REVIEW OF THE ORGANIZATION AND OPERATION OF THE STATE OF CALIFORNIA'S MAJOR REVENUE AND TAX COLLECTION FUNCTIONS AND CASH MANAGEMENT ACTIVITIES

A Report Of The

COMMISSION ON CALIFORNIA STATE GOVERNMENT
ORGANIZATION AND ECONOMY

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April 1986

STATE OF CALIFORNIA

GEORGE DEUKMEJIAN, *Governor*

COMMISSION ON CALIFORNIA STATE GOVERNMENT ORGANIZATION AND ECONOMY
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Honorable George Deukmejian
Governor of California

Honorable David A. Roberti
President pro Tempore of the Senate
and Members of the Senate

Honorable James Nielson
Senate Minority Floor Leader

Honorable Willie L. Brown, Jr.
Speaker of the Assembly
and Members of the Assembly

Honorable Patrick Nolan
Assembly Minority Floor Leader

Dear Governor and Members of the Legislature:

Last year, Assemblyman Bill Leonard asked our Commission to study the feasibility of reorganizing into one State department some or all of the responsibilities of the more than nine existing State agencies currently responsible for State revenue collection, taxation, and cash management. These agencies include the Franchise Tax Board, the Board of Equalization, the Employment Development Department's Personal Income Tax Withholding Program, the State Controller, and the State Treasurer, as well as other departments. The major revenue collection and taxation agencies alone are responsible for collecting more than $38 billion annually.

The scope of the study requested by Assemblyman Leonard was also consistent with the conclusions and recommendations of our Commission's August 1985 study on the underground economy. In that study, we found that the State's organization of taxing and enforcing agencies was a major obstacle to more effectively combatting California's rapidly growing underground economy which now totals more than $40 billion in California annually, and accounts for the State losing $2 billion in taxes -- that represents almost 20 percent of the income taxes collected last year.

California is the only State in the Union that does not have a single, consolidated revenue collection and taxing agency. The potential benefits of a consolidated agency are many. Consolidation could minimize or eliminate overlapping functions, focus accountability, cut overhead costs, increase productivity, and ultimately lead to enhanced State revenues. In contrast, California's current organization of these responsibilities has left our revenue, taxation, and cash management without any central guidance and oversight.

In considering the conduct of this study, our Commission recognized the constitutional and, quite candidly, the political constraints to consolidating some or all of these activities into a single department. The idea is certainly not new; more than fifteen similar studies, including one by this Commission in 1964, have already been conducted on the subject all of which recommended reorganization. None of these studies have ever received serious consideration.

However, because this Commission recognized the substantial benefits to California taxpayers from improvements in these systems, we designed the approach of the study to ensure it would not end up on the same shelf as those other reports. Specifically, we did three things:

First of all, our Commission decided not to just look at the "boxes." Rather the critical questions are: Is there accountability, can we cut our costs, and can we increase our revenues? The second action we took was to expand the scope of the study to include a detailed analysis of how well the State manages its cash. Prior studies had never looked at this on a statewide basis. Finally, we required our consultants to develop detailed analyses of costs and benefits for a series of alternative solutions. If change was warranted, we wanted to know what it would cost, and what our return on that investment would be.

Because of the many strong viewpoints on the issue of reorganization and cash management, our Commission appointed a Blue Ribbon Study Advisory Committee which included the directors of each affected agency, as well as representatives of the private sector to assist and advise the Commission subcommittee and our consulting team from the international accounting and consulting firm of Peat, Marwick, and Mitchell and Co. to help ensure that the study would result in practical and effective recommendations.

Among the Commission's 37 specific findings are the following:

- Substantial duplication of functions exists in the State's major revenue and tax collection departments. Neither the Federal government nor any other state has fragmented their revenue, tax collection, and cash management functions like California.

- Major opportunities exist to generate millions of dollars in additional interest earnings from improved cashiering. Specifically, certain departments are (1) failing to have district offices deposit funds in local banks, (2) not intercepting mail at its point of origin thereby delaying processing, (3) not beginning daily processing as early as possible, (4) not working weekend shifts, and (5) not using effective techniques to screen mail for large tax payment checks.

- The use of old equipment by certain departments results in slower processing and lost interest earnings.

- The State experiences substantial amounts of processing holdover because cut-off times are up to five hours earlier than they need to be.

- The State's major revenue and tax collection departments could increase audit coverage by jointly conducting field audits. Additionally, individual departments need to expand the scope of certain audits to test for other departments. Finally, the State employs too few revenue and taxation auditors.

- The establishment of an independent tax appeals board or tax court would enhance the credibility of the State's tax appeals process.

- State collection activities could be performed more efficiently through the expanded use of automated systems. Furthermore, the State could generate additional revenue by using private collection agencies for certain accounts and expanding its interdepartmental offset program. Finally, duplication could be reduced and collections improved by jointly conducting collection activities.

- The Department of Finance and the Commission on State Finance revenue forecasts would be more useful if they were performed on consistent time periods.

The unnecessary duplication of functions and the fragmentation of responsibility within the State of California's major revenue collection departments result in operational inefficiencies and lost earnings for the State. While the members of our Commission support the general concept of creating a single revenue and tax collection department, we also recognize the significant political and institutional barriers to the full consolidation of these entities.

To realize the potential cost savings and additional revenue available from more efficient operations, our Commission recommends a functional consolidation of certain revenue and tax collection operations currently performed by certain State departments. To accomplish this consolidation, as well as to improve operations within the individual departments involved in cash management, this report presents 35 recommendations which include the following:

1. The State should create a State run "lock-box" facility that functionally consolidates remittance processing and cashiering operations. The facility should utilize state-of-the-art high speed processing equipment. Processing workshifts should match mail availability.

2. The new facility should immediately establish procedures to reduce the float on money by intercepting mail at the point of origin, expanding the use of regional post office boxes in out-of-state locations, picking up mail earlier at the Sacramento post office, instituting weekend workshifts, and screening miscellaneous mail for large payments.

3. The lock-box facility should perform remittance processing until the latest possible cut-off time. Additionally, the

State Treasurer should negotiate later deposit cut-off times with banks.

4. The State should expand the scope of field audits to include testing for other departments, and for detection of the underground economy. Finally, the State should further increase the number of revenue and tax collection auditors.

5. The Governor and Legislature should support legislation to establish an independent tax appeals board.

6. In addition to consolidating cashiering, the State should establish a central State collection agency.

7. The Governor and Legislature should officially act to establish central responsibility with either the State Treasurer or Department of Finance for overseeing the operations and performance for cash collection and depositing activities by State departments.

8. Each affected State revenue and taxing agency should place greater emphasis on cost benefit analysis regarding the use of available resources and technology.

As part of this study, the Commission's consultants have prepared detailed, conservative estimates of the benefits and costs associated with the recommendations we present in this report. Those estimates project that the State would experience a net increase in revenues of more than $127 million over three years if our recommendations are fully implemented. This Commission can see no justifiable reason for not immediately acting upon these practical and realistic approaches to an improved operation of our revenue collection, taxation, and cash management responsibilities.

