

**A STUDY OF INTEREST USAGE
ON CHILD SUPPORT ARREARS
STATE OF COLORADO**

Final Report
June 1, 2000

Submitted to:

State of Colorado
Department of Human Services
Division of Child Support Enforcement
303 E. 17th Street, Suite 200
Denver, Colorado 80203

Submitted by:



Jane Venohr, Ph.D.
David Price, Ph.D.
Policy Studies Inc.
999 18th Street, Suite 1000
Denver, CO 80202
(303) 863-0900

Esther Griswold, M.A.,
Center for Policy Research
1570 Emerson Street
Denver, CO 80218
(303) 837-1555



Table of Contents

Chapter I.....	1
Chapter II - Experiences of Other States	5
Chapter III - Collections from Interest.....	37
Chapter IV - Costs of Interest	53
Chapter V - Conclusions and Recommendations	63

APPENDICES

Appendix I: State Statutes and Rules

Appendix II: Examples of Interest Notifications



EXHIBITS

Exhibit 1: Comparison of Interest Usage by States	6
Exhibit 2: States Interviewed for Study.....	8
Exhibit 3: Implementation of State Statutory Provisions Concerning Interest	10
Exhibit 4: Empirical or Quantitative Evidence Relating to Interest	15
Exhibit 5: Automated Interest Charges.....	20
Exhibit 6: Minnesota's Criteria for Interest Exemptions	21
Exhibit 7: Notification Practices by State	24
Exhibit 8: Advice from Other States	36
Exhibit 9: Number of Colorado Counties Assessing Interest.....	41
Exhibit 10: Projected Inflation in Accounts Receivable.....	43
Exhibit 11: Arrears per Case and Payment by Whether County Assesses Interest	45
Exhibit 12: Percent of Current Obligation Paid by Whether County Assesses Interest	47
Exhibit 13: Percent of Arrears Cases with Payments by Whether County Assesses Interest	50
Exhibit 14: Estimated Costs of Automating Interest for ACSES	58
Exhibit 15: Estimated Start-Up Costs for Automating Interest and Institution of a Statewide Policy	62
Exhibit 16: Annual Costs of Notification and Customer Service.....	62

Chapter I

Introduction

In 1999, the federal Office of Child Support Enforcement (OCSE) awarded the Colorado Department of Human Services, Division of Child Support Enforcement (CSE) a grant to study the effects of charging interest on child support arrears. In turn, CSE contracted with Policy Studies Inc. (PSI) and the Center for Policy Research (CPR) to conduct the study and make recommendations for a statewide, interest policy. Currently, interest usage varies between Colorado counties.

The study focuses on:

- ❖ The effects of assessing interest statewide on staff, equipment and resources, including the costs of automation; and
- ❖ The potential effects of assessing interest on collections, accounts receivable and obligor payment behavior.

The report also addresses other issues related to interest such as how to:

- ❖ implement the interest function;
- ❖ notify obligors of interest charges;
- ❖ distribute interest payments,
- ❖ ensure fairness to the child, custodial parent, and noncustodial parent; and
- ❖ make use of alternatives to assessing interest, such as fees and interest amnesty programs.

These issues are addressed by examining other states' experiences with interest, how current interest usage affects payment in Colorado as well as in other states, and other cost information.

Federal Regulations

Historically, interest has not received much attention at the federal level.



For example, we have found nothing in writing from OCSE on how interest should be calculated. We have, however, found some guidance on how it should be distributed. Federal rules state that if accrued interest attaches to the support debt, it becomes “child support” and subject to the same distribution, federal incentive payments and collection remedies. Interest must follow the same complex distribution rules as arrearages that require separate tracking of six categories of assigned and unassigned arrears. Yet, it is up to the State to determine whether to apply collections to interest or principal first within a mandated arrearage category.¹

Since all states have adopted the Uniform Interstate Family Support Act (UIFSA), state differences in arrearage and interest calculation have recently become an issue. UIFSA requires the responding state to enforce the order of the initiating state.

The law of the issuing state governs the nature, extent, amount, and duration of current payments and other obligations of support and the payment of arrearages under the order. [§604(a)]

This has been interpreted that the responding state, regardless of whether the responding state assesses interest on its orders, must collect and enforce interest if the issuing state assesses interest.²

The Interstate Reform Workgroup is reviewing whether a uniform policy of arrears and interest calculations is necessary for UIFSA. Appointed by the federal OCSE in 1999, the Interstate Reform Workgroup will recommend what uniform standards for collection, disbursement, distribution and case processing, and improved accounting would ease UIFSA/IV-D case processing across states. Interest is just one of the many issues they are considering. To our knowledge, a release of their recommendations has not yet been scheduled.

Another current policy issue that may affect interest is child support passthrough. Representative Benjamin Cardin (D-Maryland) has introduced legislation that would pass all child support paid on to TANF recipients and eliminate the complex distribution scheme. This could indirectly affect interest by requiring that all interest payments go to

¹ Federal Office of Child Support Enforcement Action Transmittal 98-24.

² See *OCSE Region IX-X State: 1998 Bi-Regional Report*, Bi-Regional Conference, San Francisco, CA, Appendix B.

the family, rather than some of it being assigned to the State through the current distribution rules.

Colorado Law, Policy and Practices

The CSE system in Colorado is state-supervised, county administered. Counties have the discretion to assess, or decline to assess, interest on arrears. Colorado law currently provides that “Interest per annum at four percent greater than the statutory rate set forth in §5-12-101, C.R.S., on any arrearages and child support debt due and owing may be compounded monthly and may be collected by the judgment creditor” (§14-14-106 C.R.S.).³ Effectively, the interest rate is 12%. Yet, the interest rate has changed several times since 1963—from 6% to 8% to 12%—as has the method used to calculate interest—from simple per annum to compounded annually to compounded monthly. This statute and CSE policies pertaining to interest are provided in Appendix I.

The Colorado Department of Human Services Child Support Enforcement Staff Manual Volume VI [9CCR 2504-1 §6.805.4] further specify that interest should be considered support and collections on it should be used to reduce unpaid public assistance or paid to the family for non-IV-A cases.

A 1999 performance audit of the Child Support Enforcement Program by the Colorado Office of the State Auditor included a limited assessment of interest usage and recommendations about how to improve that use.⁴ When the Auditor's report was released, this study was just beginning. Thus, the auditors did not have the benefit of this study's findings in developing their recommendations. Nevertheless, one of the recommendations was to review this study's findings to determine how best to use interest in the State.

The interest functions on ACSES, the statewide child support enforcement automated system, are limited. ACSES does not automatically calculate interest and does not track interest arrears and principal arrears separately. However, technicians can add interest charges to the ACSES ledger on a current delinquency or on judgment and non-judgment arrears. The county technician is responsible for the interest calculation. Some counties

³ Absent an agreement or provision of a statutory rate, it is set at 8%. (§5-12-101 C.R.S.)

⁴ Office of the State Auditor, *Child Support Enforcement, Department of Human Services Performance Audit: June 1999*. Colorado Legislative Audit Committee, Denver, Colorado.



use a software package to calculate interest (either their own or off-the-shelf, commercial software); others calculate it manually.

ACSES contains reason codes that can be used for interest adjustments. State administrators believed these codes were used infrequently so they developed a memorandum in May 1999 clarifying the procedure for entering interest on ACSES. In a survey we administered in October 1999, all counties assessing interest reported that they follow state procedure on this issue.

County Interest Usage

Somewhat less than half of Colorado counties currently assess interest. Among these counties, most do not calculate interest monthly on all arrears cases. Instead, they typically assess interest at the time of a child support action (e.g., entering a judgment, negotiating a lump-sum payment, or conducting other actions requiring a calculation of arrears or unpaid public assistance). Several of the counties that assess interest are frustrated that the calculation is not part of the statewide-automated system.

County perceptions about assessing interest vary widely. Some believe it to be effective, while others do not. To further complicate the issue, some believe it *could* be effective or could be more effective with automation and notification. Even with these improvements, however, there is still a faction that does not believe interest could ever be effective.

Report Organization

The remainder of this report is divided into four chapters. In Chapter II, we examine other states' experiences with interest. Chapter III examines how interest affects payment behavior. The costs of implementing statewide interest, statewide automation and notification are estimated in Chapter IV. Conclusions and recommendations are provided in Chapter V.

Chapter II

Experiences of Other States

This chapter focuses on the results of a detailed telephone survey of selected State CSE agencies regarding their philosophies, experiences, and practices around interest. Prior to discussing the results, we provide an overview of all state interest practices and a discussion of the survey design. The remainder of this chapter discusses the specific results of the survey. This includes discussions of:

- ✓ the factors contributing to each state's decisions to charge or not charge interest;
- ✓ what factors appear to contribute to effective interest charges in other states; and
- ✓ the challenges other states have faced with interest usage and how these challenges were overcome.

This chapter concludes with a summary and recommendations from other states.

PRIOR STUDIES OF STATE PRACTICES

We know of only one study analyzing state-by-state interest practices. In 1998, the Region VIII Office of Child Support Enforcement surveyed states and found that states are as varied in their interest usage as are Colorado counties. As shown in Exhibit 1, about half (47 percent) of the states assess interest. Most (about three quarters) of the assessing states have only recently begun to charge and collect interest, a task made easier by implementation of statewide automated systems. The remaining states have always charged interest.

The Region VIII survey also asked states whether they believed interest charges encouraged payment of current support and whether it was cost effective. The states charging interest were evenly split on the question of whether interest encourages payments of current support. Slightly more than half the states that assess interest said it is cost effective to do so. States did not document the basis for their answers.



**Exhibit 1
Comparison of Interest Usage by States¹**

State	Does State Currently Charge Interest?	Remarks
Alabama	Yes, recently started	
Alaska	Yes, always did	
Arizona	Yes, always did	
Arkansas	No	
California	Yes	Counties vary in their approach
Colorado	Varies by county	
Connecticut	No	
Delaware	No	
District of Columbia	No response	
Florida	Yes, always did	
Georgia	Yes, recently started	
Hawaii	No	
Idaho	No	
Illinois	No	
Indiana	Yes, recently started	Decision to assess interest not made by CSE agency
Iowa	No	
Kansas	No Response	
Kentucky	No	
Louisiana	No	
Maine	No Response	
Maryland	Yes, recently started	
Massachusetts	Yes, recently started	
Michigan	No	Imposes a surcharge
Minnesota	Yes, recently started	
Mississippi	Yes, recently started	
Missouri	No	State Statute (Chapter 454) allows interest charges
Montana	No	
Nebraska	Yes, always did	
Nevada	No	
New Hampshire	No	
New Jersey	Yes, always did	
New Mexico	Yes, recently started	reported an amnesty program
New York	Yes, recently started	
North Carolina	No	
North Dakota	No Response	
Ohio	Yes, always did	
Oklahoma	Yes, recently started	Reported an amnesty program
Oregon	Yes, recently started	Decision to assess interest not made by CSE agency
Pennsylvania	No	Permits individual counties to charge interest
Rhode Island	Yes, recently started	Reported a 10% increase in collections
South Carolina	No	
South Dakota	No	
Tennessee	No	

Exhibit 1 Comparison of Interest Usage by States ¹		
State	Does State Currently Charge Interest?	Remarks
Texas	Yes, recently started	
Utah	No, but used to	
Vermont	No response	
Virginia	Yes, recently started	
Washington	No	State Statute (Title 26) states that interest may be charged
West Virginia	Yes, recently started	
Wisconsin	Yes, recently started	
Wyoming	Yes, recently started	
TOTAL NUMBER OF STATES	Yes, always did = 18 Yes, recently started = 6 Other = 1 No = 21 No Response = 5	

¹Based on spreadsheets prepared by Region VIII staff and updated by PSI/CPR staff.

For those states that do not charge interest, their reasons for not charging interest included: (1) interest is administratively complex or burdensome, (2) the state's automated system cannot handle interest, and (3) collecting interest is not cost effective. Several states indicated that charging interest is under consideration.

SURVEY DESIGN

The survey we administered was designed to expand upon the findings of the Region VIII survey. One objective was to provide further insight on why some states thought interest was cost effective whereas others did not. Another objective was to draw from a range of state experiences; whether they recently added interest to their automated system, discontinued charging interest, or developed a relatively trouble-free system of assessment and distribution.

The contractual agreement was to survey 13 states, but because of the diversity of experiences, we interviewed 19 state Child Support Enforcement agencies. Exhibit 2 lists these states. The states selected represented a diversity of approaches and beliefs about interest charges. Preferences were also given to county-administered programs.

Representatives from these states were interviewed by telephone during the summer of 1999. Each interview lasted approximately one hour. It involved a series of forced-choice and open-ended questions covering a range of topics, including policies and



procedures; automation; and outcomes, benefits and costs. CSE interviewees were asked if they had knowledge or data regarding the influence of interest on payment behavior, and on the cost of implementing and managing interest. Respondents were also queried about their agency’s experience with adding interest to an automated system, or beginning an interest program when starting up a new automated system. CSE representatives who were interviewed were generous in sharing agency notices, training materials, and their own work experiences with the interviewer.

Exhibit 2 States Interviewed for Study		
Charges Interest Statewide	Interest Is Not Charged Statewide	Does Not Charge Interest
1. Alabama	11. Indiana (must be ordered by judge)	16. Michigan (uses surcharge in lieu of interest)
2. Arizona	12. Nebraska (administered through County courts)	17. Pennsylvania
3. Massachusetts	13. New Jersey (must be ordered by Board of Social Services or custodial parent)	18. Washington
4. Minnesota	14. New York (County office must reduce arrears to judgment)	19. Utah
5. New Mexico	15. Oregon (if custodial parent initiates it)	
6. Oklahoma (in process of implementation)		
7. Rhode Island		
8. Texas		
9. Virginia		
10. West Virginia		

WHY CHARGE INTEREST?

