

OSBM

**COST OF COLLECTING CIVIL PENALTIES  
FOR PUBLIC SCHOOLS**

**Management Study**

**As Directed by Session Law 2005-276, Section 6.37(w)**

**May 2006**



*Prepared By:*

*Office of State Budget and Management*

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# INTRODUCTION

## *Scope of Study*

The Office of State Budget and Management (OSBM) was directed by the General Assembly in Section 6.37(w) of Session Law 2005-276 to develop a methodology for computing the actual costs of collecting civil penalties by State departments and agencies.

## *Methodology*

In conducting the study, the OSBM study team performed the following tasks:

- Reviewed General Statutes related to civil penalties.
- Surveyed all State departments, agencies, boards, and commissions<sup>1</sup> to determine whether they (1) collected civil penalties, (2) withheld actual collection costs, and (3) had performed a cost analysis of actual collection costs. Additionally, the survey asked the State agencies to identify the types of collection cost that they should be allowed to withhold.
- Obtained copies of the Civil Penalty Deposit forms submitted to the OSBM Fiscal Office from July 1, 2005 through December 31, 2005 to determine which State agencies were actually withholding collection cost.
- Obtained copies of the cost analysis that State agencies had prepared to document their actual costs of collecting civil penalties.
- Interviewed Chief Financial Officers and staff of several State agencies.
- Analyzed the survey responses, agencies' costs analysis, and deposit forms.

# BACKGROUND

General Statute 115C-457.1 created the Civil Penalty and Forfeiture Fund and required the OSBM to administer the Fund. According to the Statute, the Fund shall consist of the clear proceeds of all civil penalties, fines, assessments, and forfeitures<sup>2</sup> collected by State agencies. The Fund and all interest accrued to the Fund shall be faithfully used exclusively for maintaining free public schools.

Even though the civil penalties were earmarked for North Carolina's public school systems, some State agencies were not remitting the penalties they collected to OSBM for the Civil Penalty and Forfeiture Fund. Therefore, The North Carolina School Boards Association and several school systems<sup>3</sup> sued secretaries of State Departments, chancellors of the North Carolina University System, and the chairpersons and directors of various commissions and boards in December 1998 to force them to comply with General Statute 115C-457.1. In July 2005, the court ordered all State agencies that collect civil penalties to remit the clear proceeds of the penalties to North Carolina public schools. Section 6.37(v) of Session Law 2005-276 reaffirmed the General Statute by requiring civil penalty funds be submitted to OSBM on a monthly basis and allowing agencies to withhold the actual cost related to collecting civil penalties not to exceed 10 percent. The Session Law increases the collection cost that can be withheld to 20 percent beginning July 1, 2006.

The General Assembly estimated that the civil penalty collections would be \$120.5 and \$125.5 million in fiscal years 2005-06 and 2006-07, respectively. Table 1 on page 3 shows the primary sources of civil penalty collections for fiscal years 2005-06 and 2006-07.

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<sup>1</sup> For brevity, this study will use the term "State agency" or "State agencies" to refer to all of these entities.

<sup>2</sup> For brevity this study will use "civil penalty" or "civil penalties" rather than distinguishing between penalties, fines, assessments, and forfeitures.

<sup>3</sup> The school systems included Wake County Board of Education, Durham Public Schools Board of Education, Johnston County Board of Education, Buncombe County Board of Education, Edgecombe County Board of Education, and Lenoir County Board of Education.

**Estimated Civil Penalty Collections  
FYs 2005-06 and 2006-07, (Dollars in Millions)**

**Table 1**

State Agency	FY 2005-2006		FY 2006-2007	
	Funds	Percent	Funds	Percent
Department of Revenue	\$ 80.0	66.4%	\$ 85.0	67.7%
Department of Transportation	15.0	12.4%	15.0	12.0%
Employment Security Commission	3.0	2.5%	3.0	2.4%
Department of Insurance	3.0	2.5%	3.0	2.4%
University of North Carolina System	5.0	4.2%	5.0	4.0%
Other Agencies	14.5	12.0%	14.5	11.5%
Total Funds Available	\$ 120.5	100.0%	\$125.5	100.0%

Based on the estimated collections, the General Assembly budgeted approximately 85 percent of the collections for the State Public School Fund and the balance to the School Technology Fund. Table 2 shows the budgeted amounts for fiscal years 2005-06 and 2006-07.

