State of North Carolina

FINAL REPORT OF THE NORTH CAROLINA EFFICIENCY AND LOOPHOLE-CLOSING COMMISSION

April, 2001

MEMBERS OF THE GOVERNOR'S COMMISSION ON TAX LOOPHOLES AND GOVERNMENT EFFICIENCIES

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Treasurer Harlan Boyles

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State of North Carolina

North Carolina Efficiency and Loophole-Closing Commission

Governor Jim Holshouser	Governor Bob Scott	Treasurer Harlan Boyles
Co-Chairman	Co-Chairman	Co-Chairman

April 18, 2001

The Honorable Mike Easley
Governor
State of North Carolina
State Capitol
Raleigh, NC 27699

Dear Governor Easley:

On behalf of the North Carolina Efficiency and Loophole-Closing Commission, we are pleased to submit this report to you. It represents the results of the intensive review undertaken at your request to identify tax loopholes that could be closed and efficiencies that could be implemented. Given the circumstances, we think both the loophole and the efficiency recommendations represent as fair and balanced a package as we could assemble within the required time frame to yield the target savings of $150 Million in tax loophole savings and $25 Million in efficiency savings.

In both areas this report also identifies areas for further study that the Commission feels are important, but didn't feel comfortable in offering recommendations within the required time frame.

We wish to compliment the members of the Commission for their contribution of time, effort, and expertise. In addition, we acknowledge the input of both state employees and citizens who offered their suggestions.

We appreciate your commitment to give the consideration of these recommendations the highest priority.

Sincerely,

Governor Jim Holshouser	Governor Bob Scott	Treasurer Harlan Boyles

INTRODUCTION

Scope

Anticipating a major budget shortfall in the upcoming biennium gave impetus to the formation of the North Carolina Efficiency and Loophole-Closing Commission. This Commission was charged with evaluating tax loopholes that could be modified to generate revenue, and with proposing ways for government agencies to work more efficiently and also provide direct cost savings. Governor Easley also set a specific target that the Commission should achieve: identify $150 million in tax loopholes and $25 million in efficiency savings for each year of the biennium.

The Commission, co-chaired by former Governors Holshouser and Scott and by former Treasurer Boyles held its first meeting on March 16, 2001, at which Governor Easley presented his charge to them, and asked for a report by April 15, 2001. The Commission members, comprised of people in the private and the not-for-profit sectors, former legislators, and state agency managers, divided into three subcommittees; a full membership list appears following the title page. The subcommittees were a Government Efficiency Subcommittee, and two Loophole Subcommittees. The subcommittees were assisted by members of the Office of State Budget, Planning and Management and a senior staff person from the Department of Revenue, who arranged for background briefings and preparation of materials as needed by the subcommittees. Preliminary findings were presented by each subcommittee to the full Commission on March 30th, with final recommendations being submitted and voted on at its meeting on April 6, 2001. This report incorporates the modifications approved at the Commission meeting.

Methodology

At the beginning of the Commission, the members received two listings of what were considered tax loopholes, defined as taxes that give preference to certain commodities or to certain taxpaying groups. The first listing of loopholes was prepared by the Fiscal Research Division of the General Assembly, and contained over 150 items. The second listing was prepared by the Department of Revenue (DOR) and contained a subset of the above list with its two kinds of loopholes. The first set of loopholes met all the following criteria: that closing the loophole would not raise the tax rate, would broaden the tax base, would resolve an inequity, would not affect individual income taxes, and would generate at least $5 million annually. The second set of loopholes that DOR provided met some but not all of the criteria identified in the first set of loopholes. Loophole Subcommittee 1, the Business, Economic and Individual Tax Loopholes, was chaired by former Treasurer Boyles. Loophole Subcommittee 2, General, Government, and Miscellaneous Tax Loopholes, was chaired by former Governor Scott.

The Government Efficiency Subcommittee, chaired by former Governor Jim Holshouser, gathered ideas for efficiency measures from a variety of sources, due to the time constraints under which the report was due. The ideas were considered for their value from the standpoint of cost savings, efficiency, no loss in service to taxpayers, low implementation cost, and improved accountability. After much discussion, the Subcommittee felt that to be effective and generate savings, its focus should be in the areas of enhanced tax collection, management flexibility and accountability, consolidation of functions which could both reduce cost and deliver services more efficiently, and improving business systems and processes. Where a suggestion appeared to have merit but required additional study, or where dollar savings could not be developed in the time frame, the recommendations were nevertheless included in this report because it appeared that the potential for savings was high.

RECOMMENDATIONS SUMMARY

A summary of the areas where loophole closings, savings and efficiencies are proposed is detailed in the chart below. Full detailed explanation is contained in the pages which follow.