As shown in Exhibit 2, ten of the 19 states interviewed charge and collect interest on arrears statewide on all cases with some minor case exceptions. Interest is not charged statewide in five of the states interviewed, but is charged on an individual case basis if it is ordered, is pursued by the custodial parent, is reduced to judgment or meets some other criteria. Exhibit 2 also shows that we interviewed four states that do not charge interest.

Generally, states reported that their decisions to charge and collect interest, as well as to charge interest statewide, were based on four factors:

- ✓ statutory provisions;
- ✓ statewide automation capability and costs;

- ✓ moral issues; and
- ✓ likely effects on payments.

Whether the state has provisions mandating interest charges is the most significant factor contributing to a state's decision to charge interest. In turn, this has also resulted in statewide automation of interest. In other states where interest charges are permitted, the capacity to charge interest and the costs of automating interest appear to be primary considerations. Other factors considered by states in the decision to charge interest involve moral issues (i.e., child support arrearages should be subject to interest just as consumer debts are) and the likely effects on payments. These factors are discussed in greater detail below.

Statutory Provisions

Some states' statutes *permit* interest charges, whereas other states *mandate* interest charges. As shown in Exhibit 3, every state interviewed for this study has, at a minimum, a statute permitting or mandating that interest be charged on debts reduced to judgments. In addition, many states have statutes authorizing the state CSE agency to assess interest on arrears. New York requires that CSE first reduce arrears to judgment through a court process before assessing interest. Texas, in contrast, has statutes dictating that interest accrue on both pre-judgment and post-judgment arrears. Most states do not distinguish between pre- and post-judgment arrears, and authorize interest to be assessed on past due child support.

Statewide Automation Capability and Costs

The interaction between a state CSE automated system's capacity to assess interest and the state's interest policy is partly reflected by those states that have statutory provisions permitting interest charges but do not assess or calculate interest statewide. For example, the states of New Jersey, Oregon and Indiana have policies whereby entities other than the child support agency have the authority to request or assess interest on arrears. Neither New Jersey nor Oregon has statewide automated capabilities for tracking interest. In the case of Indiana, judges and courts set the interest rate, using a variety of methods of calculation.



Exhibit 3 Implementation of State Statutory Provisions Concerning Interest		
STATE	DOES STATE CSE CHARGE INTEREST?	STATE STATUTE ON INTEREST
Alabama	yes	Post-judgment interest is statutory entitlement.
Arizona	yes	Post-judgment interest is statutory entitlement.
Indiana	only if ordered and at county discretion	General judgment statute; child support statutes allow interest.
Michigan	no	“a surcharge shall be added to support payments that are past due” Ch.552
Massachusetts	yes	“Interest and penalties shall be assessed annually if...” T.830
Minnesota	yes	“interest accrues from the date the unpaid amount due is greater than the current support due” T.548
Nebraska	county decision	“All delinquent child support payments shall draw interest”T.42
New Mexico	yes	Post-judgment interest on past-due child support is mandatory.
New Jersey	Only if ordered	“the state IV-D agency shall have the authority to assess interest on any support order not paid within... “ T.9
New York	only if reduced to judgment	“judgment shall provide for the payment of interest if ...” Ch.14
Oklahoma	yes	“Court ordered child support payments shall draw interest” T.43
Oregon	only if initiated through CP	“Support order may include interest” T.25
Pennsylvania	no	General judgment statute
Rhode Island	only if reduced to judgment	Post-judgment interest on past-due child support shall accrue.
Texas	yes	“interest accrues on an unpaid child support obligation prior to judgment at the rate of and any unpaid judgment amount” T.157
Utah	no	General judgment statute.
Virginia	yes	“Interest at the judgment interest rate shall be collected” T.63
Washington	no	“child support may assess and collect interest “ T.26
West Virginia	yes	“the court shall enter judgment for such arrears and award interest from the due date” T.48

The Michigan CSE program, which is not fully automated throughout the state at this time, has devised a unique solution to the difficulties associated with interest and automation. In 1996, CSE developed a program to exempt child support cases from judgments rather than deal with the complicated state formula for calculating interest on

debt reduced to judgment.⁵ In lieu of assessing interest, the agency imposes a surcharge on past due support. On January 1 and July 1 of each year, a surcharge calculated at an 8% annual rate is added to support payments that are past due as of those dates, less two weeks' support. The surcharge policy states clearly "A support order shall not accrue interest" (M.S.A. 552.603 [7]).

Washington is another state that has elected not to assess interest. According to CSE administrators, the statewide-automated system is old but very effective. However, it was not designed to handle interest. The Washington CSE agency has determined that assessing interest would not be cost effective, in part because adding interest to the automated system could only be done at great expense. The cost rationale of Washington CSE is discussed in more detail later in this chapter.

Utah is the one state participating in this survey that collected interest in the past but stopped the practice. The policy of Utah CSE, as stated in its "Notice of Services" is that the agency only collects interest "if it is listed as a specific dollar amount in a judgment." The state interest rate on debt reduced to judgment has changed several times, and in 1993 the state adopted the federal post-judgment rate plus 2% as its interest rate. Because the CSE automated system lacks the capability to calculate the rate variations, the agency stopped charging interest on judgments.

Moral Issues

Several respondents labeled charging interest as "the right thing to do" because children need whatever support can be collected, and because paying interest on debts is something all Americans understand.

Interest is a fairness issue...the obligee is due a certain amount of money at certain times. If the money is not paid timely, the obligee should be recompensed.

It would be criminal *not* to collect interest. For one thing, it builds credibility and respect for the agency. For another, an agency is open to lawsuits if it doesn't charge interest.

⁵The interest rate in Michigan for judgment is linked to the variable Treasury-bill.



Although some states hoped to see an increase in collections with the implementation of interest assessment (and the interviewees thought this had happened), this was never the primary reason given for charging interest. Many of the interviewees cited “affecting payment behavior” as the rationale for interest, even while expressing uncertainty that it makes a difference.

We charge interest in order to send a message that if a person does not keep current with payments, he will owe more -- but it probably drives some obligors away, if they really can't pay the arrears.

Effects of Interest on Payments

Only about a quarter of the states mentioned that the effects of interest on payments were factored into their decision to charge interest. Most of these states hoped that interest would improve payment behavior, but few had collected any empirical evidence. Only one state (Oregon) had put the decision to charge interest in the context of a cost-benefit study.

Nonetheless, most of the interviewees held two perspectives on how interest affects payment behavior:

- ❖ Equating child support debt with consumer debt, charging interest encourages timely and regular payments by obligors. According to this line of thinking, obligors will tend to ignore or dismiss child support payments unless support is placed on a par with other debts.
- ❖ Charging interest causes obligors who are unwilling or unable to pay to build up a huge debt that will never be paid.

Many participants had anecdotes relating to both perspectives. For example, one respondent said that while he has observed obligors who try to pay off arrears quickly to avoid paying interest, he has seen even more obligors who lose hope of ever paying off the arrears when interest begins to accrue. Yet another respondent said, “We expected and hoped that charging interest would improve payment behavior, but we don't have any indication that it does. Sometimes it incites the obligor to more anger, and makes the relationship of the CP and NCP even more difficult.” In contrast, several respondents

said that in their states the introduction of assessing interest had not created any kind of hostile response, and that “people just accept it.” An advocate for interest argued, “It is well known that people always pay the most demanding bills (meaning the ones with the highest interest rates) first, and ignore the less harsh ones.” Therefore, this person believes that interest does make a difference, and CSE agencies should not be afraid to assess interest at a hefty rate.

Relevant Findings from IRS Study

Without empirical data regarding the impact of interest on payment behavior, it is difficult to reconcile these perspectives—or at least determine which outweighs the other. However, a recent report analyzing the \$214 billion in unpaid assessments of the IRS as of 1997 contributes to the discussion.⁶ The GAO reviewed 1997 unpaid assessments to determine whether the classification and balances of the unpaid assessments were accurate, and to estimate the amount of taxes receivable that the IRS could anticipate collecting. More than one third (36 percent) of the unpaid assessments were considered to be uncollectible. In 22 percent of the unpaid assessments neither the taxpayers nor a court agreed with the IRS that these taxes were owed to the government. Researchers found that among these cases, there was little or no payment activity. This led researchers to conclude that, “Based on our sample, we found that taxpayers who do not agree that they owe the IRS usually do not make payments” (GAO 1998:12). Cases which were more likely to be collected were defined by (a) evidence of regular payment, (b) the ability or willingness of the taxpayer to pay, and (c) the newness of the debt. If it had accrued within the past four years, the debt was more likely to be paid.

This distinction between people who are willing to pay and those who will not pay because they disagree that they owe something was also made by state CSE respondents during the survey interviews. “For some obligors, interest doesn’t matter, because they are not going to pay (voluntarily) anyway.” But for other obligors, the threat of interventions such as interest does act as a deterrent to non-compliance. These obligors would be the equivalent of the taxpayers who have paid in the past, who have the ability or willingness to pay, and who have a fairly new debt.

⁶United States General Accounting Office, 1998. Internal Revenue Service: Composition and Collectibility of Unpaid Assessments. GAO/AIMD-99-12. Washington DC: U.S. Government Printing Office.



Empirical Evidence

As shown in Exhibit 4, few states could provide empirical or quantitative evidence corroborating their beliefs concerning the theoretical impact of interest or on the collections and costs relating to interest. The most detailed information comes from Virginia. In one year, Virginia was able to collect about \$0.5 million of their \$80 million interest debt or about 0.6%. Virginia's collection rate on all past due child support is about 11%. Principal is satisfied first then interest for each disbursement category.

Exhibit 4	
Empirical or Quantitative Evidence Relating to Interest	
Evidence Relating to Collections	Evidence Relating to Costs
<ul style="list-style-type: none">❖ Massachusetts new interest program (1999) generated payments averaging \$400 each from 2,000 obligors❖ In 1999, 7.6% of Minnesota's Child Support debt is interest. Total interest debt is about \$70 million. Interest and arrears totals about \$900 million. About 70% of the interest debt is public assistance.❖ Oregon (1994) estimated that interest accrued on all cases for a 20-year period was about \$400 million❖ Oregon (1994) estimated that less than 1% of the \$400 million would likely be collected over 5 years❖ Virginia notification (1995) resulted in payment from 27,000 obligors❖ Virginia has accrued about \$80 million in interest debt since 1995. Average interest owed is about \$400 per subaccount❖ Virginia collects from about 15% of the subaccounts with interest assessment. The average collection on these subaccounts is about 4%. In one year, they collected about \$0.5 million in interest (0.6% of the interest due)	<ul style="list-style-type: none">❖ New York devoted 3 f-t staff for six months to develop and test automated interest❖ Washington (1993) estimated the cost of reprogramming necessary to automate interest is more than \$2 million. Estimate included "lost collections" from staff effort being rerouted to the automation efforts❖ Washington (1993) estimated the cost of calculating interest for each case to be entered on the automated system would be more than \$24 million❖ Iowa (1992) estimated the cost of automating interest to be \$50,000❖ Iowa (1992) estimated the cost of developing policy, procedure and system requirements would be \$27,000

Although Minnesota does not have collection information, its information provides some insight on whether interest inflates arrears. Interest comprises about 7% of all arrears. The majority (70%) is owed to public assistance.

Several interviewees described considerable staff investment in preparing for an interest program. In New York, for example, three people devoted six months full-time to developing and testing the interest component for the automated system. Another state created an interest work group to develop business rules at the time of conversion. Massachusetts policy staff spent months working out the details before announcing the program.

When Virginia CSE began assessing interest in 1995, the agency mailed a notice to all noncustodial parents, informing them that interest would be charged on past due child support obligations, and describing other enforcement remedies which could be applied, such as driver's license suspension. According to the survey respondent, this notice generated payment activity by approximately 27,000 obligors who had not paid child support in the three previous months. Likewise, when Massachusetts announced its new interest program this year, more than 2,000 obligors responded by sending in payments, averaging \$400. In summary, based on the experiences of Virginia and Massachusetts, notification has a positive effect on payment behavior.

Respondents from states that recently experienced system conversions described extensive loss of staff time and loss of income, but they could not separate out the cost of interest from the cost of other problems, except to say that programming for interest complicates the conversion process.

When asked if they believed interest had a positive impact on collections, most interviewees were cautious. Although a few people thought interest had increased the state's collections, they explained they had no evidence to support their theory. The general response was that it is impossible to sort out the impact of interest from other remedies. Thus, the surveyed states that are assessing interest have not analyzed the economic impact of the program. However, three states—Iowa, Washington and Oregon—have conducted studies to estimate the costs and benefits of implementing interest.

Iowa. In 1992, Iowa CSE considered the cost of assessing interest or penalty charges on arrears as a way to increase compliance with child support obligations. Iowa statutes



allow an interest charge of up to 10 percent per year on judgments. The agency's estimate of the costs to develop the policy and procedures and to reprogram the automated system for interest was \$77,000. For a late penalty program, the estimated cost was \$87,500. These estimates did not include the costs of system maintenance, increased case activity, or a public awareness campaign. An estimate of the return on the investment was not made.

Washington. In 1993, the Washington CSE Division weighed the costs of implementing an interest program. The state statute allows CSE to assess interest at 12 percent per annum, simple (RCW 26.23.030). Staff personnel estimated the costs to reprogram the information system to be more than \$2 million, much of which represented "lost collections" staff believed would occur during the time they were involved with training or developing, testing and implementing the program. Staff estimated it would take approximately 18 months, from the study phase to implementation, to complete the program. Additionally, Washington CSE projected it would cost more than \$24 million to retroactively calculate interest on all cases with arrears.⁷ From this information, CSE administrators determined that charging interest would not be cost effective. According to the CSE survey respondent, "We could define the costs fairly easily. But the benefits were indeterminate." We should note that Washington CSE only considered the approach to implementing interest which involved calculating each case retroactively. Alternative approaches to implementing interest are discussed in Chapter IV.