**Civil Penalty Appropriations for Public Schools  
FYs 2005-06 and 2006-07, (Dollars in Millions)**

**Table 2**

Funds Use	FY 2005-2006		FY 2006-2007	
	Funds	Percent	Funds	Percent
State Public School Fund	102.5	85.1%	107.5	85.7%
School Technology Funds	\$18.0	14.9%	\$18.0	14.3%
Total Appropriation	\$120.5	100.0%	\$125.5	100.0%

## FINDINGS

### *Survey Results*

A survey was sent to all State agencies asking whether they: (1) collect civil penalties, (2) withhold collection cost from the civil penalty collections, and (3) have prepared a cost analysis to document the actual cost of collecting the penalties. The survey also asked agencies to identify the types of collection cost which agencies are withholding or should be allowed to withhold. Sixty-nine agencies responded with 39 indicating that they collect some type of civil penalty. Of the 39 agency responses:

- 12 agencies reported that they withheld collection cost based on actual cost.
- 9 agencies reported that they withheld collection cost based on the 10 percent allowed by General Statute 115C-457.2.
- 18 agencies reported that they do not withhold any collection costs.
- 14 agencies reported that they have prepared a cost analysis to support the amount of collection costs withheld.
- 25 agencies reported that they have not prepared a cost analysis or are not aware of an analysis being prepared.
- 701,811 collection actions were reported by the 39 agencies for fiscal year 2004-05.

In the survey instructions, we identified the types of collection cost which we considered specifically related to the collection of penalties, such as the billing, recording, receiving, and recovery of civil penalties. We also identified costs which agencies may incur that are related to their normal duties and responsibilities and the imposition of penalties; and therefore should not be included as collection cost. These costs included law enforcement, inspections, regulatory compliance, and collection of taxes and fees. The types of costs which the 39 agencies reported as being related to their cost of collecting civil penalties varied considerably. A composite list of cost categories identified by the agencies follows:

- Administrative and clerical salaries and benefits

- Enforcement officers salaries and benefits
- Officer uniforms, equipment, and supplies
- Vehicles
- Maintenance and fuel for vehicles
- Office supplies
- Computer hardware, software, and supplies
- Postage
- Printing
- Collection agency fees
- Utilities
- Rent/lease
- Returned checks
- Travel
- Building maintenance
- Contracts
- Other (professional development, radios, batteries, charge card fees, and long distance phone calls)

### *Quality of Cost Analysis*

For the 14 agencies that reported preparing a cost analysis, we requested copies of their analyses. Six agencies—the Department of Transportation (DOT) and five universities —provided copies of their cost analyses. The DOT analysis showed that collection costs (\$2.2 million) were 30 percent of the \$7.5 million of penalties collected during the period of July through December 2005. Eighty-four percent of the collection costs were attributed to contract labor and computer usage.

For the five universities, several of the cost categories which we consider related to the normal duties and responsibilities of the universities police force were included in their cost analyses. For example:

- Four included the salaries of enforcement officers,
- Three included the cost of officer uniforms and equipment,
- Three included the cost of maintenance and fuel for enforcement vehicles,
- One included the cost of enforcement vehicles, and
- One included maintenance agreements and hand held ticket writers.

The collection costs in the five universities’ cost analyses ranged from 59 to 130 percent of the total civil penalties collected by each university for the July to December 2005 period.

The North Carolina University System also compiled collection cost data for all 16 universities for fiscal year 2004-05. The analysis included three broad cost categories—officer salaries, office staff salaries, and other costs<sup>4</sup>. Chart 1 shows the dollar amounts and percents for the three cost categories for the 16 universities.

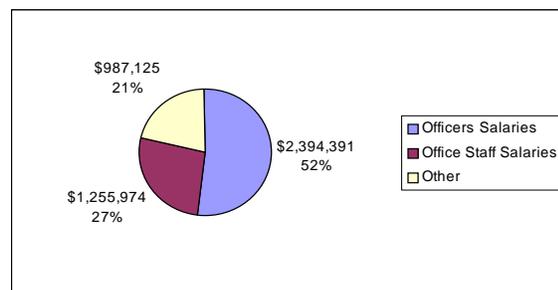
The majority of the collection costs included by the universities is also related to the performance of their normal duties and responsibilities, and therefore, should not be included as costs of collecting civil penalties.

