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Section 7
organization and Staffing Issues

Department of Revenue
Functional Reorganization

Issue Statement

The objective of this paper is to assess the Department of Revenue's proposed functional reorganization.


Background

The Department of Revenue (DOR) administers the tax laws of North Carolina and collects the taxes due the state. The Department has approximately 1,189 positions responsible for administering and collecting various state and local taxes. The Department's 1992-93 budget is $52,739,894. Gross revenue collections for 1991-92 were approximately $10.1 billion and have steadily increased over the past six years as shown in Exhibit 1.

In September 1988, a committee of DOR employees was formed to develop a plan for modernizing existing tax processing systems, addressing other automation needs, and developing a functional concept for the new building into which the Department was planning to move. The committee's functional concept of the new building was for an open office environment and for one floor to be devoted to linear processing of tax returns. In May 1990, DOR senior management presented a plan of reorganization to the Secretary of Revenue. The Secretary endorsed the reorganization plan in October 1990, and Governor Martin approved plans to reorganize the Department in September 1991.

In December 1992, the Department will move to the new revenue building in the downtown government complex. In conjunction with the move, DOR plans to reorganize along functional lines so that like functions will be together. For example, a sales and use tax audit and an income tax audit often encompass many of the same steps. Under the current organization, a business could be audited independently by a sales and use tax auditor and an income tax auditor and the two auditors would most likely not share information discovered during each of their audits. In the new functional organization, a business will be audited by a single auditor or a team of auditors. In this way, much of the information discovered in one audit could be used in the other audits. Other staff in the various taxing divisions will be consolidated in the same way.

Previous studies of DOR have advocated this functional organization. The 1985 Governor's Efficiency Study Commission Report stated that "the tax collection divisions have many duplicate functions which could be consolidated to achieve substantial economies." A 1988 report prepared by the State Auditor's Office recommended that DOR consolidate its auditors in one division much like the South Carolina Tax Commission, which is organized on a functional basis and has all of its auditors assigned to the Field Services Division. These auditors exercise all of the Commission's audit responsibilities. At the time, the DOR did not believe that consolidating its auditors was feasible because of space limitations in its existing building, but said it would consider the idea when established in the new building.