Proposed Loophole Closings	Implement Cost	Year 1 Savings	Year 2 Savings	Types of Loopholes
A. Affecting Individual Taxpayers		$52,817,000	$55,900,000	Child Health Insurance Credit Amusements Taxes Vending Machine Sales
B. Affecting Businesses		$70,500,000	$70,500,000	Tax on HMO's & Insurance LLC's in Franchise Base Holding Company Royalty & Expense Taxes Subsidiary Dividend Deduction
C. Affecting both Business & Individual Taxpayers	$5,500,000 (one time) $300,000 (recurring	$121,836,600	$173,000,000	Enhanced Delinquency Collection Uniform Telecommunication Tax Sales Tax on Fertilizer, Seed to Non-FarmerS
TOTAL PROPOSED LOOPHOLE	**IMPACTS**	**$245,154,500**	**$299,400,000**	
Proposed Areas of Efficiencies	**Implement Cost**	**Year 1 Savings**	**Year 2 Savings**	**Types of Initiatives**
A. Expand Management Flexibility	$0	$80,358,386	$85,273,275	Enhanced management flexibility Partial retention of savings
B. Consolidate Functions to Provide Services Better, at Lower Cost	$227,500	$4,319,445	$4,544,445	Consolidation of programs where it makes functional sense.
C. Improve Business Systems and Processes	$4,500,000	$24,906,675	$27,656,675	E-Government initiatives Improved project management state assets, printing, mailing
D. Increase Tax Collections	N/A	N/A	N/A	Expanded Electronic Filing
E. Increase Accountability and Program Evaluation	$0	To Be Determined	To Be Determined	Increased accountability thru routine program evaluation
F. Study Areas with High Potential for Significant Savings	To Be Determined	To Be Determined	To Be Determined	Wide ranging issues incl. Medicaid, managed competition, consolidation of networks, etc.
TOTAL EFFICIENCY IMPACTS:	**$4,727,500**	**$109,584,506**	**$117,474,394**	
TOTAL—ALL		**$354,739,006**	**$ 416,874,394**	

DETAIL OF RECOMMENDATIONS

The following sections provide more detail on each recommendation proposed by the North Carolina Efficiency and Loophole-Closing Commission. The sections are organized as follows:

Tax Loophole Recommendations

A. Loopholes Affecting Primarily Individuals
B. Loopholes Affecting Primarily Business
C. Loopholes Affecting Both Business & Individuals
D. Loopholes That Should Be Studied Further

Government Efficiency Recommendations

A. Increased Management Flexibility
B. Organization and Consolidation Recommendations
C. Improved Business Systems and Processes
D. Enhanced Tax Collections
E. Increased Accountability and Program Evaluation
F. Initiatives with Potential Savings Needing Further Study

For each recommendation, additional background information is provided if further explanation is deemed necessary. Effective dates and/or implementation costs are included, as are the Year 1 and Year 2 projected savings.

CONCLUSION

In addition to the recommendations which are discussed in more detail in the following pages, the Commission endorsed the recommendation that the Governor not overlook the importance of performance and merit increases as funds become more available.

The Commission gratefully acknowledges the suggestions that were sent to the members, the staff and to the Legislature by citizens and state employees. The Commission also wishes to express its appreciation for having had the opportunity to serve the State of North Carolina in this capacity.

RECOMMENDATIONS REGARDING TAX LOOPHOLES

AS ADOPTED BY THE NORTH CAROLINA EFFICIENCY AND LOOPHOLE-CLOSING COMMISSION

April 6, 2001

	Sector Affected	Effective Date	2001-02	2002-03

A. LOOPHOLES AFFECTING PRIMARILY INDIVIDUALS

		Sector Affected	Effective Date	2001-02	2002-03
1	**Eliminate the Children's Health Insurance Tax Credit**	Individuals	January 2001	$18,900,000	$18,900,000

Background: In 1998 Extra Session, the General Assembly created the Health Choice Program, a federal/state cooperative program providing health insurance to children under age 19 in families with incomes at or below 200% of the Federal Poverty Level (FPL). The program provided insurance to 80,750 children. Governor Easley recommended additional funding ($10.0 million in 2001-02 and $20.9 million in 2002-03) to increase the number of children served to 99,515 by 2002-03. These funds would match all federal funds anticipated to be available for this program. Also in 1998, the General Assembly created the Child Health Insurance Tax Credit, a refundable income tax credit for taxpayers who pay health insurance premiums for dependent children. The credit is equal to

the amount of the premium paid up to $300 for taxpayers with AGI under 225% of FPL, or up to $100 for taxpayers whose Adjusted Gross Income (AGI) exceeds 225% of AGI. (There are income limitations.) Elimination of the tax credit will provide more funding for the expansion of the Health Choice program resulting in more children served under the program. This will save the state money and expand services to children.

		Sector Affected	Effective Date	2001-02	2002-03
2	**Equalize the rates on Amusements at either 5% or 6%.**	Individuals	July 2001	$28,417,700	$31,000,000

Background: Amusements are defined as live entertainment, movies, cable (local franchise) and direct TV. Various tax rates are used and are shown below.

Amusements	Current	Recommended
Live Entertainment	3% (state)	6%
Movies	1% (state)	6%
Cable TV	to 5% (local)	5%
Direct TV	0% (no tax)	5%

Amusements competing with each other would be taxed at the same rate. Live entertainment and movies would be taxed at 6%. Satellite companies and cable television would be taxed at the same rate. Cable companies have been required by local governments to pay up to 5% in local franchise taxes while satellite companies have not. To equalize this, satellite companies would be taxed at 5% (sales tax). If a cable company is paying less than 5% in local franchise taxes, the differential up to 5% would be assessed as a sales tax.

NOTE: Annual savings of $24.5 million are attributable to Direct TV.