Respectfully submitted,

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Reorganization of Revenue
Collection and Taxation
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Abraham Spiegel
Jean Kindy Walker
Assemblyman Phillip Wyman

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EXECUTIVE SUMMARY

In response to a request by Assemblyman Bill Leonard and as a follow-up on a recent study regarding the underground economy, the Commission on California State Government Organization and Economy, also known as the Little Hoover Commission, initiated a study of the organization and operation of the State's major revenue and tax collection functions and selected cash management activities. While there have been numerous prior studies regarding the organization of California's taxing agencies, the Commission's study focused on identifying practical and useful recommendations for improving the revenue and tax collection operations, generating additional revenue for the State, and reducing costs.

The State of California collected approximately $38.3 billion in fiscal year 1984-85 in revenue and tax collection payments from businesses and individuals. There are several major departments in the State which are responsible for revenue and tax collection payments. These include the Board of Equalization, the Franchise Tax Board, the Employment Development Department, the Department of Motor Vehicles, and several other departments. The study reviewed the cashiering, auditing, appeals, collections, data processing and revenue forecasting functions performed by these departments.

While California is a leader in certain aspects of its revenue and tax collection activities, the study identified certain problems and opportunities that exist in how the State conducts these activities. Based upon conservative estimates, the State could generate additional revenue and cost savings ranging from $35 million to $52 million annually by taking action to address the problem areas and opportunities identified in this study. The study identified 37 individual recommendations that affect one or more of the departments reviewed. These findings also may pertain to some extent to other departments in the State involved in revenue and tax collection activities. The following sections provide a summary of the findings identified in each of the areas reviewed in the study.

GENERAL FINDINGS

Although there are historical reasons for the present assignment of tax collection responsibilities among state agencies, there is considerable duplication in the functions and activities performed by the State's major revenue and tax collection departments. This duplication occurs in the areas of cashiering, auditing, appeals, collection, and data processing. As a result, the potential exists to reduce the costs of operation, administration, and overhead through the consolidation or integration of organizations and functions.

A survey of other states and the Internal Revenue Service showed that California, unlike the federal government and all other states in the country, does not have a consolidated department of revenue. While California is well-respected for some of its revenue and tax collection operations, including the joint collection of personal income tax withholding and employer payroll-based taxes, there are significant differences between how other states and the federal government collect revenue and taxes and how California conducts these activities.

CASHIERING

The State of California is experiencing delays in the mailing, processing, and depositing of payments received by its revenue and tax collection departments. As a result of these delays, funds are not being deposited in the bank as soon as possible and the State is losing interest earnings. In the area of mail handling, the State is not taking full advantage of opportunities available to it to expedite the receipt of mail, such as intercepting mail at its point of origin and taking special measures to speed its delivery to the department's cashiering operations.

Among the remittance processing problems that the State is experiencing are the failure of some departments to pick up mail when it is first available at the post office and the lack of matching mail processing shifts with mail availability at the post office. Moreover, some departments are not operating work shifts on week-ends or using the necessary remittance processing equipment to ensure the timely processing of payments.

Certain departments are not conducting their remittance processing activities in a manner that ensures the timely deposit of funds in the bank. This occurs for a variety of reasons, including the failure to perform remittance processing until the latest possible cut-off time, the lack of use of appropriate payment processing priorities, and due to insufficient sorting and encoding of checks for deposit to banks.

AUDITING

Each of the State's major revenue and tax collection departments, including the Franchise Tax Board, Board of Equalization, and the Employment Development Department, conduct separate audits of taxpayers. As a result, individual departments are not necessarily aware of what audit activities are being performed by other departments and the State is not maximizing audit coverage and penetration. The study showed that the audit programs used by individual departments do not include testing for other departments or the detection of the underground economy. Moreover, the current number of revenue and tax collection auditors in the State do not allow the State to perform the level of auditing necessary to deter tax avoidance and ensure the full integrity of California's self-assessment taxation system.

APPEALS

The study revealed that there is a concern by taxpayers regarding the lack of independence of the current appeals process within the Franchise Tax Board and the Board of Equalization. This occurs because two persons who are members of the Franchise Tax Board, the State Controller and the Chairman of the Board of Equalization, sit on both the Franchise Tax Board and the Board of Equalization. Taxpayers do not believe they receive an impartial hearing from the leaders of the same organization that is imposing the questioned taxes.

In addition, the study found that if the State rescinds the unitary tax method, the State's current appeals process would probably have to be modified to handle the increased complexity of cases and the more time it takes to hear tax cases under "waters-edge accounting" methods.

COLLECTIONS

The State's major revenue and tax collection departments are not taking full advantage of automated collection systems to increase the productivity of staff involved in collections activities. While the Franchise Tax Board uses an automated collection system, the Employment Development Department and the Board of Equalization are in the process of developing automated collection systems. The State also is only making limited use of private collection agencies to collect delinquent accounts receivable that are not profitable for the State to pursue.

The State could make greater use of its inter-departmental offset program to ensure that funds owed by a taxpayer for any of the taxes collected by the State are paid prior to a taxpayer receiving any tax refunds. In addition, the study indicated that the State could increase its collections of delinquent accounts, reduce collection costs and help avoid the large write-off of uncollectible accounts that it experiences each year by establishing a central state collection agency.

DATA PROCESSING

The major revenue and tax collection departments in the State, including the Franchise Tax Board, the Board of Equalization, and the Employment Development Department, operate separate automated data processing systems to maintain their taxpayer information. Although these departments have been making improvements in their systems, the study indicated that these departments need to continue to improve them by working toward the development of more compatible automated data processing systems and applications. This will allow these departments to share information more readily and minimize the amount of redundant information maintained regarding taxpayers.

FORECASTING

There are two state departments with responsibility for revenue forecasting, the Department of Finance and the Commission on State Finance. While having two departments producing forecasts is a duplication of effort, the study indicated that since these departments' revenue estimates are based on different assumptions, there is value in having this duplication. However, the study showed that if the departments issued revenue forecasts on consistent time periods the revenue forecasts would be more useful to the Governor, the Legislature and the general public.

OTHER ISSUES

The State's revenue and tax collection departments operate in a dynamic environment. Virtually all of the factors which impact the efficiency of revenue and tax collection are subject to rapid change. Therefore, no matter how effectively a system is established initially, it could soon be out-dated if management is not vigilant and aggressive in anticipating or reacting to changes in the environment. The State of California has not established one department with the ongoing responsibility for managing the cash collection and deposit activities performed by all departments conducting revenue and tax collection activities. As a result, the State is unable to achieve and maintain a high-level of performance in these activities.

The opportunity cost of activities plays a prominent role in management decision-making in remittance processing operations. The study showed that the State has not paid sufficient attention to the cost-benefit considerations related to remittance processing in terms of interest earnings, equipment costs, salaries, and facilities to ensure that the State is maximizing the benefits of its remittance processing activities. As a result, the State is unnecessarily losing interest earnings and/or incurring unnecessarily high processing costs that could be avoided.