Oregon. Policy Studies Inc. (PSI) staff conducted research for the Oregon Department of Justice, Support Enforcement Division in 1994 to estimate how much the State would likely collect from interest on arrears accrued between 1975 and 1995. Oregon had plans to implement a new statewide automated system in 1996, with the capability to calculate and track interest. It wanted to know how much could be collected if they retroactively entered interest for all cases back to 1975, the year when statutes allowing interest charges were passed. The study estimated that the amount of interest on arrears that had accumulated over the 20-year period was \$400 million. While the study found that collections deriving from interest over the next five years could be between \$0.8 million

⁷This amount was arrived at by conducting a time study of calculating interest on 99 open cases with orders, and multiplying the average time per case (47 minutes) by the number of cases statewide, then comparing the staff-months required to complete the work to the amount of lost collections which would accrue.

and \$3.5 million, most of that would come from non-AFDC arrearages rather than AFDC arrearages. Oregon did not believe their share of the collections would offset the costs of back-entering interest. They based their cost estimates of back-entering on the Washington study.

None of the three states discussed above are currently assessing interest on arrears. Of those states that do assess interest, some programs appear to be more successful than others. What is of particular importance for this study is that the respondents who expressed satisfaction with their state's interest program described a fully automated system and set of procedures that, *once implemented*, requires very little from workers. In the next section, we take up what CSE interviewees listed as the elements of effective interest programs.

FACTORS CONTRIBUTING TO EFFECTIVE INTEREST USAGE

Some of the CSE respondents expressed satisfaction with their state's automation system and interest program; others were less positive and described problems with the program or system they are struggling to overcome. Here we concentrate on what CSE staff have learned from their experiences, and what they suggested an agency should do to create a successful program. We have divided the factors of success into the following topics:

- ✓ planning and development;
- ✓ automation;
- ✓ information and notification;
- ✓ preparing staff and resources; and
- ✓ policy variation.

Planning and Development

Respondents noted that because of the many ramifications of adding interest to a child support program, planning is a key element to having a successful program. According to the respondent from West Virginia, if a state wants to add interest to its automated system, investing in a thorough planning stage to develop business rules is crucial:

Before making the change of adding interest, think of everything you can that will be impacted. Tighten your laws and procedures; work out ahead



of time ALL details. For example, think of how you will handle dates: what will be the rule regarding interest if the order is established on a certain day, but the agency does not receive the order until three months later? Try to simplify the law; try to keep the application of interest uniform. Avoid rules that will require workers to constantly make adjustments.

This planning advice was echoed by the respondent from New York, who talked about programming:

Think it through from start to finish. Anticipate how it will affect everything, at the county and the state level, from creating judgments to entering the data for the first time. Test it (on a small system) until you are sure of it. Even then, there will be glitches.

Another respondent discussed the experience of her state this way:

Going forward is easy; the hard part is dealing with the past. Calculating interest in the past was not uniform (in this state), so we had to set up a number of rules. Are arrears owed to the state or the CP? We had to decide on the rules to distribute interest paid when recalculating, and then figure out how to program it.

Other respondents described preparing workers or customer service departments for an onslaught of calls when interest was initiated.

Automation

Exhibit 5 lists the states interviewed that currently assess and track interest on their statewide-automated system. Somewhat more than half (60%) of these states did not charge interest before they developed their new systems, which were developed to meet federal requirements. The remaining 40 percent of the states also assessed and tracked interest on their old systems.

**Exhibit 5
State Experiences with Automated Interest**

State	Year of System Conversion or Interest Automation	Did Old System Handle Interest?	Level of Manual Effort	Merits or Limitations of Automated System
Alabama	1995	Yes	Some adjustments	<i>Merit.</i> Reduce labor
Arizona	1995	no, manually calculated	New Cases: Input data and turn on interest indicator Old Cases: Review, recalculate, then turn on interest calculator	<i>Merit.</i> Accurate <i>Limitation.</i> Entering old cases
Massachusetts	1998	interest was not charged prior	Adjustments	<i>Merit.</i> Reduce labor
Minnesota	1997	Yes	None	<i>Merit.</i> Reduce labor <i>Merit.</i> Uniform treatment
New Mexico	1997	Yes	Some adjustments Error check from old system	<i>Limitation.</i> Conversion problems require manual checking of interest
New York	1995	Yes	Some adjustments	<i>Merit.</i> Reduce Labor <i>Limitation.</i> Up to county to reduce to judgment before it can be entered
Rhode Island	1991	interest was not charged prior	Adjustments	<i>Merit.</i> impossible calculation without automation
Texas	1996	interest was not charged prior	Adjustments	<i>Merit.</i> impossible calculation without automation
Virginia	1993	interest was not charged prior	Some Adjustments	<i>Merit.</i> uniform treatment
West Virginia	1994	interest was not charged prior	Adjustments	<i>Limitation.</i> Difficult to program

In addition, Exhibit 5 summarizes the level of manual effort required on the automated system. With the exceptions of New Mexico and Arizona, which are discussed in greater detail later, the level of manual effort is limited to adjustments made by caseworkers or staff with the proper security level. Finally, Exhibit 5 summarizes some of the merits and limitations of automated systems as identified by interviewees. Merits are generally



reduced labor costs and increased accuracy. The limitations mostly involve automation and conversion issues.

A number of respondents stressed that if a state is going to charge interest, the program must be fully automated, and applied uniformly to obligors with arrears. Of course, exceptions to being assessed interest can be programmed into the system. For example, Minnesota's automated system PRISM contains nine categories of criteria for interest exemptions (see Exhibit 6.)

Exhibit 6 Minnesota's Criteria for Interest Exemptions	
Criterion	Example
1. Non IV-D Obligation	private orders
2. CP or Employer Obligations	overpayments to CP
3. Obligation code is not listed on Table 220 on the Table Value Browse screen (TAVM)	see criterion 9
4. Interest override indicator on the NCP Obligation Detail screen (NCOD) is set to "Y"	manual adjustment
5. Reserved debt on the NCP OBLIGATION screen (NCOD). The reserved indicator is set to "Y" and the debt/arrears indicator is set to "D."	unclear what "D" refers to
6. The court order fips on the Support Order Detail screen is not equal to "27" for MN	non-Minnesota child support orders
7. Arrears are less than the monthly accrual.	
8. Arrears are not greater than one month old	
9. Obligation codes and debt type are any of the following combinations: <ul style="list-style-type: none">• Spousal Maintenance (AFDC/TANF/MA/Non-IV-D/NPA)• Fee (Non-IV-D service fee/non-court ordered/posting error recoup)• Education Trust Fund (AFDC/TANF/MA/Non-IV-D/NPA)• Judgments for fees (Non-IV-D service fee/non-court ordered/posting error recoup)• Paternity Escrows (AFDC/TANF/MA/Non-IV-D/NPA)	

Alabama illustrates some of the issues with automating interest, particularly how it interfaces with manual functions. Alabama converted to the new system ALECS (Alabama Locate and Enforcement Collection System) in 1995 and was certified by OCSE in 1997. CSE created a special "interest unit" to address the problems of converting from the old to the new system. Programmers and systems staff do not recall any problems in getting the new system up and running. With the new system,

- ❖ Calculation of interest is automated, although workers can open a spreadsheet and plug in numbers for calculation, when clients request reviews.
- ❖ The system calculates interest according to the statutes relevant for the time periods during which arrears accrued.⁸
- ❖ Automation handles tracking of interest, notification, and distribution.
- ❖ Adjustments are done manually and by automation. Alabama CSE has security levels that keep most workers from being able to change balances. In order to make an adjustment to a case, the worker must submit an adjustment request, and someone at the proper security level will review the request and make the adjustment.
- ❖ The system is programmed to make the interest calculation the first day of the next month after the payment is due, or when a judgment is entered.
- ❖ The system registers how much interest is collected on each case.
- ❖ The impact on the worker is negligible; the worker enters the data when opening a case.

It seems logical that the less complicated a state's statutory history has been with regard to interest rates, the easier it would be to create a satisfactory computer program to handle interest calculations and collections. Yet this is not always the case. Alabama, with a number of rate changes over the years, and Minnesota, with a variable interest rate tied to the general judgment rate, both have automated systems that handle interest without problems, according to the survey respondents. Arizona, with one statutory change in the past 20 years, has experienced extensive problems in adding interest to the automated system during conversion. The Arizona respondent explained that interest calculations were not done uniformly prior to the system conversion in 1995, so cases must be recalculated as they are entered into the new system. Additionally, the state has numerous

⁸The rate has changed from 6% in 1975, to 8% in 1979, to 6% in 1981. It has remained at 12%, fixed, simple, since 1991.



cases that do not fit programming operations, such as employers withholding wages every other week rather than monthly.

Sometimes the automation system itself is the problem. New Mexico, for example, reported that its new automated system continues to be unpredictable, requiring that all cases involving interest be recalculated before going to court. Another state experienced so many errors made during conversion that the agency had to conduct a reconversion. The interest-related automation problems listed by the Texas respondent included the state law, the changing laws, and the state distribution scheme: “Because (by law) each child support arrearage must be tracked to determine when it is 30-days past-due, and thus eligible for interest accrual, the programming task was formidable.” Further, Texas law regarding interest on child support arrears has changed four times in the past ten years. Finally, Texas has a complex state distribution scheme that caused significant problems in coding it correctly.

Information and Notification

Does the obligor understand that interest may be assessed on arrears? Does the obligor know when s/he is being assessed interest? It makes sense that if the reason for assessing interest is to affect payment behavior, the obligor must be informed of the penalties for nonpayment. Yet several of the states explained it is not the responsibility of CSE to inform the obligor. According to one respondent, “Charging interest is statutory, so CSE isn’t required to provide notification.”

Exhibit 7 shows whether and how states notify obligors about interest charges. (Examples of notifications are provided in Appendix II). Notification of the use of interest and other remedies appears to be a practice some state CSE agencies used to their advantage when launching an interest program. New York, Virginia and Minnesota sent letters to obligors with arrears just prior to implementing interest, warning the obligors what would happen if outstanding balances were not paid.

Virginia is a state that has continued the practice of sending one-time notices. When interest was implemented in 1995, every NCP was sent a one-time “Important Notice”, which listed all possible enforcement actions for arrears, including interest. Now, when a new case opens, the obligor receives a similar notice. The system does not send out monthly bills or statements. But if a CP or an NCP requests a statement, the agency

sends a case account summary. It breaks out interest separately from arrears and current monthly support, and public assistance arrears are differentiated from non-public assistance arrears. As noted previously in this report, approximately 27,000 noncustodial parents who had not paid in the three months prior to July 1, 1995 started paying after receiving the notice.

Exhibit 7			
Notification Practices by State			
	Notified with Order	Billing Statement Separates Interest	Other Notification
Alabama	✓	✓	
Arizona	✓		<ul style="list-style-type: none"> ❖ Notices of enforcement actions ❖ “Important Notice” describes interest and other enforcement remedies
Massachusetts	✓	not applicable, interest charged annually	<ul style="list-style-type: none"> ❖ Annual notification required ❖ Obligors with arrears
Minnesota	✓	✓	<ul style="list-style-type: none"> ❖ Initial notices sent when program first implemented
Nebraska			
New Mexico	✓		
New York		✓	
Rhode Island	✓	✓	
Texas			<ul style="list-style-type: none"> ❖ Upon request of arrears calculation
Virginia			<ul style="list-style-type: none"> ❖ Statements separating interest on request ❖ “Important Notice” describes interest and other enforcement remedies
West Virginia		✓	

Massachusetts is unusual because it charges both a 12 percent interest rate and a penalty of 6 percent on all arrears. Notification is critical to Massachusetts’ interest program, which was initiated this year. The Massachusetts policy is to send out an Annual Notice which explains liens, interest, remedies and enforcements, and lists what is owed. This notice is also sent as soon as \$50 is owed by an obligor. In addition to the Annual Notice, CSE staff sent a notice to obligors with arrears in May of this year, explaining that the fiscal year would be ending in June. At that time, the system would tally the arrears for an obligor, and would assess interest at 12 percent and penalties at 6 percent. The



letter explained the conditions under which an obligor with arrears could avoid interest and penalties, and it included a work sheet. This approach is discussed in more detail in the section on Incentive Structures.

Worker Impact

How does assessing interest impact the workload of CSE personnel? Respondents stressed that a good interest program that is folded into the automated system should have very little impact on the average worker. Three states reported that no training involving interest is given to workers, since the system does all the work. Four states give workers a little information and training (“only a couple of hours”), so that they can explain interest to obligors and obligees when they review cases. Minnesota, for example, includes a small segment on interest in a class on collections and disbursement. Two states reported that specialized workers receive substantial training (1-3 weeks) on interest-related issues. Finally, two respondents explained that when interest was first implemented, workers received extensive memos regarding the new program.

If errors were made in data entry during conversion, workers may be required to constantly recheck their work. Several states talked about the time involved in recalculating interest because of errors that were rolled over during conversion. If a new interest program is complex, the agency must have personnel ready to explain interest to its customers and court personnel.

The impact on programmers can be significant when a state is converting to a new system or adding interest. Although no state had actual figures to share with us, several respondents talked about the sizeable amounts of time that programmers invested in implementing interest. Many states expressed concern about the new PRWORA distribution requirements, and suggested that their programmers will have difficulty meshing the existing program with these new mandates.

Policy Variations

The policies and procedures for assessing interest of each state are naturally different. In this section, we will discuss briefly some of the similarities and variations of states' policies, looking at the rate and method of calculation, amnesty programs and waivers of interest, the use of interest in negotiation, and incentive structures.

Rate and Method of Calculation

Although the eleven states in this survey that charge interest have interest rates that vary from 9 percent (New York and Virginia) to 12 percent (Alabama and Texas) to variable (Minnesota, Nebraska and New Mexico), they all use simple interest as the method of calculation. West Virginia used compound interest in the past, and has incorporated both simple and compound calculations into its automated system. Minnesota has the authority to charge 2 percent higher than the general judgment rate when arrears have been reduced to judgment; otherwise, the general judgment rate is used. Minnesota's automated system distinguishes between whether arrears have been reduced to judgment or not, and assesses accordingly.