		Sector Affected	Effective Date	2001-02	2002-03
3	**Eliminate Special Tax Treatment of Vending Machine Sales by imposing a uniform 6% Sales Tax** Background: A 6% sales tax (4% state and 2% local) is currently imposed on tobacco products and canned soft drinks sold through vending machines. All other items are subject to a 6% levy on 50% of the total dollar sales. The recommendation would impose uniform taxation of sales through vending machines. Further, prepared food and soft drinks sold by vending machines would be taxed uniformly with the sales of prepared food and soft drinks sold at restaurants and take-out facilities. Likewise, tangible property sold through vending machines will be taxed uniformly with other tangible property subject to 4% state sales tax and 2% local sales tax.	Individuals	July 2001	$5,500,200	$6,000,000

		Sector Affected	Effective Date	2001-02	2002-03

B. LOOPHOLES AFFECTING PRIMARILY BUSINESS SECTOR

		Sector Affected	Effective Date	2001-02	2002-03
4	**Treat HMO's and other insurance providers equally by using the 1.9% gross premium tax currently in effect for other insurance providers only.** <u>Background</u>: Under current law, HMO's are not subject to a gross premiums tax as are other insurance companies. However, HMO's pay the 0.5% regulatory fee. All 50 states impose a gross premiums tax on insurance companies. Twenty-three (23) states tax HMO's, 15 at lower rates than other insurance companies, while 10 (including NC) do not impose a gross premiums tax on HMO's.	Business	January 2001	$19,500,000	$19,500,000
5	**Include Limited Liability Companies in the Franchise Tax Base.** <u>Background:</u> The State franchise tax is among the oldest taxes in N.C. It is a tax on S corporations and C corporations for the privilege of doing business in the State. Currently, the tax does not apply to a limited liability company (LLC). The General Assembly authorized LLCs consisting of two or more members in 1993 and authorized single-member LLCs in 1997. The proposal is to apply the franchise tax to LLCs and to reduce the annual report fee from $200 to $20. The tax rate is $1.50 per $1,000 value of the greatest of (1) apportioned net book value of the corporation, (2) 55% of appraised value of real and tangible personal property in N.C., and (3) total actual investment in tangible property in N.C. Several states, such as Tennessee and Texas, tax LLCs at the entity level, but most states that have a franchise tax do not apply the tax to LLCs.	Business	Taxes due on or after 1/1/02	$6,000,000	$6,000,000
6	**Follow the Ohio law on related companies and require and adjustment for royalty expenses and interest expenses.** <u>Background:</u> This affects holding companies that have subsidiaries and charge their subsidiaries royalty and interest expenses. Many corporations create holding companies in states that do not tax royalty or interest expenses. These companies charges their subsidiaries a royalty and /or interest expense and pay no corporate income tax on the profit. Other states, most notably Ohio and Connecticut, have approved statutes to disallow deductions between their corporate taxpayers and related out-of-state trademark protection companies or other affiliates that manage intangibles. The proposal recommends adoption of the Ohio approach.	Business	January 2001	$15,000,000	$15,000,000

		Sector Affected	Effective Date	2001-02	2002-03
7	**Conform North Carolina's Subsidiary Dividend Deduction to the generally accepted tax practices in use in other states, eliminating preferences.** Background: Companies that own more than 50 percent of N.C. subsidiaries can currently deduct all of the dividends received from the subsidiary plus all expenses related to the dividends. General taxation practice is to tax income and deduct expenses related to generating that income. This treatment was in place in N.C. until 1997 for most corporations. Until 1997, N.C. provided this dividend-related deduction only for companies that had dividends from North Carolina subsidiaries; other corporations did not qualify for this exemption. With the U.S. Supreme Court's decision on the intangibles tax case, this preference could be declared unconstitutional. For compliance, the General Assembly broadened the exemption to all subsidiaries, eliminating the economic development justification. Now N. C. provides a far greater benefit than do most other states. 18 states (40%) adhere to the federal definition. 17 states (38%) require unitary reporting. This conforms NC law to that of most states and has no anti-competitive effects.	Business	January 2001	$30,000,000	$30,000,000

	Sector Affected	Effective Date	2001-02	2002-03

C. LOOPHOLES AFFECTING BOTH INDIVIDUAL & BUSINESS

		Sector Affected	Effective Date	2001-02	2002-03
8	**Treat all Telecommunication Services Equally by Using the Uniform Tax Rate.** Background: Tax rates for telecommunication services are established at different rates for different services in North Carolina. This recommendation attempts to simplify the tax rate on telecommunications by applying one tax rate (6%) to all telecommunications including interstate telephone calls. It lowers the rate on local service from 6.22% (3% on sales tax and 3.22% gross receipts tax) to a 6% sales tax; lowers rates on intrastate long distance tax services fee from 6.5% to 6% and adds interstate long distance to the sales tax base at 6%. Currently the interstate service (long distance calls) is not taxed. The recommendation holds local governments harmless. The 6% rate is recommended since it is the basic sales tax rate charged in North Carolina. Thirty-one of the 35 states surveyed levy sales taxes or excise taxes on intrastate telecommunication services.	Business Individuals	July 2001	$82,503,000	$90,000,000
9	**Eliminate the Preference of Not Charging 6% Sales Tax on Fertilizers and Seeds Purchased by Non-Farmers.** Background: Currently, all fertilizers and seeds are exempt from the sales tax. This exemption dates back to when these items were primarily used in agricultural production. Today, there is an increasing volume of these items purchased for non-agricultural uses (residential as well as commercial uses such as golf courses and lawn maintenance services).	Individual Business	July 2001	$7,333,600	$8,000,000