EXHIBIT 1
Gross Revenue Collections for Fiscal Years
1986-87 to1991-92

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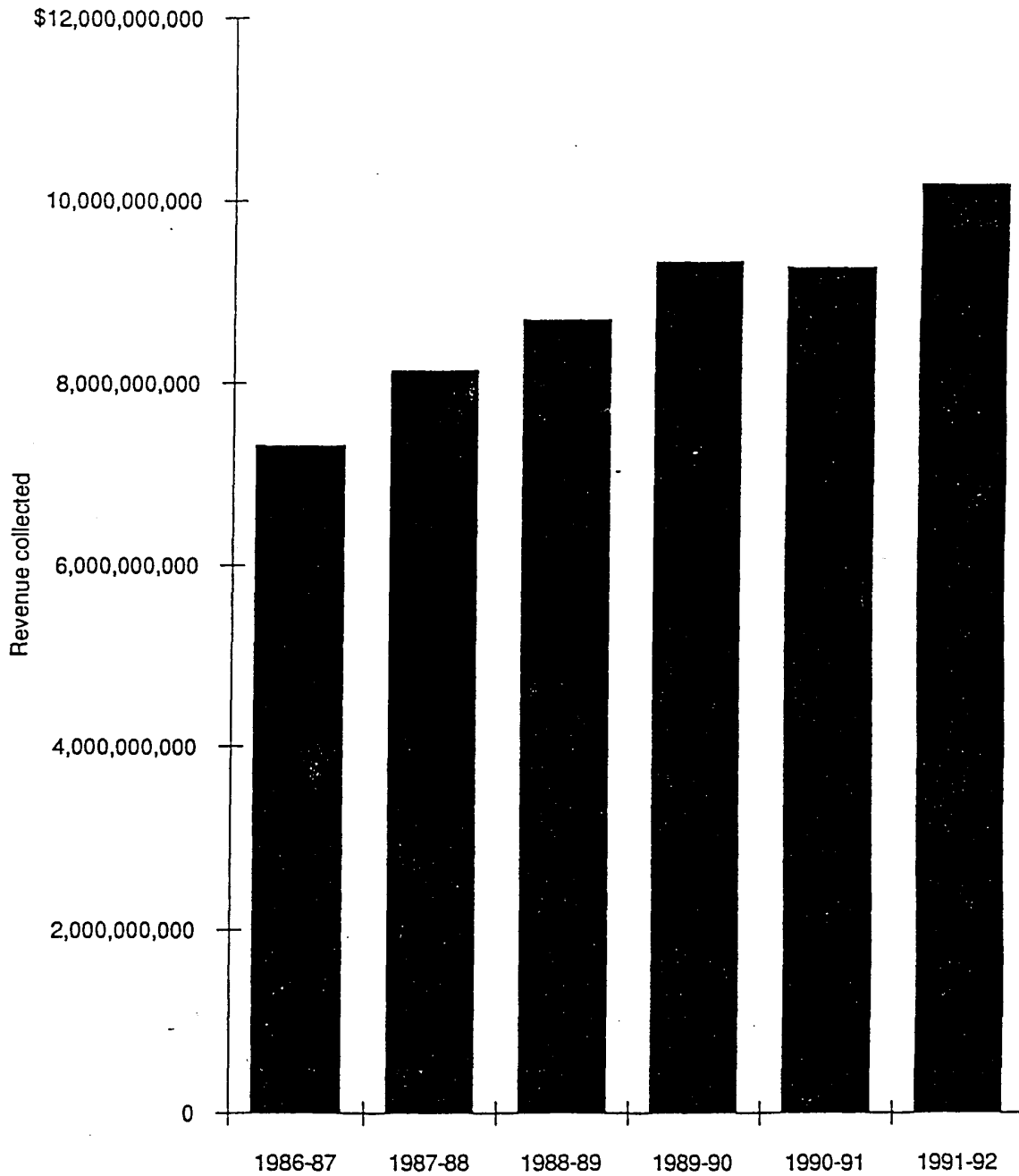
Current organization. The Department of Revenue is currently organized by tax schedule as shown in Exhibit 2. Each type of tax is administered by a separate tax division and each tax division has its own auditors, accounts receivable clerks, file maintenance clerks, secretarial support, etc. Under this organization, employees' responsibilities are limited to the taxes administered by their respective divisions.
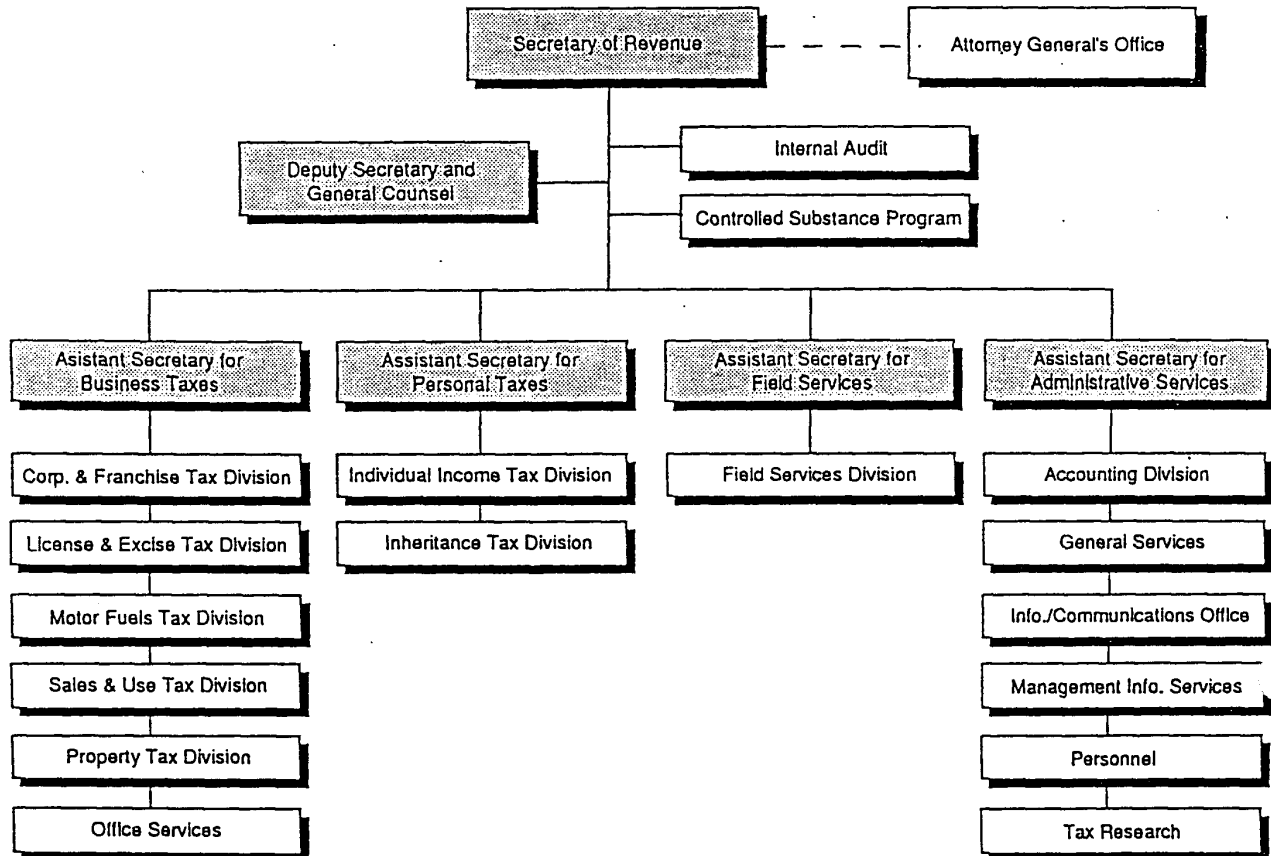
The Department currently has four major divisions:

■   Business Taxes

-   Corporate & Franchise Tax Division   - Sales & Use Tax Division
-   License & Excise Tax Division   - Property Tax Division
-   Motor Fuels Tax Division   - Office Services

■   Personal Taxes

-   Individual Income Tax Division
-   Inheritance Tax Division

■   Administrative Services

-   Accounting Division   - Management Information Systems
-   General Services   - Personnel
-   Information/Communications Office   - Tax Research

■   Field Services

-   Four regions comprising 55 permanent offices and 20 suboffices

Proposed organization. When the Department reorganizes, several of these divisions will undergo major changes. Under the new organization, the major divisions will be:

■   Tax Administration - This division will consist of the former directors and managers of the Business Taxes and Personal Taxes divisions. The Tax Administration Division will be responsible for formulating tax policy, sponsoring and proposing legislation, representing the division at administrative tax hearings, planning and developing strategies for implementing changes in legislation and new laws, etc. Staff members will specialize in the various taxes administered by the Department.

■   Tax Compliance - The new Tax Compliance Division will consist of the Office Examination Division and the Office Services Division:

-   The Office Examination Division will be made up of revenue tax auditors and various support staff (from the various taxing divisions) such as the assessments and

EXHIBIT 2
North Carolina Department of Revenue
Current Organization Chart

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┌─────────────────────┐              ┌──────────────────────────┐
│ Secretary of Revenue │─ ─ ─ ─ ─ ─ │ Attorney General's Office │
└─────────────────────┘              └──────────────────────────┘

        ┌──────────────────────┐        ┌─────────────────────┐
        │ Deputy Secretary and │────────│   Internal Audit    │
        │   General Counsel    │        └─────────────────────┘
        └──────────────────────┘        ┌──────────────────────────────┐
                                        │ Controlled Substance Program │
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Asistant Secretary for Business Taxes	Assistant Secretary for Personal Taxes	Assistant Secretary for Field Services	Assistant Secretary for Administrative Services
Corp. & Franchise Tax Division	Individual Income Tax Division	Field Services Division	Accounting Division
License & Excise Tax Division	Inheritance Tax Division		General Services
Motor Fuels Tax Division			Info./Communications Office
Sales & Use Tax Division			Management Info. Services
Property Tax Division			Personnel
Office Services			Tax Research

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overpayments, file maintenance, word processing, and receiving units. The Business License and Return Unit; Tobacco Products, Soft Drink and Conveyance Tax Section; and License & Alcoholic Beverage Section are also in this division.