Amnesty Programs

Amnesty programs for interest accrued are not offered currently by any of the states surveyed. However, an amnesty program is now built into Oklahoma law and, according to the survey respondent, will be used when the interest program is implemented. The Department of Human Services and district attorneys are authorized "to periodically offer an amnesty program for those who owe past-due child support." (56 O.S.1991, Section 234, amended.) Two states, Arizona and Rhode Island, offered amnesty programs just prior to implementing interest assessment. According to the interviewee from Arizona, the response was minimal because the child support interest rate is too low, and does not represent much of a penalty to obligors. Another respondent explained that in his state, an amnesty program is not possible because interest becomes part of the "unmodifiable" child support arrears.



Waivers of Interest

Very few of the surveyed states allow the CSE agency to waive interest. Several states expressly forbid waiver of interest. Alabama, for example, does not allow interest on child support to be waived by either custodial parents or CSE personnel. Interest which has accrued on arrears is considered to be child support, and state law prohibits both the waiver of child support and the forgiveness of arrearages. Arizona, on the other hand, limits the waiver of interest to non-TANF custodial parents and judges, with one exception. The Attorney General can waive interest as part of a settlement on a TANF case. Although Minnesota CSE cannot waive interest, a noncustodial parent can have the interest on his arrears waived by the court if he can demonstrate that he has paid both current support and court-ordered arrears for 36 consecutive months.

Interest Used in Negotiation

The use of interest in negotiation is allowed by some, but not all, states that were surveyed. Negotiation is usually limited to CSE attorneys or high level financial personnel. According to the New Mexico respondent, interest plays a role in perhaps 30 to 40 percent of the cases that are negotiated in that state. It is the one area that private attorneys, hired by NCPs, can affect. Agreements that involve setting aside or reducing interest contain the language “so long as the obligor pays as ordered herein”. Surprisingly, interest is even used in negotiations in Utah, although CSE no longer collects interest. The CSE respondent explained that because the agency will collect interest if it has been listed as a specific dollar amount in a judgment, interest is still a useful tool.

Five of the states with fully automated systems do not permit negotiation of interest to be part of child support enforcement (Alabama, Minnesota, Texas, West Virginia, and Virginia). Each of the respondents from these states stressed they believe one of the strengths of their program is that interest is uniformly applied, and the rules are clear. It is because interest is never waived or negotiated away that obligors, obligees and courts accept interest on arrears as fair.

Incentive Structures

The IRS Restructuring and Reform Act of 1998 contains an incentive for delinquent taxpayers to begin paying: the penalty for failing to pay their original tax will be reduced by half for taxpayers who enter into active installment agreements with the IRS (GAO 1998). Could CSE agencies also use incentives to encourage obligors with past due accounts to alter their payment behavior? Can interest be structured as an incentive for paying child support on a regular basis? Although several respondents stated they believe interest is an incentive for some obligors to remain current with their payments, only one state has actually structured its interest program to *be an incentive*. The Massachusetts CSE respondent explained,

We believe it is more important to increase current collections than to collect interest on what is past due. We are trying to encourage people to keep current, rather than discouraging them by building up a debt that they will never pay off.

To accomplish this, CSE policy staff created an interest and penalty program with carrots and sticks. Designed to affect payment behavior, the program has several exemptions from having interest and penalty applied. The exclusions are based on payment performance, as well as personal and financial circumstances. There are formulas and rules that cases must measure up to:

1. If the NCP has paid at least 75 percent of his current child support obligation during the past year, and has reduced arrears (by even \$1) from the previous year, no interest or penalties will be assessed.
2. If there is no current child support obligation and
 - a. arrears are less than \$500; or
 - b. the obligor paid off total arrears (if less than \$3,600); or
 - c. the obligor paid at least \$3600 plus 25 percent of any arrears in excess of \$3600; or the obligor paid at least \$10,000; or
 - d. the obligor has been approved for hardship exemption, no interest or penalties will be assessed. (Massachusetts Final Regulation, Amendment).



As discussed previously, a program like this will only succeed if the obligors are informed. This is the first year of the program. According to the CSE representative, the response of obligors was largely positive.

We had prepared workers and customer service, because we thought there would be a huge number of people calling. We thought people would have trouble understanding the exemptions, or how to calculate where they stood. But really, the response was not that negative or great, in terms of calling in.

The payment response was highly satisfactory. More than 2,000 obligors sent in monies, averaging more than \$400. The collections from this mailing, according to the respondent, were close to \$1 million.

The Massachusetts interest program is similar to an amnesty program. The respondent believes it is a fair system, since it has a number of exemptions, and obligors are notified in advance of what steps the agency may take. It has clear rewards for improving payment behavior. If a person with arrears moves on to wage withholding, Massachusetts law requires that the employer withhold an additional 25 percent of the current order to address arrears. CSE encourages obligors to be on a wage withholding regimen, telling them that complying with the rules of wage withholding will automatically keep them from accruing a larger debt with interest. According to the respondent, the agency plans to revise the notice and worksheet to make it even easier to understand, and plans to send the notices out a month earlier next year. Policy analysts look forward to seeing the results of a second year of this program, and to collecting some hard data regarding obligor response. As the respondent explained,

We believe we have found a way to increase collections without grossly increasing accounts receivable. Based on the response to our first mailing, the rational conclusion is that we have developed a policy that will work.

CHALLENGES OF CHARGING INTEREST

There are many elements that contribute to an agency's decision regarding implementation of an interest program. In addition to the economic, technical and personnel aspects of implementation, there are political considerations. In this section, we briefly discuss three challenges which Colorado CSE may encounter: lawsuits, PRWORA distribution requirements, and adding interest to an automated system.

Lawsuits

Since 1997, a lawsuit has been pending against the Office of the Attorney General in Texas over the collection of interest on past due child support payments. Attorneys for custodial parents filed a class action lawsuit, claiming that interest on arrearages can be collected back to the date of delinquency. The Attorney General's Office argues that Texas law prohibits them from assessing interest on arrears which occurred prior to 1991. Similarly, the Washington CSE study on the cost of adding interest to their system was generated by a lawsuit brought against the agency by the Northwest Women's Law Center, pressing for interest to be charged. One respondent for the state survey suggested that any agency not collecting interest is vulnerable to lawsuits.

PRWORA Distribution Requirements

The question of distributing arrears and interest came up several times during state interviews. Most respondents said their agency follows PRWORA rules regarding the hierarchy of distribution (revised Section 457 of the Social Security Act). According to one respondent, interest is the last item to be paid in his state, but with the new federal distribution schemes, there are some questions regarding which arrears and which interest gets paid first. Several respondents noted that the federal requirements are now so complicated that agencies will be unable to explain them to courts and obligors. At least one state, Texas, has its own mandated sub-categories for distribution of payments. When PRWORA's distribution schemes are added, Texas CSE is faced with 24 sub-categories of arrears that must be tracked. For states that have already had problems programming the automated system to handle interest, the PRWORA regulations for arrears and interest represent another round of computer-driven headaches.



Adding Interest to an Automated System

A challenge Colorado faces if a statewide interest program is implemented is developing a process to handle cases with arrears that is fair. In some counties, cases with arrears will have no interest calculated; in those counties that have been charging interest, the methods of calculation have varied. With this in mind, states that recently implemented interest, or that moved from calculating interest manually to automatically, were asked to describe the method they used. Was interest calculated from the beginning of each order and entered into the ledger, or was interest charged only from the time that the program began operating? In some cases, the answers were quite detailed. We have included the details to show the range of approaches used.

Alabama

- ❖ Began charging interest in 1992, with an automated system; converted to a new system in 1995.
- ❖ At the time of automating interest, interest was calculated on the date the order was set and the rate of interest at that time. Changes have been made in the statutes, and the system calculates interest according to the statutes relevant for the time periods during which arrears accrued.
- ❖ The state agency did not want to burden workers with the preparations for conversion or interfere with their regular jobs. Instead, the state contracted with outsiders who reviewed every case with arrears, made sure calculations were correct and entered correct data into the system. This task was done prior to the conversion, with the hope that the conversion would handle interest without problems. Of course there were some errors made, and some obligors appealed their cases. But overall, this method worked.
- ❖ The reviewing and correcting of cases took approximately a year to complete. The same contractors were used to do all the work, so that some individuals worked in more than one county.

Arizona

- ❖ Has always charged interest. The state moved to an automated system in 1990, but calculated interest manually until 1995-96, when the system was converted and interest was included.
- ❖ Interest is being added to the caseload slowly. The interest for each case is based on the arrears, dates and previous payments. “When we converted to the certified system, we turned off the interest accrual indicator. All cases were converted without interest accruing. Then, as each old case is touched, the debt worker updates it, makes sure the information is correct, uses the ‘Arrears Calculation Tool’ to make sure the calculations are done uniformly, and turns on the interest indicator. With each new case, the interest indicator is turned on.”
- ❖ The respondent was not sure how many cases have been updated, but noted it is three years worth. But Arizona CSE staff don’t really think of it in terms of cases: a single case (obligor) can have multiple debts, each in the system with ledgers. The debt worker will have to turn on the interest indicator for each debt. After three years, some cases reflect interest accrued, and others are just waiting to be touched.

Massachusetts

- ❖ Began charging interest in 1997, and added it to the automated system.
- ❖ At the time of automating interest, CSE calculated interest on whatever an obligor owed. The automated system keeps a running tab of arrears and interest (called temporary penalties); at the end of the fiscal year, a case is run through a series of exclusions, and interest is applied on arrears that have accrued. An obligor is assessed once a year.

Minnesota

- ❖ Began charging interest in 1993, and it was included in the automation system. In 1997, CSE converted to a new system.



- ❖ Interest is calculated from the date of the order. At the time of converting to the new automated system, interest was calculated on cases that met the criteria, and cases were transferred into PRISM (the new automated system) from CSES (the old system). The system now runs each case through a series of exemptions prior to assessing interest.

New Mexico

- ❖ Has always charged interest. It had an old automated system that handled interest. In 1997, a new system was brought in.
- ❖ The interest is always calculated on the rate used for the date of the original filing of the order. At the time of conversion, interest was rolled over into the new system “as is”. The agency had hired temporary workers to enter data, and many errors were made. The result is that constant checking of data is required.

New York

- ❖ Has charged interest since 1981. In 1995, the automated system was changed to include interest. Counties have discretion regarding how aggressive they are in pursuing interest.
- ❖ Interest was added to each case based on the actual filing date of the judgment.
- ❖ The Systems Unit released two lists of cases with active judgment ledgers to counties: one list of cases which contained a judgment ledger in which no payments have been applied, and one list of cases which contained a judgment ledger where payments had been applied. In all cases, the county was to verify that a judgment had been filed with the county clerk’s office, and obtain the date of filing. For those cases where no payments had been applied, the county was told to enter the filing date into the first charge date field. If payments had been applied to the judgment since the filing date or interest had been charged previously, the county then calculated manually the correct judgment principal amount and the judgment interest amount that were to be added to the interest ledger. County workers then input the data into the system.

-
- ❖ Counties received instructions from the state. Once a case is entered, the mainframe system calculates and tracks interest from that point on.

Texas

- ❖ Had an old system, which handled interest marginally. When the system was replaced in 1997, interest was included and the agency began an active interest program.
- ❖ “The challenge was the Texas law. Because each child support arrearage must be tracked to determine when it is 30-days past-due, and thus eligible for interest accrual, the programming task was formidable....Moral of the story: don’t have a law that says an obligation accrues interest after X days past-due....have your law say that ALL arrears, MINUS some fixed amount...accrues interest.”

Virginia

- ❖ Bought a new system in 1993, and adding interest was part of the contract. The state began assessing interest in 1995.
- ❖ CSE did not go back retroactively for each case. Instead, starting in 1995, a 9% interest rate was applied for each case with arrears in a subaccount.

West Virginia

- ❖ Although the law had been in effect for a long time, the state did not begin to assess interest until 1994, when the agency converted to a new automated system.
- ❖ “We did not start with zero, because the law had been in effect so long. We put all previous payments, dates, judgments, and interest if it had been paid, into the system. (Sometimes the court put interest amounts on orders; some regions of the state tried to handle interest, but these cases were few and far between.) The system then calculated interest on the entire case, from the time of the order, reflecting the different rates at different times. This was not retroactive interest -- everyone knew interest was being charged, it was just not being collected. So we didn’t change the law, we simply began enacting it.”



-
- ❖ An administrative decision was made in 1994, to not collect interest on public assistance cases, even though the automated system has the capability to calculate interest on all cases, whether the support is owed to the state or to the CP. But PRWORA requires that interest be collected on public assistance cases, also.

 - ❖ To begin doing this, CSE has decided they will zero out interest in accounts where interest is owed to the state (but the state has not been collecting it). This is because in the past, from 1994 to now, they often did not compute the interest in these cases, knowing it would not be collected. Rather than handle each case, they will simplify the process and start from zero.

SUMMARY AND RECOMMENDATIONS

This survey was designed to hear from states that have implemented interest programs. Although respondents certainly expressed a range of opinions and experiences on most topics, several themes emerged from the interviews:

- ✓ Develop a system that requires little or nothing of CSE workers.

- ✓ Apply interest across the board, but allow for exceptions.

- ✓ Interest programs that are fully automated can work well.

- ✓ Simplify the state law, if possible, in order to simplify your work.

- ✓ Interest may affect payment behavior, so it is useful to inform them of the practice of assessing interest.

Respondents were quite willing to make recommendations, and their advice was direct and concrete. Some of their advice appears in Exhibit 8.