		Sector Affected	Effective Date	2001-02	2002-03
10	**Endorse enhanced collection of delinquent taxes as reported by the Department of Revenue. Introduce legislation to assess the fee (currently 20%) charged by DOR's contract collection agency to the delinquent taxpayer, for all delinquencies including those collected by the DOR. Also strongly suggested is that the Governor request an emergency appropriation to expedite the collection. And finally, the Department is directed to aggressively promote its Voluntary Disclosure Program to ensure broadest tax compliance.**	Individual Business	July 2001		
	Background: At the end of FY99-00,DOR estimated $120 million in delinquent, collectible taxes. DOR is reviewing these accounts for collectibility, with the expectation that the total will increase. Of the $120 million, $18 million was included in the Governor's budget in 1st year revenue from this. This recommendation addresses the remaining $102 million, of which DOR has a preliminary projection of $32 million in Year 1 and $70 million Year 2. The Commission will rely on the decision of the Governor, the Department, and State Budget to set the final goals but with strong encouragement to bring in the maximum amount in Year 1. DOR estimates that $5.5 million will be needed for increased staffing and related support costs to generate this revenue. DOR's estimated cost to implement the 20% collection is $300,000 in fees, computers, software for an additional $5 million in Year 2.				
	Delinquent Collections Projections	One Time	$5,500,000	$32,000,000	$ 70,000,000
	Collection Fee Projections	Recurring (note: rate will be different in out-years)	$300,000		$ 5,000,000

Summary of Tax Loopholes by Sector

	2001-02	2002-03
Individual	$52,817,900	$55,900,000
Business	$70,500,000	$70,500,000
Both	$121,836,600	$173,000,000
Total	$ 245,154,500	$ 299,400,000

		Sector Affected	Effective Date	2001-02	2002-03

D. LOOPHOLES RECOMMENDED FOR FURTHER STUDY

		Sector Affected	Effective Date	2001-02	2002-03
11	**Conform to Federal Law on the Taxation of Social Security Benefits** <u>Background</u>: North Carolina does not tax social security benefits. However, depending on the level of income a portion of these benefits are taxed by the federal government. Under this proposal the state would conform its law to that of the federal government. It is estimated that this change would bring in $85 million in fiscal 2001-02.	Individuals	Jan. 2001	$85.3 million	$85.3 million
12	**Eliminate the Special Expense Deduction for Financial Institutions** <u>Background</u>: Under current state law financial institutions can deduct the expense incurred in generating tax-exempt income. The proposal would eliminate this tax preference and conform state tax law to the federal law.	Business	Jan. 2001	$85-114 million	$85-114 million
13	**Eliminate or Modify Tax Credits in Tiers 4 and 5.** <u>Background:</u> Under the provisions of the Bill Lee Act counties are placed in five tiers based on certain economic and demographic characteristics. The higher the tier the more prosperous the county. Although business entities located in lower tier counties receive large tax credits, most of the credits are claimed in the more prosperous counties. The proposal would lower or eliminate the tax preference allowed in the more prosperous counties.	Business	Jan. 2001	$20+ million	$20+ million
14	**Restore the Single-Weighted Sales Apportionment Formula** <u>Background:</u> A corporation uses a three-factored formula in determining its state income tax liability. The three factors are the relative share of the corporation's sales, wages, and real property located in North Carolina, with the sales factor being doubled weighted. The apportionment typically gives a preference to corporations with a sizeable physical presence in the state.	Business	Jan. 2001	$56.1 million	$56.1 million
15	**Conduct a comprehensive study of the taxation of services under the sales and use tax.** <u>Background</u>**:** This option involves the expansion of the Sales Tax Base to include repair and installation of tangible personal property and personal services such as beauty and barber services. Traditionally, the sales and use tax has been levied on the retail sale of tangible goods. As incomes have grown, the demand for services has escalated. In 1960, services represented only 41% of total consupmtion expenditures compared to 58% in 2000. To combat the erosion of ther sales tax base, many state have begun to tax various types of services.	Individual	July 2001	$278 million	$303 million

		Sector Affected	Effective Date	2001-02	2002-03
16	**Evaluate the partial rate/cap on Boat, Plane, and Train purchases.** <u>Background</u>**:** Currently, boats, planes, locomotives, and railway cars are taxed at 3%, with a cap of $1,500. The taxation of these items should be evaluated in comparison to the policies (rates and caps) of neighboring states.	Both	July 2001	$9.6 million if cap eliminated $1.9 million if cap at $2,500	$10.5 million if cap eliminated $2.1 million if cap at $2,500
17	**Evaluate the maximum rate ($1,500) on Motor Vehicle purchases (Motor Vehicle Use Tax).** <u>Background</u>: Currently, the sales of motor vehicles are taxed under the Motor Vehicle Use Tax at a rate of 3% of the net sales price, with a maximum tax of $1,500. The maximum limit should be evaluated from the perspective of fairness and competitiveness.	Individual	July 2001	$2.4 million if cap eliminated $1.8 million if cap at $2,500	$2.7 million if cap eliminated $2.0 million if cap at $2,500
18	**Study the exclusion from sales tax for custom software**. <u>Background</u>: Currently, custom computer software is exempt from the sales tax since it is primarily the provision of a professional service. Independent of a comprehensive review of the taxation of the services, the exemption of custom computer software should be evaluated.	Business	July 2001	$5.04 million	$5.5 million
19	**Study the exclusion from sales tax for door-to-door sales of newspapers and periodicals.** <u>Background</u>: This special exemption is for door-to-door sales of publications and advertising inserts. This exemption was enacted in the days of paperboys and the advertising insert exemption was enacted in response to an exemption for free circulation papers, which has since been repealed.	Individual	July 2001	$4.1 million	$4.5 million
20	**Evaluate the preference given to pension benefits for public employees (other than *Bailey) for equity and constitutionality.*** <u>Background</u>: Unlike the $2,000 exclusion for private retirees, a $4,000 exclusion of pension benefits is provided for governmental retirees. The Commission requests an evaluation of this exclusion from the standpoint of equity and constitutional requirements.	Individual	Jan. 2001	$10.0 million	$10.0 million
21	**Study the Corporate Income Throwback rule.** <u>Background</u>: Currently, out-of-state sales of multistate corporations escape all state taxation. Establishing a Corporate Income Tax Throwback rule would include this "nowhere sales" as taxable in North Carolina.	Business	Jan. 2001	$12.0 million	$12.0 million