- The Office Services Division will consist of the Taxpayer Assistance Section and the Accounts Receivable and Collections Section.

■ Administration - The Administrative Services Division will house the newly created Returns Processing Division, consisting of the Validation and Error Resolution Section and the Data Entry Section. This division is where the linear processing of returns (discussed below) will take place and where a major functional reorganization will occur. Data Entry personnel will be assigned from the MIS Division, and Validation and Error Resolution personnel will be assigned from the various tax sections.

The Accounting Division, MIS Division, General Services Division, and Personnel will continue to report to the Assistant Secretary for Administrative Services under the new organization. The Tax Research Division, which used to report to the Assistant Secretary for Administrative Services, will report directly to the Secretary of Revenue.
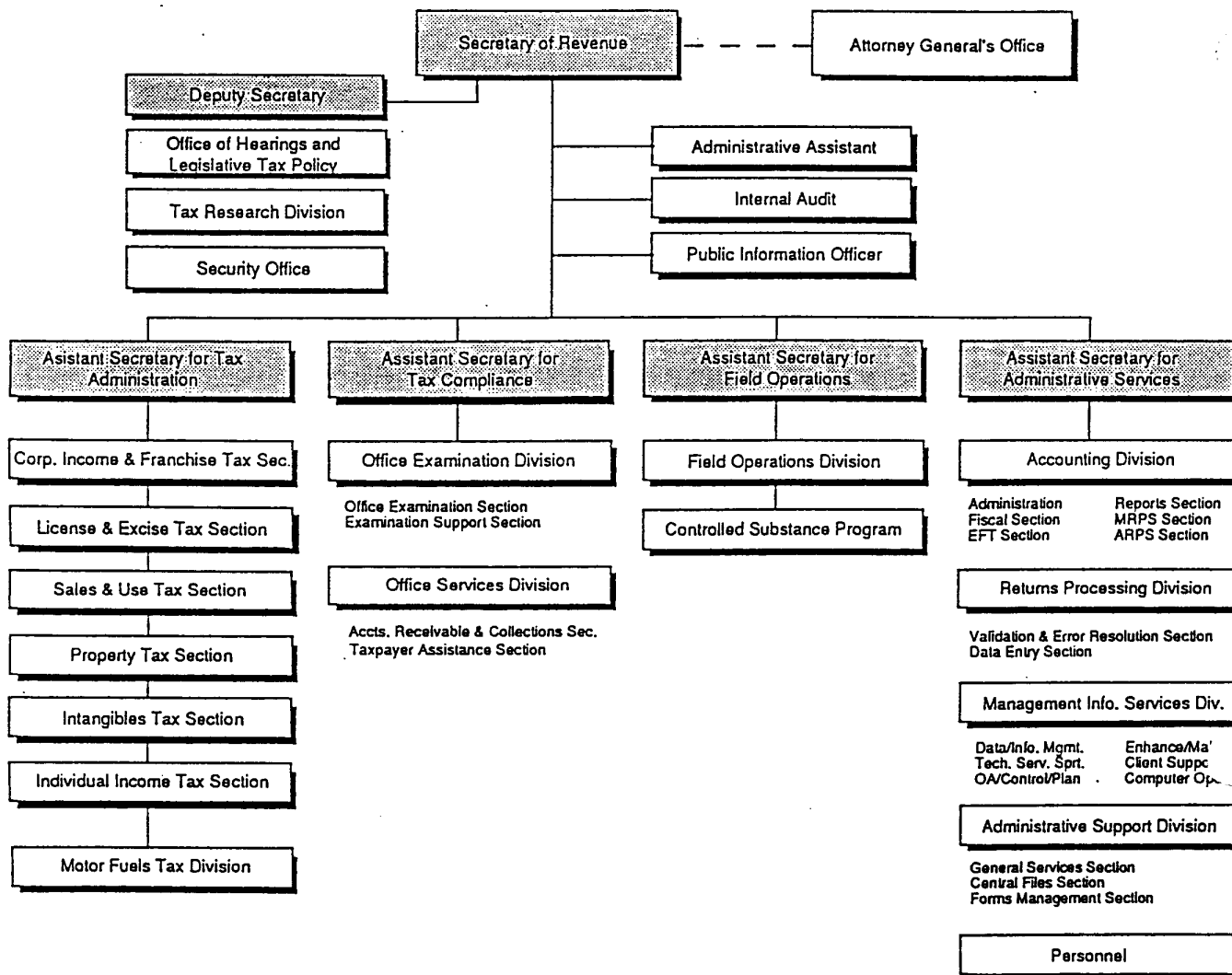
■ Field Operations - The Field Operations Division will not be affected by the reorganization (this division is discussed in a separate issue paper entitled "Department of Revenue Field Operations").