Exhibit 8
Advice from Other States

- ❖ Before you get into it, you need to be committed to the idea. It takes a long time to work out all the wrinkles. To collect interest, you must have enforcement tools. You need to look at your state laws. Make sure your laws say that interest is defined as support, then you can use enforcement tools.
- ❖ Keep your law simple, keep the rate fixed and stay with simple calculations. Bring in outside help to calculate arrears, rather than use workers. Send blanket notices to everyone when you start, which will also help clean things up.
- ❖ I think the most important aspect is that the methodology be simple. If a relatively intelligent obligor or obligee can't sit down with a spreadsheet application and build a total arrears calculator, including interest accruals, then the system is too complicated.
- ❖ An automated system that doesn't deal with interest is worthless. It is malpractice to go to court and not be able to make a presentation that includes correct interest charges.
- ❖ In terms of changing your automation system, it is better to go find a system you like and bring it in. Since every state basically has to report and track the same things, all systems are very similar. Therefore, you should be able to locate one that works for you.



This page is intentionally blank.

Chapter III

Collections from Interest

This chapter discusses the potential impact of interest assessment on child support collections. It explores several research questions.

Research Questions

1. Will interest inflate accounts receivable?
2. What proportion of interest arrears is likely to be collected?
3. Does interest encourage timely payment of current support; hence, improve current collections?
4. Is interest an effective negotiation tool?
5. Does interest encourage some groups of obligors to pay but discourage other obligors from paying altogether? For example, do some low-income obligors stop paying when they are faced with even higher arrears due to interest?
6. Does notification of interest increase collections?

The data and methods used to test these research questions are discussed in the next section. This is followed by a separate discussion of each research question. The chapter concludes with a discussion about the relationship between interest and arrears.

DATA, METHODOLOGY AND LIMITATIONS

The primary data used for analysis are Colorado-specific. We use data from other states for comparisons.

Colorado-Specific Data

To study the effect of interest on payment behavior in Colorado, we use data from four primary sources.



1. Information from six counties that tracked negotiations about interest during October 1999.
2. A telephone survey of county interest practices.
3. State Monitoring Reports.
4. ACSES (Colorado's automated child support enforcement system).

Negotiation study. State staff sent an email to Colorado counties asking whether they would participate in a study where they would track interest negotiations during the month of October 1999. There were six counties that agreed to cooperate. If staff from any of these counties negotiated interest in a case they were asked to complete a form identifying the reason for the negotiation (e.g., lump-sum settlement), what was negotiated, and other details about the case. The forms were sent to project staff for analysis. In all, 37 forms were returned to project staff: 26 included interest negotiations that occurred in October 1999, and the remaining 11 were cases negotiated in other months or failed negotiations.

County Interviews. Child support administrators from all of the Colorado counties were interviewed in September or October 1999 about current and past interest usage in their respective counties. Conducted by CPR staff, the telephone interviews followed a structured set of questions.

State Monitoring Reports. County-specific information was obtained from Monthly and Quarterly Monitoring Reports, which are produced by the State. The tabular reports provide extensive information about caseload, collections, and performance by county. The reports were expanded in 1999 to include several federal performance indicators. Reports from December 1998, June 1999, and October 1999 are used. The December 1998 report captures performance for the 1998 calendar year, the June 1999 report captures performance for the first half of calendar year 1999 and the October 1999 report captures the most current information available.

ACSES. A random sample of arrears cases was selected for analysis. It included 400 cases with arrears from all counties charging interest and additional cases from two counties that recently changed their interest policy. Payment history, interest assessment and other information were collected on these cases. Of the 400 randomly selected cases,

18% showed a ledger adjustment for interest. However, most (64%) of the cases with an interest ledger adjustment were closed. Years ago, several counties would assess interest at case closure, but most have discontinued this practice. Nonetheless, this may explain why most of the cases with interest posted on ACSES are closed.

The most common reason for case closure is that the obligor could not be located. Disabled and “invalid case” are other common closure reasons. Only 23% of the closed cases with interest posted are closed with no arrears balances. As a result, the subsample was reduced to 11 cases for analysis. This is an insufficient number for statistical analysis.

In sum, the random sample of 400 ACSES cases did not yield significant sample sizes for analyzing interest assessment and interest collections. Furthermore, the sample is likely to be non-representative because ACSES tracks only the interest adjustments entered by the technicians and in the past, technicians were more likely to enter these adjustments at case closure. The analysis of the targeted counties was also not fruitful because only a very small proportion (i.e., less than 5%) of the cases reviewed indicated interest was posted on ACSES. As a result of these issues, the analysis relies more heavily on the other data sources.

Data from Other States

Most of the collections data from other states were obtained from the Federal Office of Child Support Enforcement’s Report to Congress. We use information from 1998 because that is when the survey of state interest usage was conducted.

Methodology

Several different methodologies were used to answer the research questions. One of the more frequently used methodologies was to compare differences in collections between interest-assessing counties and non-interest assessing counties. A similar comparison is made between interest-assessing states and non-interest assessing states. In effect, these are natural experiments because roughly half of the Colorado counties assess interest and roughly half of the states assess interest. This methodology was used to gain insight into interest’s impact on arrears payments (research question 2); interest’s impact on payment of current support (research question 3); and interest’s impact on different groups of obligors (research question 5). However, there are at least two limitations to this approach. First, whether and when a county assessed interest is subject to the



interviewer's response, who may not recall this information precisely. Second, counties that assess interest do not assess it uniformly. Some counties assess interest on judgments only, others assess it in conjunction with an arrears calculation, and still others assess it differently. The comparison does not capture the impact of these variations between counties. In additional analysis, we attempted to capture these county variations by grouping counties with similar interest policies (e.g., counties that assess interest on judgments only in one group and counties that assess interest on judgments and non-judgments in another group). We did not detect statistical differences between these subgroups.

The second most commonly used method was to apply information from other states. This was used in part to answer how much interest would likely be collected (research question 2); the impact of interest on difference groups (research question 5); and the effect of notification on collections (research question 6). The limitation of this approach is that Colorado might not replicate another state's experience.

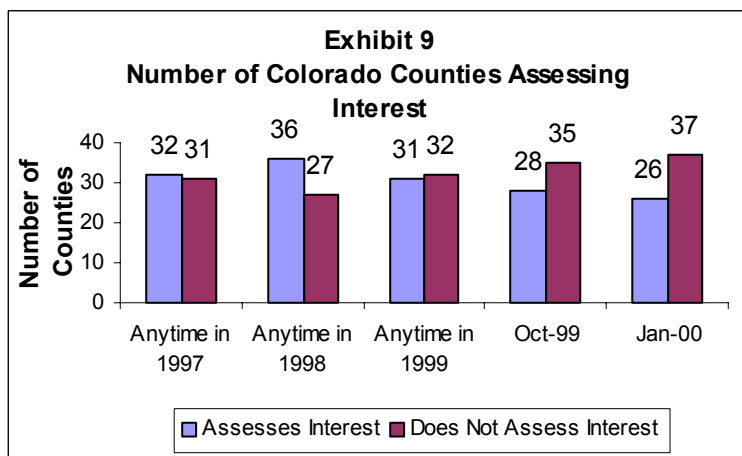
Two other methods were used. The first question, which addresses interest's impact on statewide accounts receivable, is answered by projecting accounts receivable using statistics from 1999 State Monitoring Reports and State performance standards. The projection is based on three major assumptions: (1) if the State begins charging interest statewide, the amount of arrears would be equivalent to that of January 1, 2000; (2) counties will achieve the State performance standards for percent of current obligation paid; and, 3) that interest arrears will be paid at the same rate as 1999 arrears. Generally, this assumes an optimistic scenario and is likely to underestimate interest's impact on accounts receivable.

Another method was used to analyze the impact of interest on negotiations. This consisted of compiling the information collected from the negotiation survey.

County Usage of Interest

Exhibit 9 shows the number of counties that assessed interest in 1997, 1998, 1999 and January 2000. As of January 2000, 26 counties assess interest and 37 counties do not. As is evident in Exhibit 9, the number of interest-assessing counties has declined since 1997. In 1997, 32 counties assessed interest and 31 counties did not. Counties have stopped assessing interest due to a variety of issues. Some counties found it too burdensome to

compute and did not feel they had the automation to support it. Other counties were concerned about equity issues. For example, one interviewee pondered whether it was fair to assess interest at case closure when the obligor had not been previously notified of the amount of interest that was accruing. Most recently, Garfield County suspended interest assessment due to a lawsuit pertaining to interest that is currently being appealed.



Although there are more counties that went from assessing interest to not assessing interest, there are a few counties that have just begun to assess interest in the last few years. One of these counties reported that their County Commission drove their recent policy change.

As discussed earlier, counties differ in when they assess interest and on what type of arrearages they assess interest (e.g., those reduced to judgments). Among the counties assessing interest, most of them only assess it when they are preparing a case for a specific enforcement action (e.g., preparing for a lump-sum negotiation). The only exceptions are two counties that assess interest monthly on judgments among paying cases.

Q.1 WILL INTEREST INFLATE ACCOUNTS RECEIVABLE?

As discussed in the last chapter, interest arrears account for about 7% of Minnesota's total IV-D arrears, and about 14-17% of Virginia's total IV-D arrears.⁹ It is not clear what causes the precise difference between Minnesota and Virginia. One explanation may be time. Virginia began assessing interest in July 1995. Although Minnesota began assessing interest in 1993, it was not routinely assessed until implementation of the statewide automated system in 1997.

⁹ Interest is based on a handout prepared by Virginia in 1996 or 1997. The precise year cannot be determined. The handout states that, "Since Virginia started charging interest on arrears effective July 1, 1995, the total interest accrued is \$77.5 million on approximately 208,000 arrears subaccounts." Based on the OCSE reports to Congress, Virginia accounts receivable for prior support due are \$564 million in 1995 and \$461 million in 1996 and unavailable for 1997. We estimate interest arrears (\$77.5 million) as a proportion of the 1995 and 1996 amounts.



Another difference between Minnesota and Virginia is their interest rate. The interest rate in Minnesota is based on the secondary market yield of U.S. treasury bills. It is currently about 7% per annum and assessed monthly. Virginia assesses a monthly simple interest rate of 9% per annum.

Exhibit 10 displays an estimate of how statewide assessment of interest could inflate Colorado arrears in its first year of implementation. The estimate assumes that:

- ❖ interest is compounded monthly (1% per month, 12% per annum);
- ❖ counties meet the goal for current collections of 52.5% (the remainder, 47.5% of current due, will be added to arrears);
- ❖ collections on interest are at the same rate as for arrears in 1999 (6.41% per annum or 0.5% per month); and
- ❖ interest is assessed the first of the month following the month the support was due.

We make no assumptions about whether interest affects the percent of current collections paid, we simply assume that the current collection goal, 52.5%, is met. (The impact of interest on current collections is addressed in the third research question.) If the goal for current collections is unmet, the projection underestimates interest's impact on arrears balances. Furthermore, if collections on interest is less than 6.41%, the projection also underestimates interest's impact on arrears balances. (As discussed in the next research question, 6.41% is considered the high-range estimate.)

We project interest accrual for two different scenarios: (1) interest accrues only on past-due current support after January 1, 2000; (2) interest accrues on all arrears. For comparison, we also project interest accruals using simple interest on all arrears.

As evident in Exhibit 10, if interest accrues only on past-due current support after January 1, 2000 by the end of the year, interest arrears would comprise about \$1.1 million dollars and 0.09 percent of the total arrears. If interest accrues on all arrears, the year-end forecasted interest arrearages would be about \$134 million if interest is compounded and \$128 million if it is calculated using simple interest (about 10 percent of total arrears in either circumstance). These are one-year estimates. In subsequent years, these interest arrearages will likely multiply.

The State Auditors already consider Colorado arrears high relative to other states. Over \$1 billion is owed in Colorado child support. The State Auditor's report shows that arrears per case average \$4,400 in Colorado while the national average is \$2,263.¹⁰ Statewide interest assessment will increase the gap between Colorado and the national average, particularly if interest is assessed on all arrears.

Exhibit 10				
Projected Inflation in Accounts Receivable to Statewide Assessment of Interest				
	End of Month Principal (includes arrears as of 01/01/2000)	Compounded Interest on Past-Due Current Support after 01/01/2000	Compounded Interest on All Arrears	Simple Interest on All Arrears
Jan 2000	\$1,149,194,270	\$0	\$0	\$0
Feb 2000 (forecasted)	\$1,152,674,598	\$96,170	\$11,491,943	\$11,491,943
Mar 2000 (forecasted)	\$1,156,136,342	\$97,127	\$11,606,248	\$11,526,746
Apr 2000 (forecasted)	\$1,159,579,600	\$98,083	\$11,755,704	\$11,561,363
May 2000 (forecasted)	\$1,163,004,471	\$99,040	\$11,905,317	\$11,595,796
Jun 2000 (forecasted)	\$1,166,411,053	\$99,997	\$12,055,089	\$11,630,045
Jul 2000 (forecasted)	\$1,169,799,444	\$100,953	\$12,205,017	\$11,664,111
Aug 2000 (forecasted)	\$1,173,169,741	\$101,910	\$12,355,101	\$11,697,994
Sep 2000 (forecasted)	\$1,176,522,041	\$102,866	\$12,505,340	\$11,731,697
Oct 2000 (forecasted)	\$1,179,856,439	\$103,823	\$12,655,734	\$11,765,220
Nov 2000 (forecasted)	\$1,183,173,032	\$104,779	\$12,806,280	\$11,798,564
Dec 2000 (forecasted)	\$1,186,471,914	\$105,736	\$12,956,980	\$11,831,730
YEAR-END TOTAL	\$1,186,471,914	\$1,110,484	\$134,298,753	\$128,295,210
PERCENT OF TOTAL		0.09%	10.17%	9.76%

¹⁰ Report to the State Auditor, p29.



Q.2 WHAT PROPORTION OF INTEREST ARREARS IS LIKELY TO BE COLLECTED?

This is a two-fold question. It addresses what proportion of interest arrears is likely to be collected. It also addresses whether interest charges could change the amount of total arrears collected. As discussed in Chapter II, Virginia is the only state where we were able to obtain numbers on how much interest arrears was collected. In one year, Virginia collected \$460,00 from about \$77.5 million due in interest (0.6%). Virginia currently collects about 11% of its total arrears (i.e., interest and principal arrears).