		Sector Affected	Effective Date	2001-02	2002-03
22	**Study the Guaranty Association tax credit to determine whether to continue it, cap it, or eliminate it**. Background: Currently, insurance companies receive a 100% tax credit for assessments paid to the NC Insurance Guaranty Association and NC Life and Health Insurance Association. The credit is taken over 5 years. The Commission suggests a study of this tax credit to determine whether it should be continued in its current form, capped, or eliminated	Business	Jan. 2001	$14.1 million	$9.7 million
23	**Evaluate elimination of the 1%/$80 sales tax on manufacturing machinery.** Background: The 1%/$80 cap provides a sales tax preference to manufacturer purchases of manufacturing machinery. Since sales tax is typically levied on sales at the retail level, many states do not tax equipment purchases by manufacturers. This item should be evaluated for effectiveness under current economic conditions.	Business	Oct. 2001	($22.0 million)	($30.0 million)
24	**Update the November 1994 Peat Marwick Study of the states economic competitiveness submitted to the Tax Policy Study Commission.** Background: In 1994, Peat Marwick prepared a study of the impact of tax policy on North Carolina's economic competitiveness for Governor Hunt's Policy Office. The study compared North Carolina with 20 other states in terms of the incidence of taxes on businesses and households. As a result of changes in North Carolina's economic and tax structure, the Commission believes that questions regarding the State's competitiveness should be revisited.	Business			
25	**Study the concept of utilizing targeted tax credits in lieu of other tax preferences such as deductions, exemptions, etc. as a means of providing relief to low-income individuals and families.** Background: The Commission discussed the potential of broadening the tax base by eliminating many of the existing tax exemptions. In order to mitigate the increase in regressivity, refundable tax credits would be enacted for low-income individuals and families.	Individual			
26	**Study the state tax policy implications of the New Economy/Internet era.** Background: The Commission is concerned that the continued evolution of retail activity from brick-and-mortar establishments to independent remote sellers (mail order, dot.com's) will further erode North Carolina sales and use tax receipts.	Both			

		Sector Affected	Effective Date	2001-02	2002-03
27	**Study the state tax effects of the underground economy.** Background: Review and estimate the impact of untaxed economic activity ("the underground economy") in North Carolina.	Both			
28	**Study the impact of tax policy regarding tobacco and alcoholic beverages on the low-income population in N.C.**	Individual			

RECOMMENDATIONS REGARDING GOVERNMENT EFFICIENCIES

AS ADOPTED BY THE NORTH CAROLINA EFFICIENCY AND LOOPHOLE-CLOSING COMMISSION

April 6, 2001

	Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings

A. MANAGEMENT FLEXIBILITY

1	**Temporarily expand management flexibility and give greater delegation to the University System, the Community College System, the public schools, and other state agencies in the areas of Budget, Personnel, Property Management and Purchasing, with regular reporting to the Governor and the General Assembly as to the results. This should provide a sound basis for reducing agency general fund budgets by 1% in 2001-2002 (excluding Public School Fund and allocation to community colleges). Agencies should be encouraged to implement other cost-savings initiatives and be rewarded with 2.5% retention of such savings which can be expended only on one-time expenditures that will not impose additional financial obligations on the State.**	$ -	$80,358,386	$85,273,275	Recurring

Background: Some agencies should be allowed to opt out of this proposal, should they demonstrate that the benefits of flexibility will not be sufficient to create the savings to offset the budget reduction. Programs with "pass-through" monies (e.g. K-12 funding, etc.) should not include those funds in the 1% reduction. A key component of this initiative will be the increased ability of agencies to transfer money between budgetary line items.

	Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings

B. ORGANIZATION & CONSOLIDATION

	Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings
2	**For those agencies dealing with the public safety, justice, and correctional systems, explore consolidation of units to better align their functions, share common services, reduce duplicated areas of coverage, streamline services, and reduce administrative costs.**	Severance, if positions eliminated by means other than attrition, vacancies & Other administrative costs			
	Background: Savings would be by elimination of functional duplication in administration. Several examples of functions that could benefit from partial or total consolidation include:				
	--Community Services Unit of Victim & Justice Division of CCPS and Community Correction of Correction Dept.		$386,154	$386,154	Recurring
	--Investigative Law Enforcement Units, such as Securities Investigators in Secretary of State, SBI's Financial Crimes Unit, Department of Revenue's Tax Fraud Investigator Unit, Department of Insurance's Insurance Fraud Investigators, and Medicaid Fraud Investigators in Department of Justice		To Be Determined	To Be Determined	Recurring
	--Enforcement Units, such as State Highway Patrol in CCPS, DMV Enforcement in DOT, State Capitol Police in DOA (savings noted include only incorporation of State Capitol Police functions into other enforcement units and related reduction of staff levels)	$227,500	$1,250,000	$1,250,000	Recurring
	--Specialty Law Enforcement Units, such as Marine Fisheries Enforcement Unit in DENR and Wildlife Enforcement Unit in the Wildlife Commission		$65,000	$65,000	Recurring
	--All Offender Programs		To Be Determined	To Be Determined	
	--Administrative Staff if CCPS is eliminated		$2,501,359	$2,501,359	Recurring
3	**Eliminate the Boxing Commission.**		$116,932	$116,932	Recurring
4	**Strengthen the procurement of information technology by consolidating the purchasing function into a single location at Information Technology Services.** Background: Senate Bill 222 from the 2000 Session of the General Assembly transferred information technology purchasing for state agencies other than universities, LEA's, AOC, and the community colleges, but positions exist in both ITS and DOA at this time because DOA can still purchase for these entities above their delegated levels. This proposal recommends that the Legislature transfer all IT purchasing to a single agency and that the agency be the Office of Information Technology Services. Prior to SB222, there were 4 FTE performing IT purchasing functions; there are currently 16 FTE doing this. Due to the transitional nature of IT purchasing and the many initiatives now underway, it is estimated that a total of 12 FTE will be required once this moves into ongoing phase, resulting in Year 2 savings of 4 FTE.	Severance, if positions eliminated, though reduction through attrition is recommended Other administrative costs	N/A	$ 225,000.00	Recurring

	Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings

C. BUSINESS SYSTEMS AND PROCESSES

5	**Identify state assets than are no longer needed or underutilized, and sell them.** <u>Background:</u> The state could sell the parcel of land where State Surplus Property is located in Raleigh. The State Surplus Property and Federal Surplus Property operations would be combined and co-located on a separate site. The estimated Year 2 savings are "net" to the state after implementation costs. The committee did not have the detailed implementation costs available for this document. Note: the Governor's 2001-2003 Recommended Budget already includes $16 million from the sale of the Polk Building in Charlotte, and a tract of land in Cary.	$ -	$ -	$2,000,000	One-time
6	**State agencies should routinely publish and distribute policy manuals, memoranda, reports, and other documents electronically. These initiatives should replace the need for printed documents.** <u>Background:</u> These initiatives should yield a reduction of 5% of the statewide printing budget, and 5% of the statewide postage budget. The state already has technical standards in place for the distribution of electronic documents to ensure that different technologies can access electronic documents.	$ -	$8,800,000	$8,800,000	Recurring
7	**State agencies should evaluate their business processes and contractual agreements for the management of contractor staffing.** <u>Background:</u> The use of performance-based contracting and routine program evaluation of agencies with significant expenditures in contracting should be done routinely. The 532199 "Misc Contractual Services" line item, if reduced by 5%, could provide significant savings.	$ -	$12,460,767	$12,460,767	Recurring
8	**State agencies should routinely review administrative line items for reduction at no harm to mission-critical functions. Such reductions could be in expenditures for non-mandatory membership dues and subscriptions, general office supplies, overtime, etc.** <u>Background:</u> A reduction of 5% in membership dues/subscriptions and general office supplies only would yield significant savings.	$ -	$2,202,803	$2,202,803	Recurring
9	**Routinely revisit and confirm that actual use of cellular phones is in line with the contracted plan to ensure best value.** <u>Background:</u> This review should be conducted every quarter by agencies to ensure that the selected plans mirror actual usage. A reduction of 20% of line item 532814 could produce significant savings.	$ -	$1,443,105	$1,443,105	Recurring

	Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings
10	**The state should utilize electronic forms capability to reduce the need to process data manually and to capture efficiencies from automated workflow and streamlined data processing.** Background: The state would realized reduced internal processing, storage, and paper costs. Savings would be derived from positions in all state agencies, and the costs to implement would be distributed to state agencies on a project by project basis. Confirmation of savings would require special reporting to ensure results are achieved.	$ 3,500,000	$ -	$ -	$10,000,000 Recurring after 3 years
11	**Implement a statewide time and attendance electronic solution. Alternative financing arrangements should be explored to provide the money needed to procure and implement the system.** Background: The system would allow the state to maintain and process timesheets electronically and interface into payroll. Alternative financing arrangements should be considered to provide the money for procurement and implementation. Examples include funding the procurement and implementation over several years, or using a central pool of funds made available from savings from e-government initiatives.	$ 1,000,000	$ -	$750,000	Recurring

Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings

D. ENHANCED TAX COLLECTIONS

12 Actively promote the electronic filing of tax returns. Background: North Carolina has led the country in the percentage of people filing electronically. It benefits the State because it reduces the requirements for mail processing, data entry and storage, and benefits the taxpayers because it provides quicker turnaround. According to the Department of Revenue, $50,000 had been budgeted to promote the program, but not expended due to the budget shortfall. Subcommittee suggestions to promote included less costly avenues such as mail inserts.	$	N/A	N/A	Recurring

E. ACCOUNTABILITY AND PROGRAM EVALUATION

13 The state should implement a routine cycle of program evaluations of state agency programs. Background: These evaluations would serve as a third party analysis of the effectiveness and efficiency of state government programs and provide detailed analysis on the results of increased management flexibility. Agencies should achieve efficiencies through increased management flexibility. It is estimated that recommendations from the evaluations will yield savings in the range of 10% of the program operating costs in the first evaluation cycle, and 3% in subsequent cycles.	$ -	Cost Avoidance	Cost Avoidance	
TOTAL :	**$4,727,500**	**$109,584,506**	**$117,474,394**	

Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings

F. INITIATIVES WITH POTENTIAL SAVINGS NEEDING FURTHER ANALYSIS

14 Update the 1995 OSBPM study of state owned aircraft to identify ways to improve management of the state's aviation functions, especially in areas of passenger travel and use of aircraft for non mission-critical purposes.