The Motor Fuels Tax Division will not be reorganized because it is funded by the Highway Trust Fund. This division will be placed under the Assistant Secretary for Tax Administration.

Exhibit 3 shows the organization structure recommended by the Department.

The functional reorganization and the move to the new revenue building will allow for the linear processing of returns. When a return comes into the Department of Revenue, it will first go to the mail room. From there it will be sent to the Accounting Division so that any money attached can be processed. The return is then verified to ensure that all data fields are completed and the return can be processed; from there it goes to Data Entry for keying. If the return is clean it goes to Central Files; if there is an error and Data Entry cannot process the return, it is sent to the Validation and Error Resolution Section. If Validation and Error Resolution can resolve the problem, the return goes back to Data Entry. If there is a computational error or another type of error that Validation and Error Resolution cannot resolve, the return goes to Office Examinations where it is examined by an auditor. When all errors are resolved, the return is sent back to Data Entry where keying is completed. The Accounting and Returns Processing divisions will be located on the same floor so that returns can be processed more quickly.

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                    ┌──────────────────────┐         ┌──────────────────────┐
                    │ Secretary of Revenue │ ─ ─ ─ ─ │ Attorney General's    │
                    └──────────────────────┘         │ Office                │
   ┌──────────────────┐                              └──────────────────────┘
   │ Deputy Secretary │
   └──────────────────┘
   ┌──────────────────────────┐        ┌──────────────────────────┐
   │ Office of Hearings and   │        │ Administrative Assistant │
   │ Legislative Tax Policy   │        └──────────────────────────┘
   └──────────────────────────┘        ┌──────────────────────────┐
   ┌──────────────────────────┐        │ Internal Audit           │
   │ Tax Research Division    │        └──────────────────────────┘
   └──────────────────────────┘        ┌──────────────────────────┐
   ┌──────────────────────────┐        │ Public Information Officer│
   │ Security Office          │        └──────────────────────────┘
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Asistant Secretary for Tax Administration	Assistant Secretary for Tax Compliance	Assistant Secretary for Field Operations	Assistant Secretary for Administrative Services
Corp. Income & Franchise Tax Sec.	Office Examination Division	Field Operations Division	Accounting Division
License & Excise Tax Section	Office Examination Section Examination Support Section	Controlled Substance Program	Administration Reports Section Fiscal Section MRPS Section EFT Section ARPS Section
Sales & Use Tax Section	Office Services Division		Returns Processing Division
Property Tax Section	Accts. Receivable & Collections Sec. Taxpayer Assistance Section		Validation & Error Resolution Section Data Entry Section
Intangibles Tax Section			Management Info. Services Div.
Individual Income Tax Section			Data/Info. Mgmt. Enhance/Ma' Tech. Serv. Sprt. Client Suppc OA/Control/Plan Computer Op.
Motor Fuels Tax Division			Administrative Support Division
			General Services Section Central Files Section Forms Management Section
			Personnel

Findings

Finding 1:   *DOR's proposed functional organization is consistent with reorganizations in several other states.*

The Department of Revenue is trying to position itself to accommodate increased revenue collections and other responsibilities without substantial increases in personnel. According to DOR, the reorganization will enable it to handle future increases in work load because it will be able to match resources to work load requirements. In its report to the Joint Committee on Governmental Operations on February 13, 1992, DOR cited the following benefits of the reorganization:

- Tailors DOR to three major functions: Tax Policy and Planning; Tax Compliance; and Operations

- Enhances productivity by eliminating duplication

- Provides a streamlined organization

- Improves taxpayer service by providing a single point of service

- Promotes uniform tax administration across all schedules

- Promotes flexibility in use of personnel

According to DOR, the functional reorganization will help eliminate duplication in the Department and increase the Department's flexibility in assigning personnel. This view is in part based on several DOR fact-finding trips to other states that have moved to a functional organization in recent years.