Based on Virginia's experience and the experiences of Colorado counties assessing interest, which is shown later in Exhibit 11, we assume that the percent of interest arrears collected will not exceed the proportion of total arrears currently collected in Colorado. In other words, the proportion of interest balances collected will be less than the proportion of total arrears collected. In 1999, Colorado collected 6.4% of its child support arrears. Thus, we assume this is the maximum percentage of interest that Colorado can expect to collect. We also assume that the minimum percentage of interest Colorado can expect to collect is the same rate experienced by Virginia (0.6%).

We are unable to develop a point estimate between the range in estimated potential interest collections (0.6-6.4%). We had hoped to gain some additional insight into this issue by tracking the payment records of obligors who were assessed interest, but we were unable to identify a large enough sample of cases with interest assessment. As discussed earlier, we had randomly selected 400 arrears cases from counties assessing interest. Only 76 cases had interest charges posted on ACSES and most of these were closed due to locate, invalid case, disability or some other factor that suggested child support was not being collected on the case. Nonetheless, even if we had the data to derive a point estimate there would also be a margin of error (e.g., a point estimate +/- 5%).

The percent of interest arrears that is likely to be collected is 0.6% to 6.4%

To gain more insight into whether interest would affect collection of total arrearages, we compared Colorado counties that assess interest to those that do not. Exhibit 11 compares the average arrears per case, the proportion of cases with arrears and the percent of arrears paid between counties that assess and counties that do not assess interest. There are no statistical differences in the percent of arrears paid between counties that assess interest and those that do not. For example, as shown in Exhibit 11, from January through October 1999 counties assessing interest collected 7.0% of their

arrears and counties not assessing interest collected 6.9% of their arrears. This suggests that interest has no effect on the percent of arrears paid (i.e., it does not increase or decrease it).

A similar comparison is made between states that assess interest and those that do not based on information provided in the Federal OCSE Reports to Congress. States that assess interest collect about 16% of the amount past due on average. In comparison, states that do not assess interest collect about 13% of the amount past due. The difference is not statistically significant.

Exhibit 11						
Arrears and Arrears Payment by Whether County Assesses Interest						
	Average Arrears per Enforcement Case		% of Enforcement Cases with Arrears		% of Arrears Paid	
	Jan-Jun 1999	Jan-Oct 1999	Jan-Jun 1999	Jan-Oct 1999	Jan-Jun 1999	Jan-Oct 1999
COUNTY ASSESSED INTEREST ANYTIME IN 1998						
Yes (n = 36)	\$6,815	\$7,079	67.6%	72.6%	4.2%	6.9%
No (n = 27)	\$5,429	\$5,994	68.6%	71.7%	4.5%	7.1%
Difference	\$ 1,386**	\$1,085**	-1.0%	-0.9%	-0.3%	-0.2%
COUNTY ASSESSED INTEREST ANYTIME IN 1999						
Yes (n = 31)	\$6,898	\$7,192	66.9%	72.2%	4.1%	6.9%
No (n = 32)	\$5,565	\$6,055	69.1%	72.3%	4.5%	7.0%
Difference	\$ 1,233**	\$1,137**	-2.2%	-0.1%	-0.4%	-0.1%
COUNTY ASSESSED INTEREST AS OF OCT 1999						
Yes (n = 28)	\$6,943	\$7,218	66.6%	72.1%	4.1%	6.9%
No (n = 35)	\$5,643	\$6,131	69.2%	72.4%	4.4%	7.0%
Difference	\$ 1,300**	\$1,087**	-2.6%	-0.3%	-0.3%	-0.1%

*0.05 < ρ < 0.10

** 0.05 > ρ

Exhibit 11 also compares the average arrears per enforcement case. It shows that counties that assess interest, on average, have significantly higher arrears per case statistically than counties that do not assess interest. As evident in Exhibit 11, the



difference in arrears is \$1,087 to \$1,386 per case depending on the time period examined. On the one hand, this is consistent with the theory that interest inflates arrears (i.e., counties that assess interest have higher total arrears than counties that do not). On the other hand, since the interest-assessing counties do not always assess interest, it may suggest that these counties have higher arrearages to begin with due to a more difficult caseload. There may be other reasons that also explain these differences.

The average percentage of enforcement cases with arrears is also compared between counties assessing interest and those that do not in Exhibit 11. This comparison shows no statistically significant differences.

Q.3 DOES INTEREST ENCOURAGE TIMELY PAYMENT OF CURRENT SUPPORT?

One of the rationales for assessing interest on child support arrears is that it puts child support on a par with other debts the obligor may owe. Moreover, it is commonly believed that interest motivates obligors to stay current. If this is true, we would expect to see a higher proportion of the current support paid in counties and states that assess interest than in those that do not.

Exhibit 12 shows the differences between Colorado counties that assess and do not assess interest on the percentage of current support paid. It should be noted that percent of current support paid is also a Federal performance indicator¹¹

One of the rationales for assessing interest is that it puts child support on par with other debts owed by the obligor. Theoretically, this should increase payment of current support. We find no statistical evidence that collaborates this theory.

Exhibit 12 shows that counties that assess interest generally perform less well on the Federal performance indicator, percent of current obligation paid. The percent of current support paid between January and October 1999 is 49.8% in counties that assessed interest as of October 1998 and 54.0% in

¹¹ The percentage of arrears cases with a payment toward arrears, which is also a Federal performance indicator, is discussed later in this paper. Other performance indicators, percent of cases under order and paternity establishment rates, are not included because they occur before the order is established, when interest cannot be assessed. The fifth federal performance indicator, cost-effectiveness ratios were not readily available.

counties that did not assess interest as of October 1998. This constitutes a gap of 5.8 percentage points in current support collected, which is statistically significant, but in the opposite direction that the theory projects. The gap is somewhat narrower for the other time periods considered and in some instances it is statistically insignificant. Nonetheless, the evidence, that shows that current support paid is **not more** in interest-assessing counties than counties that do not assess interest, does not support the theory that interest increases payment of current support.

Exhibit 12		
Percent of Current Obligation Paid by Whether County Assesses Interest		
	% of Current Obligation Paid	
	Jan-Jun 1999	Jan-Oct 1999
COUNTY ASSESSED INTEREST ANYTIME IN 1998		
Yes (n = 36)	50.7%	50.6%
No (n = 27)	53.4%	54.2%
Difference	-2.7%	-3.6%*
COUNTY ASSESSED INTEREST ANYTIME IN 1999		
Yes (n = 31)	50.2%	50.0%
No (n = 32)	53.4%	54.1%
Difference	-3.2%	-4.1%**
COUNTY ASSESSED INTEREST AS OF OCTOBER 1999		
Yes (n = 28)	50.0%	49.8%
No (n = 35)	53.3%	54.0%
Difference	-3.3%*	-5.8%**

*0.05 < ρ < 0.10

** 0.05 > ρ

A similar comparison between states that assess interest to those that do not, shows that interest-assessing states collect 51% of their current support on average, whereas non-interest-assessing states collect 52% of their current support on average. The difference is not statistically significant. Again, the fact that evidence shows that current support paid is **not more** in interest-assessing states than states that do not assess interest, does not support the theory that interest increases payment of current support.



In addition, we caution using the comparisons in Exhibits 12 to suggest that interest decreases current support paid. These bivariate comparisons do not identify what is the cause and what is the effect. For example, if interest is the cause and decreases in the percentage of current support paid is the effect, than interest could be interpreted as decreasing payment of current support. On the other hand, counties with lower percentages of current support paid may assess interest as an attempt to increase overall collections. This issue of cause and effect is analogous to the issue of whether visitation increases child support payments or whether child support payments increase visitation. It is also as difficult to determine.

Q.4 IS INTEREST AN EFFECTIVE NEGOTIATION TOOL?

Several of the counties provided additional comments in the survey about the effectiveness of interest as a negotiation tool.

Interest is a good tool for negotiation; we don't want to lose that.

Let counties keep interest as a negotiation tool; interest is a good tool, it's fair.

The survey results indicate that interest is used as a negotiation tool infrequently, but when it is used it can net big results. Interest was used as a negotiation tool 26 times during October 1999, by the six counties that participated in the negotiation survey. In somewhat less than half of these incidences interest was used to negotiate lump-sum payments that averaged \$6,297 and ranged from \$784 to \$16,000 per payment. One negotiation that was outside the study period timeframe resulted in a lump-sum payment of \$40,000. Part or all of interest was waived in these negotiations.

Interest was also used to negotiate other things beside lump-sum settlements. Some of the negotiations involved determining the amount of retroactive support and payment of current support. One county uses interest in conjunction with drivers' license suspension to guide delinquent obligors into a workforce program. Unemployed and underemployed obligors subject to drivers' license suspension who participate in the county workforce program have their interest waived for six months if they continue to participate in the program.

Q.5 WILL INTEREST ASSESSMENT CAUSE EXCESS BURDEN ON SOME OBLIGORS?

The inability of some obligors to pay child support has become a national issue. Dr. Elaine Sorenson of the Urban Institute estimates that 16-32% of young noncustodial fathers not paying support are impoverished.¹² In a report to the legislature exploring options for child support arrears forgiveness and passthrough of payments to custodial parents, Minnesota found that 50% of its obligors with arrears have gross monthly incomes of \$1,500 or less.¹³ Furthermore, 20% of the obligors with arrears have gross monthly incomes of \$500 or less; their arrears averaged \$3,055. This report also estimates that it would take an average of 8 years for an obligor to pay his or her arrears assuming he or she pays the maximum amount allowable. (Minnesota's income withholding statute allows an additional 20 percent of current support to be withheld to pay off arrears.)

This leads us to question why we are assessing interest when the obligor cannot even pay arrears. In fact, could the assessment of interest push some obligors away from paying because they never feel they can get caught up in their child support? We explore this empirically by comparing the percentage of arrears cases with a payment between counties assessing interest and those not assessing interest. Theoretically, interest charges would drive some obligors underground, so there would be a smaller proportion of paying cases in counties that do than in those that do not assess interest.

Exhibit 13 presents the results of this comparison. It shows that generally counties that do not assess interest have a higher percent of arrears cases with payment than those that assess interest. For example, during January-October 1999, 61.8% of the arrears cases in counties that assessed interest as of October 1999 had a payment. In comparison, 65.2% of the arrears cases in counties that did not assess interest as of October 1999 had a payment. The difference is statistically significant with a confidence of 95%. For other time periods, the difference is statistically significant with 90% confidence.

¹² Mincy, Ronald B. and Elaine Sorenson. (1998) "Deadbeat s and Turnips in Child Support Reform." *Journal of Policy Analysis and Management* 17, pp. 875-88.

¹³ James Hennessey and Jane Venohr. (2000) *Exploring Options: child Support Arrears Forgiveness and Passthrough of Payments to Custodial Families*. Prepared for Minnesota Department of Human Services Child Support Enforcement Division by Policy Studies Inc., Denver, Colo.



In part, the findings in Exhibit 13 provide some weak evidence to support the hypothesis that some obligors stop paying due to interest. The evidence is weak because, the gap is not always statistically significant; and, when it is statistically significant, it is usually significant at a 90% confidence level rather than a 95% confidence level.

Exhibit 13		
Percent of Arrears Cases with Payments by Whether County Assesses Interest		
	% of Arrears Cases with Payments	
	Jan-Jun 1999	Jan-Oct 1999
COUNTY ASSESSED INTEREST ANYTIME IN 1998		
Yes (n = 36)	54.9%	62.2%
No (n = 27)	58.2%	65.6%
Difference	-3.3%	-3.4%*
COUNTY ASSESSED INTEREST ANYTIME IN 1999		
Yes (n = 31)	54.6%	62.0%
No (n = 32)	58.0%	65.3%
Difference	-3.4%*	-3.3%*
COUNTY ASSESSED INTEREST AS OF OCTOBER 1999		
Yes (n = 28)	54.5%	61.8%
No (n = 35)	57.8%	65.2%
Difference	-3.3*	-3.4%**

*0.05 < p < 0.10

** 0.05 > p

Q.6 DOES NOTIFICATION OF INTEREST INCREASE COLLECTIONS?

In determining whether notification increases child support collections, we rely on the experiences of other states. Massachusetts reports that its annual notification, which was implemented for the first time in 1999, resulted in payments from 2,000 obligors averaging \$400 each. Virginia's notification (1995) resulted in payment from 27,000 obligors who were not previously paying. After receipt of the notice, \$12 million in arrears was collected from these obligors (\$444 each on average).

DISCUSSION

As is evident in this discussion, interest and child support collections have a complicated relationship because it is bridged by arrears. The amount of past due support is \$39.6 billion dollars nationally. There are many factors that have contributed to these arrears: obligors ignoring orders, obligors not modifying orders to appropriate levels when there is a change in circumstance, default orders that are ignored or set higher than the obligor has the ability to pay, arrears accrued while the obligor was in prison, and others. Currently, the Center for Policy Research is studying how arrears accumulated on 400 randomly selected cases in Colorado.

How arrears accrue may affect the obligor's willingness to pay them and any interest that accrues on them. In addition, as discussed earlier, some obligors may not have the ability to pay their total arrears even if interest is not assessed.

The issue of burgeoning arrears is of national concern. As more and more noncustodial parents enter fatherhood programs, these programs are asking what child support enforcement can do for their participants, particularly in the way of debt compromise and arrears suspension. Among others, these efforts include:

- ❖ Minnesota's consideration of compromising interest for some cases.
- ❖ One Colorado county that uses interest to propel delinquent obligors into job training programs.

In effect, both these examples use interest as a negotiation tool.



This page is intentionally blank.

Chapter IV

Costs of Interest

The major elements affecting the cost of implementing a uniform statewide interest policy include:

- ❖ Developing business rules;
- ❖ Automating the interest calculation and tracking functions (incorporating rules in the IV-D system);
- ❖ Statewide training;
- ❖ Entering retroactive interest charges if this policy option is pursued;
- ❖ Notifying noncustodial parents; and
- ❖ Providing ongoing customer service.