### *Civil Penalty Collections*

As of March 31, 2006, civil penalty collections are significantly less than estimated for fiscal

**Civil Penalty Collection Cost  
North Carolina University System  
Fiscal Year 2004-05**

**Chart 1**



<sup>4</sup> Includes fuel and maintenance for enforcement vehicles, equipment and uniforms for officers, printing, postage, and collection agency fees.

year 2005-06. During the first 9 months of fiscal year 2005-06 the OSBM received \$63.4 million in civil penalty collections from State agencies. Based on the amount of civil penalties budgeted by the General Assembly, \$90.4 million should have been received for the 9-month period. Table 3 shows the actual collections for the first 9 months compared with the projected collections for the same period.

**Projected vs. Actual Civil Penalty Collections  
July 2005 – March 2006**

**Table 3**

Department/ Agency	Budgeted FY 2005-06	Projected Collections <sup>a</sup>	Actual Collections	Percent of Budgeted
Revenue	\$ 80,000,000	\$60,000,000	\$38,899,793	48.6%
Transportation	\$ 15,000,000	\$ 11,250,000	\$11,837,857	78.9%
University of North Carolina System	\$ 5,000,000	\$ 3,750,000	\$2,995,469	59.9%
Justice	\$ 4,115,625	\$ 3,086,719	\$ 442,163	10.7%
Environment and Natural Resources	\$ 3,175,125	\$ 2,381,344	\$ 3,093,628	97.4%
Employment Security Commission	\$ 3,000,000	\$ 2,250,000	\$ 2,556,892	85.2%
Insurance	\$ 3,000,000	\$ 2,250,000	\$ 375,412	12.5%
Labor	\$ 2,338,173	\$ 1,753,630	\$ 1,526,798	65.3%
Commerce	\$ 1,818,457	\$ 1,363,843	\$ 873,404	48.0%
Agriculture	\$ 401,268	\$ 300,951	\$ 229,307	57.1%
All Others <sup>b</sup>	\$ 2,651,352	\$ 1,988,514	\$ 587,390	22.2%
<b>Total</b>	<b>\$120,500,000</b>	<b>\$90,375,000</b>	<b>\$63,418,112</b>	<b>52.6%</b>
<sup>a</sup> Projected collections are based on 75.0% (9 months) of the budgeted amount for the fiscal year. <sup>b</sup> Includes Department of State, Department of Health and Human Services, Board Of Elections, Office of State Controller, Board Of Cosmetic Art, Board of Opticians, Auctioneer, and miscellaneous.				

Many agencies are not withholding any collection costs from their civil penalty collections because they incur little or no costs in collecting the penalties. Others have decided that it is not worth the effort to prepare a cost analysis to document their collection costs. An analysis of 121 civil penalty deposits submitted to OSBM from July to December 2005, representing 28 agencies, showed that 12 agencies (42.9%) did not withhold any collection costs. For the \$13.3 million in collections during this period, only \$171,303 (1.3 percent) was withheld as collection costs by State agencies. If all of the agencies had withheld the allowable 10 percent, the total collection costs would have been \$1.3 million, a million dollars more than the amount actually withheld.

***Department of Revenue***

The Department of Revenue's primary function is the collection of taxes for the State of North Carolina. In addition to collecting personal and corporate income taxes, the Department collects more than 20 other taxes, such as franchise, sales, use, tobacco, and motor fuel taxes. When taxpayers fail to file and/or pay their taxes, pay late, or violate the State tax laws in some way, the Department determines the amount of taxes owed and assesses various penalties ranging from 5 to 50 percent of the amount of taxes due. In some instances dollar amounts are assessed for each violation rather than a percentage. Table 4 on page 6 shows the different types of penalties collected by the Department.