The Department plans to phase in the functional reorganization. In certain divisions, staff will continue to be grouped by tax type to ease the transition to the new organization. For example, in the Office Examination Section of the Tax Compliance Division, the revenue tax auditors will be organized into two groups of personal tax auditors and one group of business tax auditors. As the groups become cross trained in the various tax schedules, they will be merged into one group of auditors. The Assessment and Overpayments Branch will also initially be grouped by tax type and will be cross trained when time is available. The Taxpayer Assistance Section in the Office Services Division will initially be grouped in a similar way. The Revenue Administration Officers in this section will be organized into one of three groups - Income, Sales, and License/Corporate - to ease the transition.

Our independent analysis confirmed that several other southeastern states have changed to or are moving toward more functional organizations. Virginia reorganized functionally in 1978, South Carolina reorganized in 1983, and Tennessee reorganized about a year ago. The Kentucky

Revenue Cabinet's organization combines a functional organization with a specialized organization. Each state indicated that the functional organization is effective because duplication of effort is eliminated and taxpayers receive better service because they have a single point of contact.

Even under a functional organization, some units and staff retain their specialization. For example, Tennessee's legal staff has remained specialized around tax schedules because they found it difficult to keep up-to-date on the constantly changing tax laws. In South Carolina, auditors are all part of the same division but have remained specialized because South Carolina believes they need to retain their expertise.

The Alabama Department of Revenue also attempted to reorganize functionally for a two-year period in the late 1960s and early 1970s, but found it was not effective. The state found that too much training was required because tax laws are always changing. Alabama found specialization to be more effective. It is important to note that Alabama's experience occurred 20 to 25 years ago.

The state of Maryland is following a similar strategy to that of North Carolina in that it is currently organized by tax type and is in the process of reorganizing functionally. Initially, the auditors will remain specialized. In conjunction with the reorganization, an integrated tax administration system is being developed for the state.

Finding 2:   *The long-term success of the functional organization will depend on DOR's implementation of a new Integrated Tax Administration System (ITAS).*

DOR believes, and KPMG Peat Marwick concurs, that the success of the functional reorganization depends on the funding and implementation of the Integrated Tax Administration System (ITAS). ITAS is a computer-based, fully integrated tax administration system that would support all of the essential functions of tax administration for which the Department is responsible. All taxpayer information would be stored in a single relational data base. The functions provided by the system would include:

- Data entry
- Data base update
- Taxpayer identification
- On-line returns processing
- Delinquency processing

- Accounts receivable
- Management reporting
- Batch processing
- Other functions such as collections management, case tracking, audit management, and correspondence

According to DOR, ITAS would significantly improve the Department's ability to identify noncompliance and would reduce the Department's operating costs by minimizing MIS resources dedicated to system maintenance. In addition, ITAS would generate significant increases in revenue by identifying non-filers, improving the efficiency of the accounts receivable process,

identifying delinquent filers more quickly, and improving audit support and collections management.

The Department has selected a software package and a prospective vendor to implement the system. The projected cost of the ITAS is approximately $6.3 million, exclusive of SIPS charges for data processing services. In its 1992 short session, the General Assembly rejected the request to fund the system.

Finding 3:   DOR's Deputy Secretary position is unnecessary.

New organization charts that reflect the planned functional reorganization exist and appear reasonable. However, the Deputy Secretary position seems unnecessary because the Deputy Secretary performs similar functions as the Tax Administration Division staff. According to function statements issued by the Department of Revenue, the Deputy Secretary has two major responsibilities:

■   Hearing officer

- Deals with taxpayers and their representatives in scheduling tax hearings

- Conducts hearings, including control of taxpayer and witness demeanor, ruling on objections and motions, receipt of evidence, and monitoring of testimony and arguments

- Reviews evidence and issues, determining appropriate findings of fact and conclusions of law

- Enters formal decisions on tax controversies within the Department of Revenue

■   Legislative liaison

- Assists the Secretary of Revenue in developing and formulating tax policies

- Seeks adoption of Department of Revenue legislative recommendations by legislative study committees and commissions

- Provides technical analysis and information to legislative committees, staff, and legislators

- Monitors pending tax legislation

- Seeks enactment of legislation favored by the Department or the administration, and opposes that opposed by the Department or administration

Because the former Deputy Secretary was an attorney, he also served as general counsel for the Secretary of Revenue. Under the new organization, the Office of Hearings and Legislative Tax Policy, Tax Research Division, and Security Office will also report to the Deputy Secretary.