RECOMMENDATIONS

The unnecessary duplication of functions and the fragmentation of responsibility within the State of California's major revenue and tax collection departments result in operational inefficiencies and lost interest earnings for the State. While the Commission on California State Government Organization and Economy supports the general concept of creating a single revenue and tax collection department, it recognizes the significant political and institutional barriers to full consolidation of the State's revenue and tax collection departments. In addition, it is concerned about the potential disruption of services that might occur in a large-scale consolidation.

To realize the potential cost savings and additional revenue identified in this study, and to provide an opportunity to accommodate future growth and promote further efficiency, the Commission has made 35 separate recommendations in this report. These recommendations are presented in Chapter V. Among the Commission's major recommendations are:

- Create a state-run lock-box facility that functionally consolidates the remittance processing and cashiering operations performed by the State's major revenue and tax collection departments in one location;

- Enhance the equipment, facilities and operations used in the State's remittance processing activities;
- Expand the scope of field audits to include testing for other departments and the detection of the underground economy;
- Increase the number of revenue and tax collection auditors;
- Establish an independent tax appeals board;
- Expand the use of automated collection systems, private collection agencies, and inter-departmental offset programs;
- Establish a central state collection agency for collecting delinquent accounts receivable that are not collectible through routine collection means;
- Establish centralized management responsibility for the State's remittance processing activities; and
- Make operating improvements in individual state departments involved in revenue and tax collection activities.

By implementing these recommendations, the State will be able to improve the overall efficiency of its revenue and tax collection functions and cash management activities and generate additional revenue for the State.

I. INTRODUCTION

The Commission on California State Government Organization and Economy, also known as the Little Hoover Commission, was established in 1962 to review the management of State activities and recommend ways for the State to conduct its business operations more efficiently and effectively. Throughout its history, the Commission has conducted studies of the State's taxing and regulatory agencies with the objective of recommending improvements in management, organization and operations.

In the winter of 1984, Assemblyman Bill Leonard asked the Little Hoover Commission to study the feasibility of reorganizing certain of the State's cash management and revenue collection functions. The anticipated benefits from some type of reorganization or consolidation included reducing overlapping functions, focusing responsibility and accountability, achieving greater economies of scale, and increasing productivity. In addition, reorganization or consolidation also presented opportunities for increased State revenue.

Assemblyman Leonard's request was consistent with the conclusions and recommendations of the Commission's August 1985 study report entitled "A Review of Selected Taxing and Enforcing Agencies' Programs to Control the Underground Economy." This study pointed out some of the coordination problems inherent in having similar responsibilities performed by several agencies.

In December 1985 the Commission contracted with the international audit and consulting firm of Peat, Marwick, Mitchell, & Co. (Peat Marwick) to conduct a study of the State's major revenue collection and selected cash management functions. At the request of the Commission, Peat Marwick reviewed specific revenue collection and selected cash management functions performed within the major departments involved in these activities in the State.

BACKGROUND

During fiscal year 1984-85, the revenue and tax collection departments within the State of California collected approximately $38.3 billion in receipts directly from businesses and individuals in the form of taxes, fees, and other sources of revenue. These departments include the Board of Equalization, Franchise Tax Board, Employment Development Department, Department of Motor Vehicles, the State Controller's Office, and several other departments. These collections do not include the California State Lottery Commission, which was also reviewed, but was not in operation in fiscal year 1984-85. The revenue and tax collection activities and selected cash management functions within each of these departments were reviewed as part of this study.

Agencies Studied

Exhibit I.1 lists each of the departments reviewed and the amount of revenue each collected. In addition, Appendix A provides a detailed description of each department's revenue and tax collection functions.

The State Board of Equalization is composed of four independently elected members and the State Controller, who is also an elected official. The Board of Equalization collects the most revenue of the State's departments. In fiscal year 1984-85, the Board of Equalization collected $14.6 billion, or 38 percent of the total revenue collected by the State. This includes sales and use taxes (including the portion collected for local entities) and several other business taxes. The Board of Equalization's total operating budget for fiscal year 1985-86 is approximately $123 million. About $32 million of this total is funded by reimbursements collected from local agencies that share in the proceeds from the sales and use taxes. It employs nearly 2,800 persons, and maintains 55 business tax field offices and eight property tax field offices in California, and three out-of-state offices.

The Employment Development Department is the State's employment security agency and is responsible for administering California's employment services program. In addition, it has the responsibility for collecting employee and employer contributions to the Unemployment and Disability Insurance Programs. It also collects personal income tax withholding funds for the Franchise Tax Board. In fiscal year 1984-85, the Employment Development Department collected approximately $10.5 billion, or roughly 27 percent of the funds collected by the State. Although the Department has a fiscal year 1985-86 budget of approximately $3.5 billion and more than 6,000 personnel years, only $82.6 million and approximately 2,000 personnel years are devoted to revenue and tax collection and cash management activities. It also maintains 38 field offices throughout the State that are involved in tax collection, audit and compliance activities.

The Franchise Tax Board is composed of the State Controller, the Chairman of the State Board of Equalization, and the Director of the Department of Finance. The Board appoints an Executive Officer who implements the Board's policies. The Franchise Tax Board is primarily responsible for administering the personal income tax and the bank and corporation taxes. In fiscal year 1984-85, it collected approximately $7.6 billion, or approximately 20 percent of the revenue that the State collected. The Franchise Tax Board's budget for fiscal year 1985-86 is approximately $122 million and supports approximately 3,000 personnel years. In addition, it operates 17 district offices throughout the State and three out-of-state offices.

The Department of Motor Vehicles is responsible for registration of vehicles and drivers in the State. In addition, it collects vehicle and vessel registration fees, drivers license fees, and several other taxes and fees. In fiscal year 1984-85, the Department of Motor Vehicles collected

EXHIBIT I.1

REVENUE COLLECTED BY STATE DEPARTMENTS

Fiscal Year 1984-85
(Dollars in Millions)

AGENCY	REVENUE COLLECTED(1)	PERCENT OF TOTAL
Board of Equalization(2)	$ 14,624	38
Employment Development Department(3)	10,527	27
Franchise Tax Board	7,621	20
Department of Motor Vehicles	2,475	6
California State Lottery Commission (4)	-	-
State Controller's Office	295	1
State Treasurer's Office	-	-
Department of Finance	-	-
Commission on State Finance	-	-
Other Departments	2,763	7
Total	$ 38,305	100(5)

Notes: (1) This information was obtained from the departments reviewed and the Governor's Budget.

(2) Includes $3.077 billion in sales and use tax collected for local entities.

(3) Includes $7.581 billion for personal income tax withholdings collected for the Franchise Tax Board, $1.874 billion for unemployment insurance, $1.017 billion for disability insurance, and $.055 billion for employment training.

(4) The California State Lottery Commission did not begin collecting revenue until fiscal year 1985-86. It will collect an estimated $1.8 billion in the nine months it operates in fiscal year 1985-86.