**Types of Civil Penalties Assessed by the Department of Revenue**

**Table 4**

<b>Type of Penalty</b>	<b>Civil Penalty Amount</b>	<b>Description</b>
Bad Check	10%	Minimum of \$1 and maximum of \$1,000
Bad Electronic Transfer	10%	Minimum of \$1 and maximum of \$1,000
Payment w/Wrong Form	5%	Minimum of \$1 and maximum of \$1,000
Failure to Obtain License	5% – 25%	5% per month, not to exceed 25%, and not less than \$5
Failure to File Return	5% – 25%	5% per month, not to exceed 25%, and not less than \$5
Failure to Pay Tax When Due	10%	Not less than \$5
Finding of Negligence	10%	
Large Individual Income Tax Deficiency	25%	Underestimation of taxable income by 25% or more of gross income; assess penalty of 25% of deficiency
Other Large Tax Deficiency	25%	Underestimation of tax liability by 25% or more, assess penalty of 25% of deficiency
Misuse of Exemption Certificate	\$250	An exemption certificate authorizes a retailer to sell tangible personal property to certificate holder at preferred tax rate
Road Tax Understatement	0%	Understatement of road tax liability by 25% or more results in a penalty of two times the amount of the deficiency
Fraud	50%	Deficiency or delinquency because of fraud
Attempts to Evade or Defeat Tax	0%	Class H felony
Willful Failure to Collect, Withhold or Pay Tax	0%	Class 1 misdemeanor
Willful Failure to File Return, Supply Information or Pay Tax	0%	Class 1 misdemeanor
Aid or Assistance in Preparing False or Fraudulent Returns	0%	Class C felony if fraud of \$100,000 or more Class F felony if fraud is less than \$100,000 Class H if not covered by previous two categories
Failure to File Informational Return	\$50	
Filing Frivolous Return	Up to \$500	Failure to provide sufficient information or evidence to delay, impede, or negate revenue laws
Misrepresentation Concerning Payment	0%	Class F felony
Motor Carrier	\$100	Failure to carry registration card Failure to display and identification marker Unable to account for identification marker
Motor Carrier	\$1,000	Displays identification marker on motor vehicle that was not issued to the carrier
Transport of Motor Fuel by Transport Truck or Railroad Tank	\$5,000	Plus any assessed motor fuel tax
Transport Fuel by Tank Wagon	\$1,000	Plus any assessed motor fuel tax
Highway Use of Dyed Diesel or Other Non-Tax Paid Fuel	\$1,000	Greater of \$1,000 or five times the amount of motor fuel tax payable on fuel in the supply tank; plus any assessed motor fuel tax
Buying or Selling Non-Tax Paid Motor Fuel	\$250 per occurrence	Assessed against person who dispenses non-tax paid motor fuel or allows such fuel to be dispensed
Motor Fuel Sample	\$1,000	Refusing to allow the taking of a motor fuel sample
Source: General Statutes 105-236, 105-449.52, 105-449.115, 105-449.115A, 105-449.117, 105-449.118, and 105-449.118A		

In collecting the taxes, interest, and penalties, the Department of Revenue goes through a series of collection actions, such as notifying taxpayers of their tax liability, sending revenue agents to locate the taxpayers and collect the taxes, interest, and penalties, and initiating legal actions against the taxpayer. Costs incurred by the Department in collecting taxes, interest, and penalties include salaries and benefits of revenue agents and processing and administrative staff, postage, travel, administrative supplies, computer time and supplies, office rent, and legal resources. Because all of these expenses are related to the

collection of taxes, interest, and penalties, the process of identifying the costs specifically related to the collection of the penalties would be virtually impossible.

## CONCLUSION

State agencies are currently allowed to withhold the costs of collecting civil penalties, many agencies have elected to not withhold such costs. These agencies have determined that they have little or no collection costs or they have decided that it is not worth the effort to document their actual collection costs. Some agencies have not identified the costs of collecting civil penalties and, instead, are withholding the 10 percent currently allowed by General Statute 115C-457.1. Other agencies have prepared cost analyses that show their collection costs are significantly greater than 10 percent. A review of the cost analyses prepared by six State agencies indicated that many of the costs included in the agencies' cost analyses were related to the agencies' normal duties and responsibilities rather than being related to collecting civil penalties. We believe that only the costs specifically related to the collection of civil penalties should be withheld by agencies. Because the Department of Revenue is responsible for the collection of taxes, interest, and penalties, separating the cost of collecting civil penalties from the cost of collecting taxes and interest would be virtually impossible.