Based on other states' experiences, we believe that automation and notification are essential to a uniform statewide interest policy. We believe the former is especially critical and know of no state assessing interest statewide that has not automated the calculation and tracking of interest. Periodic notification, as practiced in Virginia and Massachusetts, also seems essential because of its potential for increasing collections.

This chapter discusses each of the major cost elements and estimates the costs of implementing a statewide interest policy.

DEVELOPMENT OF BUSINESS RULES

New business rules are typically developed by a committee composed of state and county staff. State Policy and Evaluation administrators estimate that it will take a total of 2,080 hours to develop and document business rules relating to interest. They anticipate that the task would be divided equally between state and county staff. State staff would most likely include administrators, programmers and general professionals (Levels III and IV). County staff would mostly consist of legal technicians (Levels III or IV). The estimated average pay rate for these positions is \$18.62 per hour, or \$26.31 per hour when fringe and indirect costs are included. Thus, the total labor costs of developing business rules is estimated to be \$54,725 (2,080 hours x \$26.31/hour). This does not include the costs of travel to Denver by county staff involved in the process.



AUTOMATING INTEREST

This section discusses the system requirements for automating interest (using layperson's terminology), the estimated costs of these requirements, and the time needed to implement the system changes. The estimates are based on conversations with staff and administrators responsible for policy and ACSES. Specifically, we include estimates for programming time, testing, training, development, and documentation and maintenance. The estimates may vary somewhat once business rules pertaining to interest are finalized. We have attempted wherever possible, however, to note where variations to business rules could affect automation and costs.

Programming

Costs are based on the following time estimates:

- ❖ 15 hours per program for modifications to existing programs and
- ❖ 20 hours per program for developing new programs.

The time estimates are based on the ACSES team's recent experiences modifying ACSES to accommodate PRWORA requirements.

There are eight family classifications of dollars on ACSES that will be affected by interest calculation, including:

1. IV-A
2. non-IV-A
3. non-IV-A post
4. Non-IV-D (arrear accrued prior to IV-D application)
5. costs
6. IV-E foster care
7. non-IV-E foster care
8. never assigned arrears.

All eight of these classifications will be affected because we assume that the State will want to: (1) separate interest according to federal distribution rules; (2) not assess interest on costs and fees; and (3) make other distinctions with regard to classification. Costs and fees (and any interest charged on them) are not eligible for federal incentive payments because they are program income rather than child support collections. Payment of interest is subject to federal incentive payments as long as interest is attached to child support arrears.

The screens and programs for these classifications are numerous. We discussed with State staff whether it would be possible to calculate interest on fewer classifications and thus lessen the number of screens and programs that would require reprogramming for interest automation. For example, could automation be simplified if interest would always be owed to the family rather than the state (i.e., eliminate classification 1)? While such a simplification may ease the administration of interest and the business rules, from a technical perspective the screens and programs associated with all eight families will still need to be addressed. In other words, variations in policy options will not require less programming effort.

The rest of this section identifies which programs, batch processing and screens would be affected by automating interest. These are separated by existing and new programs.

Modifications to Existing Programs

At a minimum, ACSES staff estimate that 80 existing programs would be affected by interest automation. Their estimate is based on recent experiences modifying ACSES to accommodate PRWORA, which resulted in changes to 80-120 programs. The program, screens and batch jobs that would be affected by interest automation include:

1. On-line screen with a ledger displaying current delinquency on monthly support order.
2. On-line screen with arrears obligations.
3. On-line screen with allocation and distribution (supported by about 40 programs).
4. Updating programs for arrears and ledger (about 2 programs).
5. MADJAD (Monthly Arrears Due Joint Application Development—a new function currently being developed that ages the MSO in 30, 60 and 90 day increments to better handle license suspension, credit bureau reporting and other new enforcement mechanisms triggered by payment delinquency).



6. Batch processes for arrears, ledgers and monthly calculations.
7. Display of Trans-Post Allocations.
8. State and county monthly management reports.
9. Federal reports (e.g., 157 and 34).
10. Load menus programs (5-8 programs).
11. Utilities for downloading data to other processes (about 5 programs).
12. Back-out programs for reversing a database update (8-10 programs).
13. Voice Response Unit (2-3 programs).
14. Annual noticing (2-3 programs).
15. Tax certification.
16. Enforcement remedies.
17. Bills.

These 80 programs would require 1,200 hours of programming time (80 x 15 hours per existing program). An additional 600 hours are needed to reprogram the Financial Court Case Summary which is used for credit bureau reporting, license suspension, wage assignments resulting from new hire reporting, financial institution matching and other enforcement remedies. This does not include any modifications to the monthly billing coupons. This estimate also does not include the development of business rules on how interest calculations would interact with these enforcement remedies. As discussed earlier in this chapter, this task would be completed by a workgroup of State and County administrators, general professionals, programmers, and legal technicians. They would answer policy questions such as would license suspension be triggered by the amount of arrears principal or the sum of arrears principal and arrears interest? Would a professional license be suspended if the arrears balance comprises interest only?

The total estimate of time to reprogram ACSES to accommodate interest automation is 1,800 hours.

New Programs

ACSES staff estimate they will need to write about 20 new programs for interest automation. This includes programs for:

1. interest calculation.
2. interest updating.
3. conversion.
4. programs to turn on/off the interest calculation on a case and protect that function such that only staff with security clearance (e.g., supervisors) can use it (about 5 programs).
5. interest recalculation programs to accommodate error corrections, which will also require some security functions (about 5 programs).

In all, an estimated 400 hours of programming time (20 staff hours x 20 new programs) will be necessary to develop the new programs required to automate interest. This amount may vary significantly depending on what business rules are developed.

Other Automation Costs

At a minimum, program testing takes 8-10 weeks and involves two to three staff. Another 4-6 weeks are required for documentation. The recent experience with the MADJAD for documentation and training involved 12 weeks and five staff.

Training involves another 6-8 weeks. Finally, one programmer would respond to user problems for 4-6 months after implementation.

These amounts may also vary significantly with business rules.

Total Estimated Automation Costs

The total estimated costs of automated interest are summarized in Exhibit 14. The major assumptions associated with these estimates are also listed below.

- ❖ Modifications to existing programs take 15 hours per program and the development of new programs takes 20 hours per program.



- ❖ All eight family classifications of dollars must be tracked separately (e.g., AFDC buckets from non-AFDC buckets).
- ❖ At a minimum, 80 existing programs will be affected. This is partially based on experiences with PRWORA, which affected about 120 programs.
- ❖ About 20 new programs will be needed. This includes security for turning on/off the interest calculator and interest adjustments. The exact number of new programs may vary with business rules.
- ❖ An additional 600 hours of programming time will be necessary for the Financial Court Case Summary to consider the interaction of interest with enforcement remedies (i.e., credit bureau reporting, license suspension, etc.).
- ❖ Additional costs will be incurred for testing, training, documentation and program maintenance.

Exhibit 14	
Estimated Costs of Automating Interest for ACSES	
<i>Task</i>	<i>Estimated staff requirements</i>
Modifications to about 80 existing programs	80 programs x 15 hours/program = 1200 programming hours
Modifications to the Financial Court Case Summary	600 programming hours
Write about 20 new programs	20 programs x 20 hours/program = 400 programming hours
Testing	8-10 weeks of 2-3 FTEs = 900 testing hours
Documentation	4-6 weeks of 1 FTE = 200 documentation hours
Training	6-8 weeks of 1 FTE = 280 training hours
Maintenance/Follow-up with user problems	4-6 months of 1 programmer FTE = 866 programming hours
TOTAL	3,066 programming hours 1,380 other hours 4,446 TOTAL HOURS

Finally, ACSES staff did not believe that the work requirements would differ if simple or compounded interest is used, nor did they believe the programming effort would be much different for statewide automation of interest or automating an interest amnesty

program similar to that of Massachusetts. In other words, many policy decisions have a negligible effect on programming time.

The programming would most likely be contractual at \$75 per hour. The testing, training and documenting would be performed by a general professional III, whose midrange rate is \$19.58 or \$27.66 per hour when fringe and overhead costs are included. Using these rates, the total estimated costs of automating interest on ACSES are \$268,120.

ADDING INTEREST TO AUTOMATING SYSTEMS

One of the perennial issues states face when they first automate interest is whether to enter retroactive interest and if so how. The approaches other states have taken include the following:

- ❖ No retroactive interest. Start with \$0 interest balances.
- ❖ Automatically calculate retroactive interest on arrears accrued since the beginning of the order.
- ❖ Calculate retroactive interest by applying a flat percentage to existing arrears.
- ❖ Manually calculate retroactive interest on a case-by-case basis using outside contractors.
- ❖ Enter retroactive interest on a case-by-case basis (a phased approach) by having enforcement technicians calculate it when they touch a case.

These options are discussed in greater detail in Chapter II. Based on conversations with State staff, automatically calculating retroactive interest is not a viable option. So, this leaves the options of (1) starting at \$0 interest balances, (2) starting with the interest balance that is already entered in ACSES, or (3) manually calculating retroactive interest. Based on the experiences of other states, however, we do not recommend a manual calculation. Interest was calculated manually by contractors in Alabama and New Mexico. Alabama administrators believed this conversion was generally successful although they acknowledged there were some errors that resulted in appeals. On the other hand, New Mexico encountered many difficulties and errors in their conversion; this included the conversion of interest and other information.

Arizona and New York provide examples of the phase-in of retroactive interest. In Arizona, the interest calculator is to be turned on as workers update cases. After three



years, not all Arizona cases have been updated to include interest. In New York, counties are responsible for verifying judgments and the interest on the judgment, then entering it onto the state system. From then on, the interest calculation becomes automatic. The extent to which this has been done varies among counties.

To automate a retroactive interest calculation using ACSES will be prohibitively expensive, if not impossible, because it will require automating a chronology of payments and order changes for the life of every order. Instead, an early ACSES planning committee, that had drafted a plan to include interest calculations on ACSES that became a lower priority issue when additional federal requirements were imposed, recommended starting the interest calculation with the first delinquent monthly order amount. Another option would be to start the interest calculation for all arrears beginning on a certain date. The early committee dismissed this idea because it has the potential of inflating accounts receivable quickly, particularly when interest is compounded.

In our survey of Colorado counties, we asked what approach they favored. Most favored entering \$0 interest balances or whatever amount the county gave the state to enter. One county administrator suggested going back through ACSES and zeroing out all interest arrears that could be identified.

We estimate the cost of calculating retroactive interest manually to be about \$833,756. This estimate is based on the following assumptions:

- ❖ 25 minutes to calculate interest (based on responses to the county surveys),
- ❖ 107,178 arrears cases (which is the number of arrears cases as of January 2000), and
- ❖ the interest calculation is made by a county legal technician (Level III or IV).

This estimate does not include the costs of supervision or verification. Furthermore, we believe the 25 minute average time requirement is highly variable. In another contract PSI has with the State to update its child support staffing standards, for example, we have asked technicians in several counties how much time it takes to calculate arrears alone, a first step in calculating retroactive interest. The typical response is, “It can take 10 minutes or all day depending on the case.”

The issue of how to handle retroactive interest will also need to be addressed in the development of business rules. If interest only accrues on past-due current support as of

a specified date, should there be an amnesty program for those cases that have already accrued interest? What about custodial parents? Are they entitled to interest prior to a change in policy?

TRAINING

Costs for training county staff on business rules are estimated at \$24,817 (\$1,442 incurred by the State and \$23,375 incurred by the counties). This is based on 13, two-hour training sessions administered over the course of four days to 626 county enforcement technicians at the State office. It assumes an additional 8 hours for trainer preparation and \$100 per day for refreshments. It does not consider travel expenses; that is, county staff traveling to Denver and State trainers traveling to the West Slope to hold one training session there.

NOTIFICATION

The estimated cost of one notification to all arrears cases is \$41,799. This assumes 107,178 notices (which is the number of arrears cases as of January 2000) and \$0.39 per mailing. This also includes processing time and printing costs incurred by the Colorado Information Technology System (CITS/CS) in Lakewood, the mailing and processing of envelopes by Mail Services on Sherman Street, and the costs of double-window envelopes (so the county address appears as the return address). Costs are estimated based on prior experiences mailing notifications of tax refund intercepts. They will vary somewhat according to the volume.

CUSTOMER SERVICE

Undoubtedly, statewide interest assessment will increase customer service needs. Although notification may encourage some obligors to pay, it also may cause some obligors to contact counties to request more information or to dispute the interest charges. We were unable to obtain estimates about the number of telephone calls placed in response to other notifications in Colorado. Yet, our focus groups for the staffing standards project indicate that the volume of telephone calls following tax intercept notices takes 1-5 hours per day more for at least one to two months following the date the notice is sent, and some additional time when tax refunds are mailed out. This



translates into about 3-25 minutes per letter sent. (This is regardless of whether the letter is returned due to a bad address or the addressee does not call CSE.) PSI's customer service experience in our privatization offices is about 3.5 minutes per letter sent. Nonetheless, the average number of minutes is likely to vary significantly with the contents of the letter and what actions are required.

Assuming (1) a mailing of 107,178 letters, (2) that telephone calls will be handled by County Legal Technician IIIs or IVs, and (3) 3 minutes per notice, the customer services costs are estimated to be \$100,050 for the first mailing. This is a conservative estimate. We suspect that the number of calls will decrease with subsequent mailings particularly if the mailings are monthly or quarterly.

CONCLUSION

Exhibit 15 summarizes the estimated start-up costs for automating interest and instituting a statewide policy. The estimated start-up costs are \$347,662. This assumes that interest will not be retroactively calculated. If retroactive interest is calculated, it would have to be calculated manually. This is estimated to cost \$833,756 at a minimum.