(5) Rounded.

approximately $2.5 billion, or nearly six percent of the revenue collected by the State. In fiscal year 1985-86, it has a budget of approximately $286 million and almost 7,200 personnel years; however, only a portion of this budget is devoted to the Department's revenue and tax collection and cash management activities. The Department of Motor Vehicles operates 14 regional offices and 158 field offices throughout the State.

The California State Lottery Commission has the responsibility for operating the California State Lottery. It consists of five commissioners appointed by the Governor and an Executive Director. The first game of the California State Lottery commenced in early October 1985. During the nine months of operation in fiscal year 1985-86, the Commission expects to collect an estimated $1.8 billion in revenues. This will make it the fifth largest revenue and tax collection department, in terms of the amount of revenues collected, in the State. Its budget for nine months of operation in fiscal year 1985-86 is approximately $82 million and a staff of approximately 850 positions. The Commission operates 12 district offices throughout the State.

The State Controller is an elected state official who also serves as a board member of both the Franchise Tax Board and the Board of Equalization. The State Controller's Office is responsible for providing sound fiscal control over the State's receipt and disbursement of funds. It also administers the estate, inheritance and gift tax laws. The State Controller's Office collected approximately $295 million, or close to 1 percent of the revenue collected by the State, in fiscal year 1984-85. It has a fiscal year 1985-86 budget of approximately $63 million and 1,200 personnel years. However, only a small portion of this budget is dedicated to revenue and tax collection and cash management activities. The State Controller's Office operates one field office in Los Angeles that is involved in revenue collection and tax administration.

Three of the state agencies we reviewed are not directly involved in revenue collection. These include the State Treasurer's Office, the Department of Finance, and the Commission on State Finance. These three units were included in this study because they have other responsibilities relating to revenue collection and cash management. The State Treasurer's Office provides banking and investment services for the State of California. The Department of Finance exercises budgetary oversight of all state agencies, prepares the Governors Budget, and forecasts state revenue. The Commission on State Finance also provides revenue forecasts.

In addition to these departments, the various other departments in the State are responsible for collecting approximately $2.8 billion in revenue. These other departments include the State Horse Racing Board and the Department of Insurance. While these other departments were not part of the study, many of the findings in this report relate to them.

Past Studies

In the past, there have been numerous studies of the organization of California's taxing agencies. Each of these studies was critical of the organization of tax administration in California. Most recommended the consolidation of functions within a single Department of Revenue and the removal of the appeals process to an independent organization. Appendix B provides a listing of previous revenue collection and coordination studies that have been performed. These studies have consistently mentioned the following benefits of consolidation:

- Administrative cost savings;
- Increase in efficiency;
- More uniform tax policy and administration;
- Greater accountability and responsibility for results; and
- A single point of contact between taxpayers and the State.

In August 1985, the Little Hoover Commission released its report on the Underground Economy--"A Review of Selected Taxing and Enforcing Agencies' Programs to Control the Underground Economy". In this report, the Commission identified many causes for the pervasiveness of the underground economy. One common thread to most of these was the lack of a single revenue and taxing agency which was responsible for tracking the taxes due the State. Moreover, the underground economy study recommended that a detailed study be performed of the organization and operation of the State's major revenue and tax collection departments.

During the same month, the Governor's Tax Reform Advisory Commission proposed a consolidated Department of Revenue. The Commission recommended that the new department assume the revenue collection and administration functions from the Franchise Tax Board, the Board of Equalization, the Lottery Commission and the Horse Racing Board. The Tax Reform Advisory Commission also recommended establishing a State Tax Court. Finally, in late 1985, the State Controller recommended establishing a State Tax Department and a State Tax Appeals Review Board and abolishing the Franchise Tax Board and the Board of Equalization.

STUDY OBJECTIVES

The Little Hoover Commission was aware of the numerous studies regarding the State's revenue collection systems that have been performed over the past 60 years and that these studies have had only limited impact. To ensure that the current study would be different than the prior studies and that it would result in useful recommendations that could be implemented, the Commission identified a series of objectives for the study ranging from specific to general opportunities for examining the State revenue collection and cash management system and activities. These objectives included:

- o Identifying opportunities to improve the efficiency and effectiveness of the State's revenue collection and cash management functions;

- o Assessing the feasibility of consolidating some or all revenue collection and cash management functions;

- o Determining opportunities to generate additional revenue to the State through improved revenue collection and cash management practices;

- o Identifying the potential for consolidating, or improving, the sharing of information and data processing systems; and

- o Determining opportunities to reduce general administrative and overhead costs.

Each of these objectives was designed to focus the study on specific areas in which practical recommendations could be developed.

SCOPE AND METHODOLOGY

To meet the study objectives, the Commission requested that Peat Marwick review revenue collection and selected cash management functions within the major state departments involved in these activities. The original Request for Proposal (RFP) issued by the Commission specified a review of seven of the departments in the State involved in revenue collection and cash management. However, at the request of the Commission, the project scope was expanded to nine departments, including the Department of Motor Vehicles and the California State Lottery Commission due to the large volume of receipts made by these departments. Based upon the scope of work outlined by the Commission, the study work plan included the following major components:

- o Reviewing current statutes relating to selected revenue collection and cash management activities and existing operating procedures in the following departments:

  - Board of Equalization
  - Franchise Tax Board
  - Employment Development Department
  - Department of Motor Vehicles
  - California State Lottery Commission
  - State Controller's Office
  - State Treasurer's Office
  - Department of Finance
  - Commission on State Finance

- Designing and administering a survey questionnaire for each department relating to their major revenue collection and cash management functions and activities;

- Conducting a comparative analysis of other states using a structured questionnaire and at the Internal Revenue Service's Fresno Service Center;

- Performing follow-on fieldwork at each of the departments involved in the study to better understand policies, procedures, practices and operations;

- Conducting cost/benefit analyses on selected alternatives offering potential benefits or improvements to the State's revenue collection and cash management functions;

- Developing recommendations for improving the State's revenue collection and cash management system and establishing an implementation plan to carry out these recommendations.

While the study reviewed the revenue collection and selected cash management functions performed by the major departments in the State, the scope of the study was limited to reviewing the following six functions:

- Cashiering - includes the receipt of mail, opening, sorting, batching, encoding and depositing of revenues;

- Auditing - involves the post-audit of taxes paid and revenues received from a taxpayer versus the amount due;

- Appeals - provides for resolution of disputes involving the payment of taxes to the State, including a process for fair hearing and appeal to a higher authority;

- Collections - includes the activities associated with identifying and tracking accounts receivable and using available administrative and legal recourse to ensure payment of taxes and other monies due the State;

- Data Processing - involves the use of information systems to collect and maintain information on taxpayers within the State, including identification information and tax payment histories; and

- Forecasting - involves obtaining information on current state revenues and using sophisticated statistical economic models to project future state revenues and cash flow.