## RECOMMENDED METHODOLOGIES

Since State agencies use varying methods to determine the types of costs they withhold for collecting civil penalties, we recommend that agencies use OSBM's "Collection Cost Worksheet for Civil Penalties, Fines, and Forfeitures" to determine their civil penalties collection costs. The cost collection worksheet is shown in Appendix A. Agencies that elect to not withhold collection costs should not prepare the worksheet. Appendix B shows a sample worksheet with examples of allowable collection costs. Agencies must submit their "Collection Cost Worksheets" to OSBM and receive OSBM's approval by July 31, 2006, and annually thereafter. The collection costs included in the worksheet should only be costs specifically related to the billing, recording, receiving, and recovery of civil penalties. Costs related to the normal duties and responsibilities of the agency and the imposition of penalties; such as law enforcement, inspections, regulatory compliance, and collection of taxes and fees are not related to the actual collection of penalties, and therefore should not be included in the worksheet. Agencies should be able to support the costs included in the collection cost worksheet with personnel time sheets, invoices, and other relevant documentation. As of July 1, 2006, all collection costs withheld by State agencies should be based on the actual costs, not to exceed 20 percent, as required by General Statute 115C-457.1.

Because of the difficulty of separating the Department of Revenue's cost of collecting taxes, interest, and penalties, we recommend the Department apply the following formula at the end of the year to determine its cost of collecting civil penalties rather than prepare a cost analysis.

$$\frac{\text{Annual Civil Penalties Collected}}{\text{Gross Annual Receipts (taxes, interest, \& penalties)}} \times \text{Department of Revenue's Annual Expenditures}$$

## ACKNOWLEDGEMENTS

OSBM wishes to express its appreciation to the Department of Revenue, Department of Transportation, and the North Carolina University System, as well as all of the State agencies that responded to its survey, for their cooperation during this study.

# APPENDIX A

## Collection Cost Worksheet for Civil Penalties, Fines, and Forfeitures Fiscal Year \_\_\_\_\_

**Department** \_\_\_\_\_  
**Types of Penalties, Fines, & Forfeitures** \_\_\_\_\_  
**Contact Person** \_\_\_\_\_  
**Ph. Number** \_\_\_\_\_

<u>Type of Expenditure</u>	<u>Account Number</u>	<u>Amount</u>
<b>Personal Services (Identify)</b>		\$ -
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
<b>Purchased Services (Identify)</b>		\$ -
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
<b>Supplies (Identify)</b>		\$ -
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
<b>Property, Plant, &amp; Equipment (Identify)</b>		\$ -
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
<b>Other Expenditures (Identify)</b>		\$ -
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
<b>Total</b>		<u>\$ -</u>

**Total Collections for the Fiscal Year** \_\_\_\_\_

**Percent of Expenditures to Collections** \_\_\_\_\_

**OSBM Approval:** \_\_\_\_\_      \_\_\_\_\_      \_\_\_\_\_  
Signature
Percent
Date

## APPENDIX B

### Collection Cost Worksheet for Civil Penalties, Fines, and Forfeitures Fiscal Year 2005-06

**Department** North Carolina Department of Many Purposes  
**Types of Penalties, Fines, & Forfeitures** Parking Fines  
**Contact Person** Jane Doe  
**Ph. Number** 919-555-1234

<u>Type of Expenditure</u>	<u>Account Number</u>	<u>Amount</u>
<b>Personal Services (Identify)</b>		
Administrative Clerks (1.3 positions)	531111	\$ 32,676.00
ITS Technical (0.5 positions)	532111	\$ 30,000.00
<b>Purchased Services (Identify)</b>		
Electric Services (5%)	532210	\$ 300.00
Water & Sewer (5%)	532230	\$ 150.00
Building Lease (5%)	532512	\$ 1,200.00
<b>Supplies (Identify)</b>		
General Office Supplies (8%)	533110	\$ 400.00
Data Processing Supplies (12%)	533120	\$ 900.00
Other Administrative Supplies (5%)	533190	\$ 150.00
<b>Property, Plant, &amp; Equipment (Identify)</b>		
Voice Communications Equipment (10%)	534528	\$ 500.00
Personal Computers and Printers (10%)	534534	\$ 1,000.00
Server (5% of total)	534535	\$ 400.00
Other DP Equipment (5%)	534530	\$ 500.00
<b>Other Expenditures (Identify)</b>		
Collection Agency Fees	535940	\$ 2,000.00
		<b>Total</b> \$ <u>70,176.00</u>
<b>Total Collections for the Fiscal Year</b>	\$ 455,750.00	
<b>Percent of Expenditures to Collections</b>	15.40%	

**OSBM Approval:** \_\_\_\_\_  
Signature

15.40%  
 Percent

May 1, 2006  
 Date