goggan, Blair & Sampson, LLP, Needs to Improve Compliance with FMS's Debt Compromise Requirements," OIG-08-044.

⁵ FMS compliance reviews under the current contract began in May 2008. The final compliance review under the prior contract was completed in 2006, with no reviews done in 2007.

We interviewed FMS staff in the Debt Management Services Private Collection Division, including the contracting officer's technical representative for the PCAs.

We also evaluated computer-generated data files on debt compromises from the FedDebt system, which is the current cross-servicing system. FedDebt is a Web-based application used to create and update debt and debtor information and monitor financial transactions.

We audited a statistical sample of debt compromises under both the prior and current FMS contracts with Diversified. The sample of 14 debt compromises was randomly generated from a universe of 103 compromise agreements negotiated by Diversified. The 103 agreements all had an active status during the audit period and had amounts forgiven greater than \$2,000.⁶ These agreements were posted to the FedDebt system from February 2007 through January 2008, the most recent 1-year period available at the time that we requested the automated data. The following parameters were used to determine the size of the sample: 95 percent confidence level, 3.5 percent expected error rate, and ± 3.5 percent sample precision.

For the sample, we examined Diversified's documentation for each compromise agreement to determine whether (1) required collections efforts were followed before compromise was negotiated, (2) the compromise amount was within authorized limits, and (3) required compromise agreement letters were sent to the debtors. We also interviewed Diversified officials.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the

⁶ The amount forgiven included the outstanding principal, interest, administrative charges and penalties at the time each agreement became active, and potential PCA and DMS fees, as well as potential PCA bonus charges, less the amount to be paid by the debtor. Amounts forgiven less than or equal to \$2,000 were considered immaterial for this audit.

evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

Appendix 2
Results of Review—Individual Cases

Case Ref. ^a	Outstanding balance at date of compromise	Compromise amount	Amount forgiven	A			B
				Inadequate documentation			Compromise letter not in file
				Step 1 ^b	Step 2	Step 3	
A	5,733	3,200	2,533			X	
B	50,721	19,700	31,021			X	
C	20,086	7,801	12,285			X	
D	112,750	65,000	47,750			X	
E	22,526	14,600	7,926			X	
F	43,089	20,000	23,089			X	X
G	6,965	3,840	3,125			X	
H	9,175	5,900	3,275			X	
I	31,577	16,000	15,577			X	
J	30,216	12,554	17,662	X	X	X	
K	5,902	3,500	2,402			X	
L	99,875	50,000	49,875			X	
M	5,120	2,600	2,520			X	
N	37,575	18,788	18,787			X	
Total	\$481,310	\$243,483	\$237,827	1	1	14	1

Notes:

- a. Cases A-H were under the prior contract; cases I-N under the current contract.
- b. Before compromising a debt, the contract requires a PCA to take the following three steps, in order:
 - Step 1. Attempt to collect the full amount in one payment.
 - Step 2. Attempt to collect the full amount in multiple payments.
 - Step 3. Attempt to collect a partial payment amount in one or multiple payments.

The following are brief statements of the purpose of selected federal debt collection laws, regulations, and guidance:

Debt Collection Improvement Act of 1996

To centralize the governmentwide collection of delinquent debt and give Treasury significant new responsibilities in this area and to require that agencies take prompt action to recover debts and transfer all nontax debts delinquent more than 180 days to Treasury for administrative offset and cross-servicing.

Fair Debt Collection Practices Act

To eliminate abusive debt collection practices by debt collectors, to ensure that debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent state action to protect consumers against debt collection abuses.

Federal Claims Collection Act and Standards

To set administrative procedures with respect to collection of debts owed to the United States, including the criteria for accepting installment payments and compromise agreements.

Privacy Act

To restrict the disclosure of personal information about individuals and govern the handling of such information by the federal government and its contractors.

OMB Circular A-129–Policies for Federal Credit Programs and Nontax Receivables

To prescribe policies and procedures for justifying, designing, and managing federal credit programs and for collecting nontax receivables.

Appendix 4
Management Response



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

December 18, 2008

Michael J. Maloney
Director, Fiscal Service Audits
Office of the Inspector General
740 15th Street, NW
Washington, DC 20220

Dear Mr. Maloney:

Thank you for the opportunity to comment on the November 2008 draft audit report titled "*Private Collection Agencies: Diversified Collection Services, Inc. Needs to Improve Compliance with FMS' Debt Compromise Requirements (A-FI-08-031)*." We acknowledge that with any successful program, there are still opportunities for improvement. I agree with the recommendations presented in this draft report, and offer the following actions that Financial Management Service (FMS) will take:

Recommendation #1:

FMS should take action to ensure that Diversified conducts additional training or takes other corrective action to ensure that its employees properly document the steps taken prior to compromise.

FMS' response:

Debt Management Services has been focusing on increasing the Private Collection Agencies' (PCA) compliance with this requirement. On September 16-17, 2008, the Private Collection Division (PCD) hosted a Debt Collection Forum for representatives of each of the 5 PCAs under the current contract. A major area of focus was on the payment agreement standards and the requirement to document each step in the negotiation process before proceeding to the next. PCD staff discussed the requirements of the PCA contract and Operations and Procedures Manual in detail, as well as, reminded attendees of the requirements outlined in federal regulations, particularly the Federal Claims Collection Standards. During compliance reviews, PCD will verify each PCA conducted additional training based on the Debt Collection Forum discussions. PCD is also considering traveling to each of the current contractors' sites and training the collection staff directly.

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Recommendation #2:

FMS should take action to ensure that Diversified sends and retains copies of compromise agreement letters in each case where a compromise is reached.

FMS' response:

As part of each PCA's annual compliance review, PCD reviews compromise agreements to ensure that a letter detailing the terms of the agreement was sent to the debtor. In cases where there is a finding, the PCA is required to respond to FMS in writing. PCD will continue to review each PCA's files to ensure compromise agreement letters were sent.

Thank you for the opportunity to comment on this draft OIG report. If you have any questions or wish to discuss these comments in more detail, please contact Rita Bratcher, Assistant Commissioner, Debt Management Services, on (202) 874-3810.

Sincerely,

Judith R. Tillman

Appendix 5
Major Contributors to This Report

Michael J. Maloney, Director, Fiscal Service Audits
Maria V. Carmona, Audit Manager
Kenneth G. Dion, Audit Manager
Horace A. Bryan, Auditor
Gerald H. Kelly, Auditor
Myung G. Han, Management Analyst
Jenny Hu, Referencer
Gerald J. Steere, Referencer

Department of the Treasury

Office of Strategic Planning and Performance Management
Office of Accounting and Internal Control

Financial Management Service

Assistant Commissioner, Debt Management Services
Director, Finance and Internal Control Division
Manager, Internal Control Branch (OIG Liaison)

Office of Management and Budget

OIG Budget Examiner