Furthermore, the review of the cash management function focused on the revenue collection aspects of cash management. It included a review of those activities performed from the time a taxpayer transmits taxes or fees due the State until the time that funds are deposited and made available for investment by the State. Specifically, the cash management activities that the study reviewed included:

- o Individual or business mails payment through the U.S. Postal Service;
- o U.S. Postal Service makes available to a department at its Sacramento Post Office;
- o Department picks up mail at the Post Office;
- o Department processes payment and related documentation;
- o Department deposits payments in bank; and
- o Bank makes balances available to the State for use.

The study did not review those cash management activities associated with the State's use of funds for investments or its disbursement of funds once the fund balances were made available to the State.

STUDY ADVISORY COMMITTEE

The Commission appointed a study subcommittee headed by Commissioner Haig Mardikian, and including Commissioners Albert Gersten and Lester Oshea. The Commission also appointed a Study Advisory Committee to provide input and oversight. This Committee consisted of these three Commissioners as well as representatives from each department reviewed, the U.S. Internal Revenue Service, professional and business organizations, and concerned citizens. Appendix C contains a complete list of Committee members. The Committee met formally three times during the study to review and comment on the study's approach, methodology and findings. In addition, members were encouraged to provide additional input throughout the study. While all input was considered, the findings and conclusions contained herein do not necessarily reflect those of the members of the Advisory Committee.

STUDY LIMITATIONS

This study included the review of the organization and operation of selected revenue collection and cash management functions within various state departments. As part of the study, members of the project team worked with staff from the different departments to collect information regarding their organization, operation and performance. While much of the data was developed by the consultants, other data was provided to us by the departments. Members of the project team reviewed the information provided by each department for reasonableness and accuracy; however, the project team did not independently verify the data provided by the departments.

II. DESCRIPTION OF THE ORGANIZATION AND OPERATION OF CALIFORNIA'S MAJOR REVENUE AND TAX COLLECTION FUNCTIONS AND CASH MANAGEMENT ACTIVITIES

The State of California's present revenue and tax collection structure has evolved as the result of many fiscal, political, and administrative decisions over the past 100 years. While there have been historical reasons for the assignment of tax collection responsibilities among the various state departments, there is not a clear administrative rationale for the current structure of California's revenue and tax collection departments. This chapter discusses the historical development of the State's revenue and tax collection departments. It also provides an overview of the major revenue and tax collection activities reviewed in this study.

HISTORICAL OVERVIEW OF THE DEVELOPMENT OF CALIFORNIA'S REVENUE AND TAX COLLECTION DEPARTMENTS

The first major tax levied by the State was a tax on insurance companies which was established by statute in 1853. This tax was based on premiums and was collected by the State Controller. In 1870 the Legislature created the Board of Equalization to deal with property assessment abuses among counties. The Board consisted of the State Controller and two members appointed by the Governor. This was an oversight responsibility rather than a taxing responsibility. In 1879, the Board of Equalization was established under the State Constitution to regulate county assessment practices, equalize county assessment ratios, and assess properties of intercounty railroads. At that time, the present makeup of the Board of Equalization, which consists of four members elected from the State's four separate equalization districts and the State Controller, was established.

In 1911 a constitutional amendment established a corporation franchise tax, a bank share tax, a gross receipts tax on utilities, and an insurance tax. The Board of Equalization was given responsibility for assessment of these taxes. However, in 1929 the Bank and Corporation Franchise Tax Law was enacted. This act created the Office of the Franchise Tax Commissioner and moved responsibilities for administration of bank and corporate franchise taxes from the Board of Equalization to the new department. The Board of Equalization did, however, retain appellate responsibility.

During the next decade, the Board of Equalization assumed the responsibility for administering several new taxes as they were enacted. In 1933, the Board of Equalization became responsible for assessing the Sales Tax, Motor Vehicle Transportation License Tax, and the Alcoholic Beverage Tax. In 1935, it became responsible for the Use Tax and in 1937 the Fuel Tax.

The first Department of Motor Vehicles was created in 1915. However, its powers and duties were transferred to the Department of Finance in 1921. In 1931 it was reestablished as a separate state department. Since 1931, there have been several major changes in California's vehicle codes;

however, the Department of Motor Vehicles has continued as a separate revenue producing and collecting department.

The personal income tax was established by 1935 and the Office of the Franchise Tax Commissioner was given responsibility for its administration. This tax was based on income which originates within California. The Office of the Franchise Tax Commissioner was abolished in 1950 and replaced by the Franchise Tax Board. This board consists of the chair of the Board of Equalization, the State Controller (who is also a member of the Board of Equalization), and the Director of the Department of Finance.

In 1935, as part of the Social Security program, provision was made for unemployment insurance systems in the states. California promptly enacted a tax to fund the payment of such benefits. A companion system to provide temporary disability insurance payments to workers was added in 1946. Recently, the Employment Training Tax was established to fund training programs for displaced workers.

In 1955, a program authorizing California cities and counties to impose a Local Sales and Use Tax was enacted. At that time, the Board of Equalization began administering this program for the cities and counties. Also in 1955, a Constitutional Amendment transferred the licensing and control of alcoholic beverages from the Board of Equalization to the newly created Alcoholic Beverage Control Department. However, the tax assessment and collection functions remained with the Board of Equalization.

In 1971, the State of California enacted Personal Income Tax withholding. Prior to this time Personal Income taxes had not been withheld from employees' paychecks. The Employment Development Department was assigned the responsibility for collecting the Personal Income Tax because it already had a system in place for collecting employer payroll-based taxes. However, the Franchise Tax Board retained the overall responsibility for administering the Personal Income Tax.

In 1982, California voters repealed the Inheritance and Gift Taxes and replaced these taxes with an Estate tax. The new Estate tax became the responsibility of the State Controller's Office, as had been the case with the Inheritance and Gift taxes.

More recently, the California voters approved the California State Lottery in 1984. The lottery initiative established a California State Lottery Commission to oversee the operation and conduct of the California State Lottery.

OVERVIEW OF THE MAJOR REVENUE AND TAX COLLECTION FUNCTIONS

The study reviewed six major revenue and tax collection functions performed by the State. These functions include cashiering, auditing, appeals, collections, data processing and forecasting. Each of these functions is discussed in the following sections.

Cashiering

The cashiering function for the State of California includes the sequence of activities which occur from the time a payment is initiated by a person paying a tax or a fee, typically by putting an envelop containing a check into the mail, until the time when the check is processed and the funds represented by that payment are available for use by the State. One of the primary thrusts of cash management is to reduce the time it takes to perform this process, thereby expediting the funds availability to the State for investment.

The cashiering workloads vary within individual departments depending upon the type of tax collected and its associated payment due dates. Exhibit II.1 provides a graph which shows the weekly cashiering workload of checks processed by the Franchise Tax Board, Board of Equalization, Department of Motor Vehicles, and the Employment Development Department during the first six months of calendar year 1985.

As Exhibit II.1 shows, the number of checks processed by these departments varies from a low of about 400,000 checks during the first week of January to a high of approximately 1.4 million checks during the middle week in April when personal income tax returns are due at the Franchise Tax Board. The average total number of checks processed each week by these departments at their Sacramento cashiering units was over 600,000 items. Similarly, the total amount of dollars processed by these departments generally corresponds with the number of checks processed. Appendix D provides more detailed information regarding the number of checks and the amount of dollars processed by each of these departments in their Sacramento cashiering units.