Background: The state operates a large number of aircraft for purposes of law enforcement, firefighting, photogrammetry, and transportation. Aircraft are expensive to operate and to maintain, and this is an area where an updated review is in order. Options include fractional ownership of aircraft - this essentially amounts to "time sharing" where the state buys a "block" of time to use the aircraft.

15 Carefully analyze the suggestions about decreasing drug costs at Department of Correction by implementing alternatives to specific courses of treatment, and also consider managed competition for pharmaceutical services.

Background: The Department has seen an enormous growth in expenditures for pharmaceuticals over the past 5 years. Much of this is due to the fact that there are new drugs which are not available yet in generic forms. Suggestions were made that there are alternate treatment modes of some common ailments that do not require the non-generic medicines to the degree that they are being prescribed. However, the time frame of the Commission does not allow a full analysis of the suggestion, but it appears to warrant a closer review.

16 Share telecommunications networks where practical and feasible.

Background: Much work is being done in this area, and there is the potential to begin by consolidating law enforcement networks that are currently not part of ITS. There is a potential savings in both line costs and reduction of duplicative staffing costs to operate multiple networks. Other non-ITS network should be similarly considered where consolidation potential exists.

17 Propose legislation to allow retired state employees to work for salary only and with no cap on their earnings.

Background: This would encourage agencies to use this resource which would save the State from having to contract for their services. It would also save the cost of health and retirement benefits, since their health benefits would be covered by the Retirement System, and they would no longer receive the state's contribution towards retirement. Legislation was passed last session to enable teachers to do this after a 12-month waiting period to address the teacher shortage.

Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings

18 Endorse the concept of managed competition for state services.

Background: Managed competition is used in local governments. Managers identify specific functions which are provided in both the private and public sectors. Agencies and private sector companies are encouraged to submit competitive bids on what it would cost to provide the services, and an independent reviewer analyzes the bids to determine where it can be provided most cost-effectively.

19 Establish a preference formula to determine the net benefit to the State to ensure that in-state businesses get a fair chance in doing business with the State.

Background: As more opportunities to do business with the State are publicized electronically, there is a need to consider not only the bid price, but also the value to the tax base and employment opportunities that a North Carolina business provides. Such formulas determine net benefit and are routinely used by local governments.

20 Endorse the ongoing study of Medicaid to identify key elements which the state should consider to contain ever-increasing costs.

Background: Areas of concern which are being studied include that North Carolina offers optional services and has more liberal eligibility criteria than other states in region; clients' use of services; Prescription issues; State's payment to its own institutions as cost-driver for private sector; Fees to providers; Mental health programs.

21 Direct an independent agency to conduct a review of the costs and benefits of fuel efficient vehicles in the State to ensure that fuel efficiency, operating costs, and life cycle issues are routinely reviewed.

Background: Motor Fleet Management has purchased and is using fuel efficient hybrid vehicles and alternate fuel vehicles in its fleet of passenger vehicles, which have the potential for reducing operating and fuel costs and being beneficial to the environment; however, their use is still too new to determine.

22 Develop a uniform set of statutes for conducting criminal history checks for non criminal justice agencies.

Background: The criteria for conducting criminal history checks are inconsistent among different organizations and do not reflect the new technologies. This proposal is intended to develop a more uniform approach to doing these checks and would also explore new approaches and setting fees based on the actual costs to conduct them.

	Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings
23	**Conduct a study of alternate work options as a means of energy conservation and sustainability, in a manner that ensures taxpayer services are not reduced.** <u>Background</u>: Ideas suggested include telecommuting, alternate work schedules, etc. to reduce fuel usage, building energy costs, etc.				
24	**DOR should study whether to plan for a 60-90 day tax amnesty program to encourage delinquent and non-filing taxpayers to remit what is due to the State. Commission recommends that if the Administration deems that an amnesty program will generate significant additional revenue, that it do so and that the legislature grant them the authority if needed.** <u>Background</u>: In 1989, the State had a short, well-promoted amnesty program that yielded $40 million. The primary costs were approximately $1.2 million for extensive promotion and to bring field staff into the main office for an extended period to put full attention to the effort. There is currently a Voluntary Disclosure Program that offers an amnesty to taxpayers who meet five specific criteria, and is not directed towards delinquent filers. However, it has not been widely promoted, nor have additional resources been put towards this effort. DOR says that the advance planning for such a program is extensive, both internally and in promoting it, and as such requires additional study and planning.				
25	**Establish base staffing standards for administrative support functions used in all agencies, e.g., personnel, accounting, payroll, purchasing, budgeting, fixed asset management, risk management, etc. Allow agency flexibility to determine specific levels for each function within its total administrative allotment, based on specific requirements.** <u>Background:</u> This would allow agencies to reallocate their allocation of administrative staff to meet unique program needs. It is expected that some cost avoidance would be realized through the absorption of increased workloads by existing staff.				
26	**For those agencies dealing with the employment and training systems, appoint a Task Force chaired by the VP for Workforce Development in Community Colleges to develop a plan for consolidation of units and agencies to better align their functions, share common services, streamline services, and reduce administrative costs.** <u>Background:</u> Currently there are worker training programs in eight different state agencies. According to DCC's specialist, there is potential for improved operation and savings between Employment Service and Job Link programs.				

	Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings
27	**For those agencies dealing with the collection of fees, appoint a Task Force chaired by the State Budget Director to develop a plan for consolidation of fee collection functions into the Department of Revenue to identify better ways to receive, process, and account for all revenues due to the state. Savings would be in the form of reduced staff required to process fees and conduct collection activities and improved cash flow and resulting interest received.** Background: Areas for consideration include: --Fees related to driving, vehicles, and motor fuels --Fees paid to regulatory agencies --Penalties and fines Reporting data would continue to go to the "home" agency. This recommendation only addresses expedited fee collection.				
28	**Review the State's Boards and Commissions for areas where consolidation could save money, improve efficiency, and minimize duplication of areas of responsibility.** Background: Areas for consideration include: --Sharing administrative staff among several related boards or commissions to strengthen efficiency and reduce the overall number required to support their operations --Reviewing areas of responsibility where jurisdiction overlaps, such as worker training and employment areas --Improved coordination of meeting times and frequency				
29	**Strengthen information technology procurement by establishing criteria for independent third party review of information technology projects at the outset and throughout their "life" to ensure timeliness, cost containment, and minimal changes to scope**. Background: This third party review would be used for "major" projects with high risk to the state. This recommendation would strengthen the Information Resource Management Commission's (IRMC) controls already in place of project certification, and post-project audit reviews by adding a review during the implementation of the project.				
30	**Initiate a statewide contract for express mail and overnight mail services.** Background: The state currently does not have a statewide contract for express mail and overnight mail services. It is anticipated that the state would save money through aggregate purchasing.				
31	**Combine statewide printing and mailing operations to the Mail Service Center to reduce handling and mailing costs of large volume state-agency mailings.** Background: The Department of Administration is exploring the concept of a "print to post" operation in conjunction with the Mail Service Center.				

Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings
32 Document and capture the internal processing savings resulting from the implementation of e-government projects. Agencies should also project and confirm the anticipated changes in staffing requirements once full implementation has occurred. Agencies would be encouraged to make use of normal staffing attrition over the life of the project. Background: The committee supports advance planning of these projects to allow attrition to work instead of reductions in force to the fullest extent possible so that savings might be realized. As a pilot for this concept, the Division of Motor Vehicles should begin to reduce processing staff through attrition for ongoing savings due to the elimination of data entry requirements.				
33 Implement procurement card statewide, based on results of pilot program, after confirming that strong internal controls are in place. Background: The procurement card pilot study has shown great benefits in cost avoidance through absorption of increasing workloads by accounts payable staff and greater vendor satisfaction due to faster payment by agencies.				
34 Periodic regular review of user fees should be conducted to ensure that the state is recovering the full cost of the service through its fees structure. In addition, regular reviews of fees charged to state agencies by internal service funds and enterprise funds should be conducted to ensure the rate structures are fiscally sound and appropriate for the service being delivered. Furthermore, where alternative service delivery methods exist, establish a fee structure that provides incentives to using the method which provides the service for the least cost. Background: These rates comprise a significant portion of agency budgets. The Office of State Budget, Planning, and Management-Management Section should serve as the independent review authority. As a pilot project for alternative service delivery, motor vehicle registration fees should be amended to encourage on-line registration of license plate renewals over mail-in and walk-in methods. A standard fee would be set for walk-in renewals, a lower fee for mail-in renewals, and the lowest fee for on-line renewals.				
35 State agencies should utilize a standard comparative cost model for analyzing leasing and construction alternatives for state agencies. Alternative financing options should also be examined for state government facilities. Background: A model to analyze construction vs. leasing costs was developed by the Office of State Budget, Planning, and Management, the Office of State Construction, and the State Property Office. This model was reported to the General Assembly in June of 2000.				

Recommended Initiative	Cost To Implement	Year 1 Savings	Year 2 Savings	Type of Savings
36 **The state should use performance contracting as a financing alternative for the acquisition of major equipment such as HVAC systems, boilers, auxiliary generators, etc.** Background: Funds from contractors would be used to purchase the equipment, with performance incentives built in the contracts for contractors.				
37 **Eliminate the procurement of printed letterhead for state agencies.** Background: Word processing software allows the creation of templates to produce agency letterhead at no additional cost to the agency. The committee recognizes that while the elimination of printed letterhead is a savings, analysis indicates that the savings is very small. The committee endorses this recommendation from the standpoint of sound management practices.				
38 **Develop and utilize a standard battery of financial measures to use in establishing selection priorities for e-government projects, e.g., business case analysis, return on investment, payback period, and net present value.** Background: The utilization of a standard battery of measures would assist decision makers in making more informed project selection decisions.				
39 **The state should continue to integrate business information systems to enhance compatibility and reduce the cost of maintaining multiple systems through complex and cumbersome interfaces.** Background: Most of the central business systems in use today by the central administrative agencies (Office of State Budget, Planning, and Management, Office of the State Controller, Office of State Personnel) were developed and implemented independently of one another. In addition, the University System runs independent systems. Better planning would lead to further consolidation of systems that would meet the state's needs and provide better quality and more timely business information for decision makers.				
40 **State agencies, universities, community colleges, public schools, and local governments should be encouraged to participate in the state's e-procurement program.** Background: The state currently has a e-procurement system which is being implemented by the Office of State Controller, the Office of Information Technology Services, and the Department of Administration. The committee believes that e-procurement represents a significant opportunity for cost savings to the state once implemented. In addition, increased participation by all agencies helps to mitigate risk to the state by ensuring that the financial projections will be realized.				