Exhibit 15	
Estimated Start-up Costs for Automating Interest and Instituting a Statewide Policies	
<i>Task</i>	<i>Estimated Costs</i>
Development of Business Rules	\$ 54,725
Automation	\$268,120
Training	\$ 24,817
TOTAL	\$347,662

Exhibit 16 displays the notification costs and increases in customer service costs that result from notification. Notifying obligors once a year of interest charges is estimated to cost \$141,849 per year, quarterly notification is estimated to cost \$267,246 per year, and monthly notification is estimated to cost \$601,638 per year. The customer service response to these notifications is conservatively estimated. In reality, the customer service response could vary widely.

Exhibit 16	
Annual Costs of Notification and Customer Service	
<i>Task</i>	<i>Estimated Costs</i>
Notification once a year	\$ 141,849
Notification every quarter	\$ 267,246
Notification every month	\$ 601,638



This page is intentionally blank.

Chapter V

Conclusions and Recommendations

Colorado counties have the discretion to assess, or decline to assess, interest on arrears. Currently, 26 Colorado counties assess interest, 37 Colorado counties do not. In the counties that assess interest, most calculate it as part of the arrears calculation when they are preparing a case for an enforcement action, rather than reviewing all arrears cases monthly and posting interest then. Nonetheless, all counties report they calculate interest according to statute.

The statewide-automated system (ACSES) does not compute interest; however, a PC-based program that calculates interest has recently become available to the counties. Once interest is calculated, county technicians are expected to enter the interest amount onto ACSES. Noncustodial parents are not routinely notified of interest assessments, although the support order includes a statement that interest may be charged.

A 1999 State audit of the Colorado Child Support Enforcement program criticized the program's interest policy. In the auditor's review of 9 cases with interest calculations, reviewers found that interest was not always calculated correctly. The State auditors also took issue with interest not being automated statewide and with the lack of notification about interest charges.

This chapter discusses the lessons we have learned from other states' experiences with interest. It also summarizes our estimates about interest's effect on child support collections and offers estimates of how much it would cost to assess interest statewide, including automating its calculation on ACSES.

LESSONS LEARNED FROM OTHER STATES

- ✓ **Most states' decisions to assess interest are based on moral grounds rather than on evidence that the policy would be cost effective.** Most states assessing interest believe that assessing interest on child support is important because it puts support on a par with other debts. In states where the decision was based on



economics (i.e., Oregon and Washington), they concluded interest assessment would not be cost effective and hence do not assess interest statewide.

- ✓ **Automation is essential to assessing interest statewide.** All of the states that assess interest statewide include interest calculations and tracking on their statewide automated system. Most of these states automated interest at the same time they were bringing up their statewide system.
- ✓ **Plan and keep the business rules simple.** A recurrent theme among the states when asked for advice on how to best implement interest was to (1) plan well, (2) plan for the unexpected, and (3) keep the business rules simple. In particular, avoid rules that require several manual adjustments.
- ✓ **Notification.** Only about half of the states assessing interest reported interest separately on the billing statement. The more common notification practice was to include it on the order or send an annual notification, which typically discussed interest as one of several enforcement remedies.
- ✓ **Alternatives to Interest.** Michigan and Massachusetts have alternatives to interest. Michigan assesses fees because their automated system did not initially have the capacity to track interest. Yet, fees are treated as program income and not subject to the same Federal incentives as child support collections. Massachusetts uses an interest amnesty program. If an obligor pays 75% of his/her current support and makes at least \$1 payment toward arrears, interest will not be assessed on his/her arrears. This parallels Federal performance indicators, which provide incentives based on the percentage of current support paid and the proportion of arrears cases with a payment.
- ✓ **Distribution can be difficult.** Interest adds additional complexity to an already complex distribution scheme. This is most evident in Texas where state statutes further specify interest distribution. As a result, Texas has 24 sub-categories of arrears it must track. At a minimum, Federal requirements double the number of classifications.

THE EFFECT OF INTEREST ON CHILD SUPPORT COLLECTIONS

In Chapter III we posed several research questions. The responses are summarized below.

1. **Will interest inflate accounts receivable?** Yes, assessing interest will inflate accounts receivable, particularly if it is assessed on all arrears. We estimate that that option would add about \$130 million to arrears balances within the first year of statewide implementation. An alternative option would be to assess interest on past-due current support only after a specified date and not assess it on existing arrears. We estimate that policy would add about \$1 million in interest arrears to the arrears balances within the first year of statewide implementation.
2. **What proportion of interest is likely to be collected?** The percent of interest that is likely to be collected is 0.6% to 6.4%. The minimum is based on Virginia's experience. The maximum is the amount that Colorado currently collects on its arrears.
3. **Does interest encourage timely payment of current support?** If interest does encourage timely payment and better payment compliance, it is not evidenced by a higher percentage of current support paid in counties and states that assess interest than in counties and states that do not assess interest. Nonetheless, some of the case examples provided in the interest negotiation survey suggested that interest on debt is sometimes used to effectively negotiate regular payments.
4. **Is interest an effective negotiation tool?** Yes. Although not used frequently, interest is used to negotiate lump sum payments, keep payments on current support regular and encourage unemployed and underemployed obligors to enroll in a six-month employment program. For a one-month study period in which six counties tracked their negotiations, there were 26 successful negotiations involving interest. The average lump-sum payment was \$6,297. One county also reported receiving a lump sum payment of \$40,000 shortly prior to the month of study.



5. **Does interest motivate some obligors to pay, while creating a disincentive for others? For example, do some low-income obligors stop paying when they are faced with even higher arrears due to interest?** The proportion of low-income obligors that could be affected by interest assessments could be large. Although the precise number in Colorado is unknown, national statistics and statistics from other states suggest that low-income obligors carry a large share of arrears debt. Nationally, about 16-32% of young noncustodial fathers not paying support have incomes below the poverty level. Minnesota found that 20% of its obligors with arrears have gross monthly incomes of \$500 or less.

6. **Does notification increase collections?** Yes, based on the experience of other states. Massachusetts reports that its annual notification, which was implemented for the first time this year, resulted in payments from 2,000 obligors averaging \$400 each. Virginia's notification (1995) resulted in payment from 27,000 obligors who were not previously paying. After receipt of the notice, \$12 million dollars in arrears was collected from these obligors (\$444 each on average).

In sum, if Colorado assessed interest on all arrears and collected 0.6-6.4% as suggested above, total collections from interest are estimated at \$0.8-\$8.6 million in the first year. We are not optimistic that the high-end of this estimate could be reached because as discussed above, we anticipate that a large amount of the arrears is owed by low-income obligors that do not have the ability to pay. Assessing interest on those arrears will not make them any more likely to pay. We believe the low-end is more realistic. Thus, if Colorado began assessing interest on all-past due current support beginning January 1, 2000 (i.e., do not apply interest on existing arrears retroactively) we estimate that \$7,000 to \$70,000 would be collected in the first year. Again, we believe the low-end of this estimate is more realistic.

COSTS OF STATEWIDE INTEREST ASSESSMENT

1. The estimated cost of implementing interest assessment statewide is \$347,662. This includes developing business rules, automating the interest function statewide, and training staff.

-
2. The estimated cost of notifying noncustodial parents is \$141,849 if notices are sent once per year, \$267,246 per year if notices are sent quarterly, and \$601,636 per year if notices are sent monthly. This includes the cost of producing, printing and mailing the notices and a conservative amount of customer service response. The estimate could be higher if the notices generate a greater need for customer service than staff now anticipate.

OTHER ISSUES

Prior to making recommendations, there are two other issues that should be considered in developing a statewide interest policy.

1. **Interstate Cases.** According to the Census Bureau, about a third of noncustodial parents live in a different state than the custodial parent. Recently, all states adopted the Uniform Interstate Family Support Act (UIFSA) which provides state-to-state consistency in the treatment of interstate cases. The Federal OCSE appointed an Interstate Reform Workgroup to review what uniform standards for collection, disbursement, distribution and case processing, and improved accounting would ease UIFSA/IV-D case processing. The need for uniform arrears and interest calculations is one of the specific issues they are assessing. The release of their recommendations has not yet been scheduled.
2. **National concern about arrears.** The amount of past due support is \$39.6 billion dollars nationally. Recent research showing that a high proportion of obligors are poor or near poor makes it unlikely that all of this debt can be paid. As a result, the Federal government and several states have become interested in child support guidelines amounts for low-income obligors and arrears accumulation and debt compromise policies that include setting a cap on the maximum amount of arrears that can be accumulated and compromising interest.

RECOMMENDATIONS

The two most extreme options are:

1. Assess interest statewide on all child support arrears; and
2. Eliminate interest.



The most compelling reason for assessing interest, as perceived from interviews from other states, is that it is fair; that is, it puts child support debt on a par with other debts. The most compelling reason *not* to assess interest statewide is that it will inflate Colorado's arrears balance, which is already high relative to other states.

Interest cannot be discussed separately from arrears. If obligors are not paying arrears, there is no reason to believe they will pay interest. Yet, we do not believe this justifies eliminating interest charges statewide. Interest is an effective negotiation tool that has been used to obtain large lump sum settlements and in some cases help move delinquent, unemployed obligors into employment programs.

We do not recommend either of the two most extreme positions. Instead, we recommend a third option.

3. Develop a statewide policy that will not inflate arrears, but that allows interest to be used when it can be used effectively (e.g., during negotiation).

We are intrigued by the Massachusetts interest amnesty program because its structure relates to the Federal performance indicators. Yet, it is not clear whether Massachusetts assesses interest on obligors who do not meet the criteria and are enrolled in an employment or fatherhood program. We recommend that if Colorado adopts a similar amnesty program they exclude noncustodial parents enrolled in an employment or fatherhood program from interest charges over a specified time period.

Specific recommendations for a statewide interest policy follow.

- ✓ **Automate Interest.** Without exception, the states that assess interest statewide automate the interest calculation and tracking of interest payments. Manual calculation is prone to human error.
- ✓ **Do not assess interest on all arrears, assess it only on past-due current support after a specified date (say the first of the year).** We are concerned that assessing interest on all arrears will inflate Colorado arrears to unreasonably high amounts. The State Auditors are already concerned that arrears in Colorado are high relative to other states. As a result, we recommend following the interest implementation plan drafted

when automation of interest was considered in the early 1990s. In this plan, interest would only be assessed on past-due current support after a specified date. In addition to not burdening accounts receivable, this approach would reduce customer service needs (i.e., in cases where the principal to which interest is applied is disputed, it would only require calculating past-due current support after a specified date rather than calculating total arrears on the order). However, there are at least two counter arguments to this approach. First, the collections that are likely to be realized will be small initially. Second, some may argue that the policy is not fair to those who have already been assessed interest.

- ✓ **Notify obligors that interest will be assessed.** According to some of the interviews with other states and the Colorado State Auditor's reports, notification is a fair way to inform noncustodial parents about interest. In addition, some states have experienced increased payments following notification.
- ✓ **Do not assess interest retroactively.** It appears to be extremely difficult, if not impossible to automate the calculation of interest retroactively. The only alternative is to compute interest manually, which is expensive (about \$0.8 million) and prone to error.
- ✓ **Develop sound business rules.** Business rules should be developed to minimize situations where interest would have to be calculated manually by a technician at the county level. This requires extremely clear rules on how interest will interact with other enforcement remedies. For example, if an obligor only owes interest arrears, could his or her professional license be suspended? Will interest accrue on medical support? In initiating orders, how will Colorado apprise the responding state on updated interest charges?
- ✓ **Plan for customer service needs.** Undoubtedly, interest charges and notification will generate increased telephone calls to the VRU and counties. We have considered these customer service needs in the cost estimates. Counties should be advised prior to mailing the interest notification to obligors so staff have adequate time to plan for increased customer service needs. Also, as part of the statewide training, counties should be advised on some of the likely questions and answers pertaining to interest.



- ✓ **Consider adopting simple interest rather than compounded.** Texas and West Virginia moved from using a compounded interest policy to a simple interest approach. The problem with compounded interest is not automating it, but with those situations when interest needs to be calculated manually and quickly (e.g., in court). In these situations, simple interest is easier to calculate than compounded interest. Both Texas and West Virginia administrators acknowledged this.

**APPENDIX I:
STATE STATUTES AND RULES**



Colorado law [§14-14-106 C.R.S] states:

Interest per annum at four percent greater than the statutory rate set forth in section 5-12-101, C.R.S., on any arrearages and child support debt due and owing may be compounded monthly and may be collected by the judgment creditor; however, such interest may be waived by the judgment creditor, and such creditor shall not be required to maintain interest balance due accounts. In cases in which the delegate child support enforcement unit is providing support enforcement services pursuant to section 26-13-106, C.R.S., interest collected on arrearages and child support debt shall be treated as a child support collection and distributed in accordance with federal regulations. Interest collected on obligations due recipients receiving assistance under the Colorado works program, as described in part 7 of article 2 of title 26, C.R.S., shall be deposited in the county social services fund and shall be distributed in accordance with the provisions of section 26-13-108, C.R.S.

The Colorado Department of Human Services Child Support Enforcement Staff Manual Volume VI [9CCR 2504-1 §6.805.4]

- B. Interest collected through support arrears/debt shall be considered a support collection and shall be used to reduce the UPA/UMP balances or, for non-IV-A cases, paid to the families.
 - 1. In order to collect interest, the interest rate will be calculated as prescribed by the state department on the balance past due at the current interest rate in effect as set forth in Section 5-12-101 and 14-14-106, C.R.S.
 - 2. Interest on arrears balances will be calculated for a specific amount of arrearages/debt covering a specific period of time. The amount of interest will be listed separately from the amount listed for child support arrears/debt. The two figures will be added together to show the total amount of judgment or non-judgment balances.
 - 3. If a county calculates interest on arrearages, it must calculate interest on all arrearage cases, both public assistance and non-public assistance cases, unless the non-public assistance applicant signs a waiver prescribed by the state department stating that calculation and collection of interest has been waived.
 - 4. The county Child Support Enforcement Unit may waive the collection of interest if it wishes to use interest as a negotiating tool to reach a payment settlement on both public assistance and non-public assistance cases.