Auditing

The State of California's system for collecting taxes relies heavily on self-assessed taxes. This means that taxpayers are responsible for determining, reporting and paying tax liabilities. Auditing taxpayers is one of the primary techniques used by the State to encourage a high-level of voluntary compliance. In addition, auditing provides a source of revenue to the State by identifying taxpayers who have not paid sufficient taxes.

Four of the departments reviewed in this study conduct significant auditing activities. These include the Board of Equalization, The Employment Development Department, the Franchise Tax Board, and the State Controller's Office. Exhibit II.2 provides a summary of the auditing activity performed by the State's revenue and tax collection departments in fiscal year 1984-85. This exhibit shows that the four departments reviewed performed 51,372 audits which resulted in total audit assessments of almost $660 million.

EXHIBIT II.2

Summary of Auditing Activity By State Revenue and Tax Collection Departments in Fiscal Year 1984-85

Department	Number of Audits*	Audit Assessments
Board of Equalization	22,488	$ 253,814,360
Employment Development Department	13,319	38,118,788
Franchise Tax board	14,845	367,025,157
State Controller's Office	720	635,604
	51,372	659,593,909

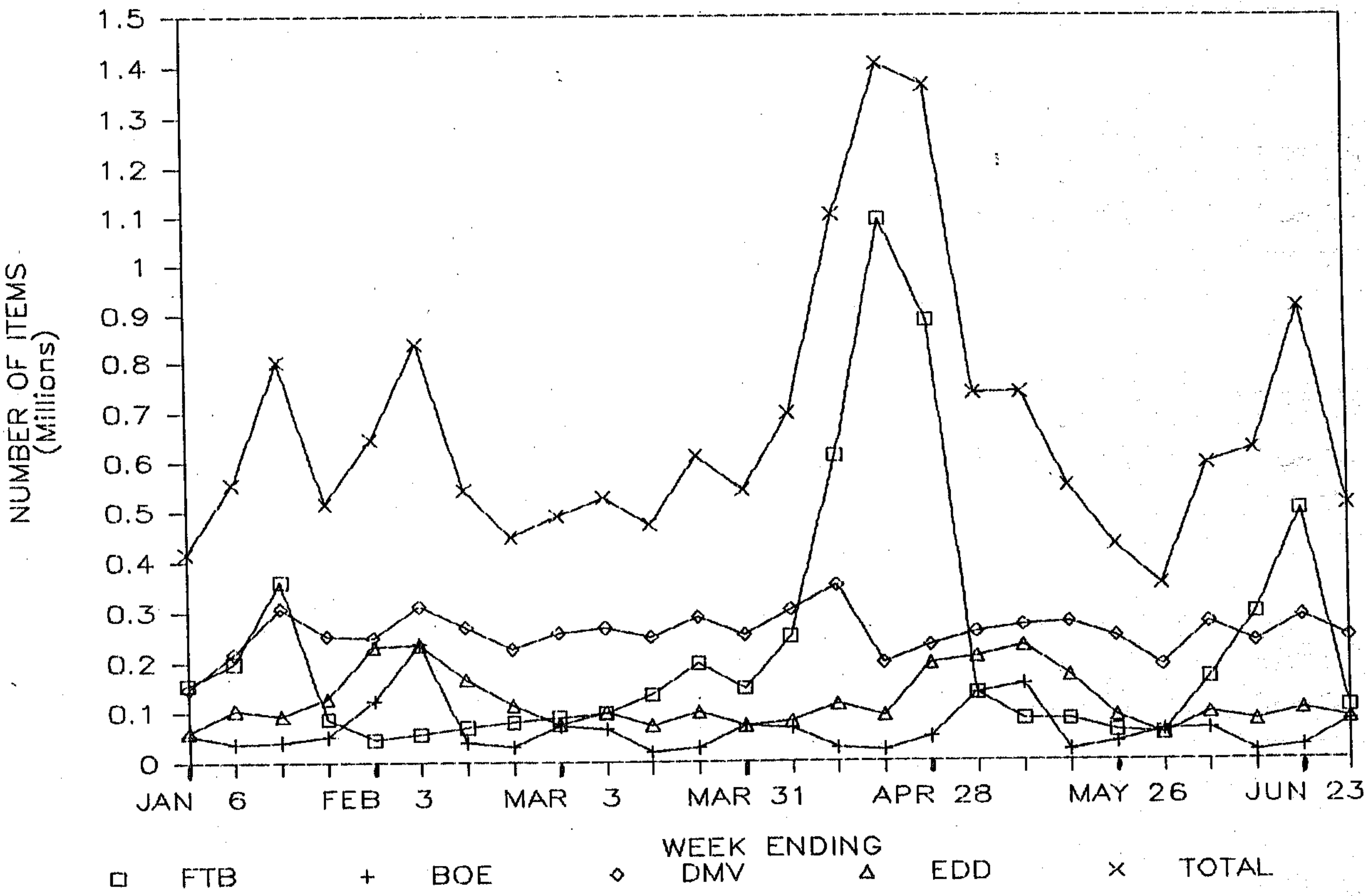
* Notes: Reflects the number of field audits, which are detailed audits. This does not include desk reviews of taxpayer returns.

Appeals

Since the major taxes in the State of California's tax collection system are self-assessed taxes, the State conducts an extensive auditing program of taxpayers. If taxpayers take exception with audit findings related to the amount of tax that the State's auditors assess them, taxpayers can file

EXHIBIT II.1

WEEKLY CASHIERING WORKLOAD
OF CHECKS PROCESSED
JANUARY 1, 1985 THROUGH JUNE 30, 1985



appeals with the State. Each of the major revenue and tax departments reviewed in the study has its own appeals process.

The Employment Development Department, the Franchise Tax Board, the Board of Equalization and the State Controller's Office each have their own administrative appeals process. In addition, after a taxpayer has pursued his or her appeal within the Franchise Tax Board, the taxpayer can then appeal to the Board of Equalization. Ultimately, if a taxpayer is not satisfied with the results of administrative appeals processes, a taxpayer can appeal taxes to the court system.

In fiscal year 1984-85, the Board of Equalization had approximately 1,900 appeals filed regarding business taxes and the Franchise Tax Board had approximately 2,900 appeals filed regarding its taxes. The Employment Development Department had approximately 1,100 appeals filed, and as of the end of fiscal year 1984-85, had approximately 1,500 appeals pending.

Collections

The collections function includes those activities which the State takes to identify, track, and ensure payment of fees and taxes due the State. Generally, the collections function involves following up with delinquent taxpayers and taking appropriate administrative or legal action to obtain payment of funds due the State.

Six of the departments reviewed in the study conduct collection activities. This includes the Board of Equalization, California State Lottery Commission, Department of Motor Vehicles, Employment Development Department, Franchise Tax Board, and the State Controller's Office. Exhibit II.3 summarizes the collections activities of these departments in fiscal year 1984-85.