The staff in the new Tax Administration Division, which consists of the former directors and managers of the various taxing divisions, also work on policy and legislative issues. In addition to certain other duties, this division is responsible for formulating tax policy, planning and developing strategies for implementing changes in legislation and new laws, sponsoring and proposing legislation, and critiquing pending legislation.

Recommendations

Recommendation 1:   *DOR should implement ITAS to achieve a highly efficient and effective operation.*

DOR's reorganization along functional lines is sound and consistent with what other states are doing. However, while the linear processing of returns will achieve economies of scale, we agree with the Department that the full benefits of the reorganization will not be realized without the implementation of ITAS.

One of the Department of Revenue's biggest challenges will be to maintain operations with its existing systems. The collection and processing of taxes are heavily dependent on the use of information technology. The Department's current information technology infrastructure is so inefficient and error prone that the mission of the Department is at risk. The Department's computer hardware is old and unreliable, and the current production tax application systems are written in an outdated language and depend on punch cards or tapes which makes processing slow. Even after the conversion effort that was scheduled for completion in September 1992, DOR's systems will still be extremely inefficient and subject to high failure and error rates.

The key to establishing a highly efficient and effective Department of Revenue is ITAS. ITAS has the potential, if properly designed and implemented, to boost productivity and potentially reduce existing staffing levels or slow staff growth over time.

According to DOR, no positions are to be abolished or created in conjunction with the reorganization. Some positions have been reallocated. While this may be defensible during a transition period, DOR's long-term goal should be to streamline operations, reduce staffing and costs, and improve service delivery. This potentially can be achieved with the implementation of ITAS.

The long-term revenue increases and personnel and operational cost savings will significantly exceed the costs of implementing and operating ITAS.

The reorganization should result in improved service to taxpayers because the taxpayer will have a single point of contact. For example, a business owner who must pay sales taxes, franchise taxes, and income taxes will be audited by one auditor or a team of auditors, instead of being independently audited by three auditors as he would under the current organization. This system, consequently, should result in less disruption of the taxpayer's business.

Implementation considerations

As noted above, the implementation of ITAS is critical to improving productivity and service quality and streamlining operations and staffing. In addition, an in-depth training program will need to be developed if the reorganization is to be successful. Employees will need to be continuously updated on changes occurring in the tax area.

Recommendation 2:   *Reclassify the Deputy Secretary position and implement several other organizational changes.*

The Deputy Secretary position should be reclassified as a hearing officer and moved to the Office of Hearings and Legislative Tax Policy. The hearing officer position should perform only those duties related to administrative hearings. The Tax Administration Division, which specializes in the various taxes administered by the state, should be responsible for the legislative liaison function.

The Office of Hearings and Legislative Tax Policy and the Tax Research Division should report directly to the Secretary. The Security Office should report to the Assistant Secretary for Administration. The position should be reclassified immediately.

Some savings will result because the hearing officer position will be classified at a lower grade than the Deputy Secretary position, and the overall personnel costs will be lower.

Service to taxpayers involved in tax hearings should improve. Hearings may be resolved more quickly because the new hearing officer position will spend the majority of his or her time on the administrative hearing function.

References

Department of Revenue organization charts - current organization

Department of Revenue organization charts - proposed organization

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North Carolina Department of Revenue Divisional Work Flow Charts - April 1992

Summary - Functional Reorganization of the N.C. Department of Revenue - Report to the Joint Committee on Governmental Operations, February 13, 1992

The Revenue Building Reorganization Plan, January 9, 1992 (DOR publication)

1985 Governor's Efficiency Study Commission Report