Exhibit II.3 shows that the six departments reviewed in this study collected a total of 924,225 accounts worth approximately $926 million in fiscal year 1984-85. However, these departments have a collections backlog of approximately $1.485 billion and had to write off 321,611 bad debts amounting to approximately $112 million in fiscal year 1984-85.

Data Processing Function

All of the departments reviewed in this study operate automated data processing systems to conduct their business operations. However, this study specifically looked at the automated data processing systems in use at the State's three major revenue and tax collection departments, including the Board of Equalization, the Employment Development Department, and the Franchise Tax Board.

The three departments reviewed in this study have separately developed their automated data processing systems and applications for use in conducting their revenue and tax collection functions. The Franchise Tax

EXHIBIT II.3

SUMMARY OF COLLECTION ACTIVITIES IN REVENUE COLLECTING DEPARTMENTS REVIEWED

Fiscal Year 1984-85

Department	Amount of Collections	Number of Collections	Amount of Collections Backlogged(1)	Number of Collections Backlogged(1)	Amount of Uncollectibles Written Off	Number of Uncollectibles Written Off
Board of Equalization	$ 134,386,000	87,850(2)	$ 312,167,000	61,582	$ 15,352,000	5,587
California State Lottery Commission(3)	N/A	N/A	735,000	100	N/A	N/A
Department of Motor Vehicles	6,415,000	61,039	408,000	2,956	56,000	787
Employment Development Department	1,074,000	30,596	118,902,000	22,843	7,537,000	2,068
Franchise Tax Board(4)	734,536,000	739,080	895,551,000	637,427	88,741,000	312,861
State Controller's Office	49,500,000	5,660	157,367,000	14,476	516,000	308
Totals	$ 925,911,000	924,225	$ 1,485,130,000	739,384	$ 112,202,000	321,611

Note:
(1) As of June 30, 1985
(2) Estimated number of collections
(3) Based on estimated long-term uncollectibles from the first three months of operations, October through December 31, 1985
(4) Includes machine billings

Board and the Employment Development Department use IBM as their primary mainframe computer hardware, while the Board of Equalization uses Sperry Univac equipment and recently went out to bid for new equipment. However, each of these departments has different data base management systems and operate their own computers. Appendix E contains profiles of the automated data processing systems and applications in these departments.

Forecasting

The State of California has two departments that are responsible for providing revenue forecasts. The Department of Finance prepares revenue forecasts each year that are used extensively in the annual state budget process. The Commission on State Finance prepares quarterly forecasts for the State's General Fund. Each of these forecasts are based on somewhat different factors and weighting.

* * * * *

This chapter has briefly described the history of the development of California's revenue and tax structure and the major functions that are currently performed. The next chapter discusses the findings identified during the study of the State's revenue and tax collection functions and cash management activities.

III. STUDY FINDINGS

The study identified a total of 37 findings which could improve the State's organization, operation and performance of its revenue and tax collection functions and cash management activities. These findings also disclosed opportunities for the State to generate additional revenue and reduce costs. This chapter presents the individual findings in each of the major revenue and tax collection functions reviewed during the study. Appendix F provides a listing of the findings and identifies which findings apply to which departments. Chapter IV discusses the alternatives for implementing action to address these findings, and summarizes the cost/benefit impact of the implementation alternatives.

GENERAL FINDINGS

1. Substantial Duplication of Functions Exists in the State's Major Revenue and Tax Collection Departments

The review of the State's major revenue and tax collection departments revealed that there is considerable duplication in the functions and activities performed by these departments. Although there are historical reasons for the present assignment of tax collection responsibilities among the State's departments, California's tax administration structure is unique and administratively unorthodox. Not only does this fragmentation of functions and responsibilities present problems in the administration of taxes, it also requires the general public to deal with multiple taxing departments.

The study showed that there are several functions which are duplicated among the revenue and tax collection departments in the State of California. Specifically, the study identified six major functions that are performed, to some extent, by two or more of the nine departments reviewed. Exhibit III.1 provides a matrix which illustrates the major functions performed by these departments.

This exhibit shows that among the six major departments reviewed that perform revenue and tax collection functions, there is substantial duplication of the cashiering, auditing, appeals, collections, data processing, and forecasting functions within these departments.

In addition to the duplication of functions and activities performed by the State's major revenue and tax collection departments, there is considerable inter-relationship of the responsibilities in these departments, including:

- o The State Controller and the Chairman of the Board of Equalization sit on both the Franchise Tax Board and the State Board of Equalization;

EXHIBIT III.1

SUMMARY OF THE MAJOR REVENUE COLLECTION FUNCTIONS PERFORMED BY THE DEPARTMENTS REVIEWED

Department	Cashiering	Auditing	Appeals	Collections	Data Processing	Forecasting
Board of Equalization	X	X	X	X	X	
Franchise Tax Board	X	X	X	X	X	
Employment Development Department	X	X	X	X	X	
Department of Motor Vehicles	X		X	X	X	
California State Lottery	X			X	X	
State Controller's Office	X	X	X	X		
State Treasurer's Office					X	X
Department of Finance						X
Commission on State Finance						X

- The Board of Equalization is a level of appeal available to taxpayers with a dispute on either their sales tax, which is administered by the Board of Equalization, or their income tax, which is administered by the Franchise Tax Board;

- The Employment Development Department collects the withheld personal income tax for the Franchise Tax Board;

- The State Controller maintains accounts and collects delinquencies for certain taxes assessed and collected by the Board of Equalization;

- The Department of Motor Vehicles collects certain taxes for the Board of Equalization;

- The Board of Equalization, the Employment Development Department, and the Franchise Tax Board each maintain separate computerized information systems with similar information on California businesses and individuals; and

- The administration of the Insurance Tax is shared by three state departments. The Department of Insurance which regulates insurers, determines the correct amount of tax. Upon recommendation from the Department of Insurance, the Board of Equalization issues the tax assessments. The Board also considers petitions for redetermination and claims for refund, and grants oral hearings to petitioners. The tax is collected by the State Controller.

As an official representing the Office of the Legislative Analyst stated before an Assembly Revenue and Taxation Committee hearing in December 1985:

> There doesn't seem to be any logical rationale for the existing allocation of responsibilities among the various state agencies. Rather, this distribution seems to reflect a series of unrelated decisions, many of them made in response to changes in the makeup of state revenues. The current fragmentation of responsibilities might have been avoided if California's founding fathers had designated a state officer as tax collector.

Considering the duplication, overlap and inter-relationship of the functions and activities performed by the State's major revenue and tax collection departments, the potential exists for increased efficiency through consolidation or integration of organizations and operations and for reducing the costs of operation, administration, and overhead. Moreover, since many taxpayers pay taxes to more than one taxing department, any reduction in the number of departments performing these functions could make the process easier and less complicated for the State's taxpayers.

2. **Neither the Federal Government Nor Other States Have Fragmented Their Revenue, Tax Collection, and Cash Management Functions Like California**

There are many differences in the political, social and economic environments among states, and between states and the federal government. While such differences can cause a wide variation in the requirements necessary to administer taxes, a comparison of the way California administers its taxes to the way that other states and the federal government administer their taxes provides useful information and contrasts.

A survey of other major states (Illinois, New York and Texas) and states that have recently considered, or performed reorganization of their taxing departments (Mississippi and Iowa), was conducted to gather information regarding how other states administer their taxes. Exhibit III.2 shows the results of this survey. Specifically, this exhibit shows that:

- None of these states have split the revenue management responsibilities among several agencies. Instead, each state has a consolidated department of revenue;
- The states contacted had a separate organization for equalizing property taxes among counties. This is the function for which the Board of Equalization was originally established in California. However, this function is also performed by the revenue agencies in some states;
- Only one state has made any major organizational changes in its revenue responsibilities in recent years. In Mississippi, the revenue collection responsibilities of the Motor Vehicle division were transferred to the Tax Commission in 1980; and
- California has one system in place to save revenue collection costs that is not duplicated in any other state. The Personal Income Tax withheld from employees by their employers is collected by the Employment Development Department along with employer payroll-based taxes. This activity capitalizes on the fact that the universe holding the funds (employers) is identical.

While it is difficult to compare a state of the size, diversity and complexity of California to other states, the comparative review showed that the administrative structure for California's revenue and tax collection activities is unique as compared to other states.

In addition to the survey of other states, the operations of the Fresno Service Center of the U.S. Internal Revenue Service (IRS) was

EXHIBIT III.2

COMPARISON OF REVENUE COLLECTION CHARACTERISTICS
IN CALIFORNIA, OTHER STATES AND THE FEDERAL GOVERNMENT

	California	New York	Illinois	Texas	Iowa	Mississippi	Federal Government
Responsibility for Administering:							
Personal Income Tax	FTB[(1)]	Tax & Finance[(2)]	Revenue	(None)	Revenue	Commission	IRS
Corporate Income or Franchise Tax	FTB	Tax & Finance	Revenue	Comptroller	Revenue	Commission	IRS
Business Taxes (such as Sales Tax)	BOE	Tax & Finance	Revenue	Comptroller	Revenue	Commission	IRS (Excise Tax)
Payroll Taxes (such as UI and DI)	EDD[(3)]	Department of Labor	Bureau of Labor	Employment Commission	Department of Job Service	Employment Security	IRS (FICA/FUTA)
Audit Techniques:							
Single audit for most taxes	No	Sometimes	Yes	Yes	Yes	Yes	Yes
Joint or Cooperative audits	No	Sometimes	N/A	N/A	N/A	N/A	N/A
Consolidated Cashiering:	No	Yes	Yes	Yes	Yes	Yes	Yes
Consolidated Collections:	No	Yes	Yes	Yes	Yes	Yes	Yes
Fiscal year 1984-85 Collections (Income and Business Taxes)	\$35 Billion[(4)]	\$26 Billion[(4)]	\$9 Billion	\$11 Billion	\$2 Billion	\$2 Billion	\$18 Billion [(5)]

NOTES:

(1) The EDD collects the PIT which employers withheld from employees.

(2) The New York State Department of Taxation and Finance also administers the city personal income tax for the Cities of New York and Yonkers.

(3) California is the only state which collects PIT withholding with other payroll taxes.

(4) Includes collections for local governments.

(5) Total collections in Fresno Service Center.

reviewed to obtain information on how the federal government accomplishes its revenue collection responsibility. The IRS is responsible for collecting most federal taxes. Its responsibilities include:

- o Personal income tax;
- o Corporate income tax;
- o Social Security tax (FICA);
- o Railroad retirement tax;
- o Estate tax;
- o Gift tax;
- o Unemployment insurance; and
- o Numerous excise taxes.

The Fresno Service Center, one of the IRS Regional Service Centers, collected over $18 billion from these taxes during the federal fiscal year October 1, 1984 through September 30, 1985.

The IRS administers these taxes through a consolidated revenue collections system. The cashiering, data processing, auditing and collections processes are all performed jointly. For example, if a taxpayer is delinquent on more than one tax, only one collector will work the case and that collector will be responsible for collecting all outstanding taxes. Similarly, one auditor (or team of auditors in the case of a large business) will audit all the records of a business. This audit will cover all aspects of the business' compliance with all federal taxes, such as income taxes and FICA. This system contrasts with the tax collection structure in California which is separately administered by different departments for different types of taxes.

To speed up the processing of deposits, the Federal Internal Revenue Service instituted a system using deposit coupons. Instead of mailing tax reporting forms and checks to the IRS, businesses are required to make tax deposits at banks using federal tax deposit coupons. The coupons are preprinted with the taxpayer's name and identifier number, and have designated areas for the taxpayer to enter the amount of the payment, type of tax being paid, and the calendar quarter for which the payment is being made. These coupons are required for most payments of withheld income tax, social security tax, federal unemployment tax, excise tax, railroad retirement tax, corporate income tax, and several other taxes. The deposits are reconciled with the taxpayer's accounts when the tax reports are submitted. For example, the quarterly payroll reports will show how the employer's tax liability was calculated and will also reconcile the various deposits made during the quarter to the liability.

Use of this coupon system provides certain benefits to the federal government. First of all, much of the cashiering function is accomplished by the banks instead of the IRS. Secondly, the funds are available for use more quickly than if they were delayed in the mail or waiting to be cashiered.

If a taxpayer chooses not to deposit taxes with a bank, the taxpayer must make the deposit with the federal reserve bank responsible for that geographic area. Payment must be made with a check or other payment instrument for which immediate credit is given. Further, the payment must be received at the federal reserve bank on the due date.

Remittances that are not paid through the coupon deposit system are processed by IRS service centers. These remittances include payments attached to individual income tax returns, quarterly estimate payments by individuals, and payments below certain dollar levels. At the IRS Fresno Service Center, all incoming mail is sorted and opened automatically and screened to determine whether or not there is a check in the envelope. All mail received on any given day is processed within 24 hours of receipt.

The State's remittance receiving process contrasts with the IRS process. The State's process relies on the U.S. Postal Service to do the majority of the sorting based on a series of unique post office box numbers or zip codes. Furthermore, the State does not have the high speed equipment similar to that used by the IRS. As a result, several agencies regularly have backlogs in mail processing.

The comparison of California's administrative structure and operations for its revenue and tax collection function to those of the federal government showed that while both entities operate high volume operations, the federal government uses a consolidated processing operation to perform its major functions but the State of California conducts these functions using numerous individual departments performing duplicative activities.

There are significant differences between how California conducts its business operations as opposed to how other states and the federal government do business. Due to the significant differences in how California conducts these business operations, it is apparent that the experience of other states and the federal government may offer California insight into how to better perform these functions and activities.

CASHIERING FINDINGS

3. Certain Departments Could Generate Additional Interest Earnings for the State by Having Their District Offices Deposit Funds in Local Banks

The review of departments conducting revenue and tax collection activities revealed that some departments have established procedures for staff within their district offices to deposit payments received each day at local branch offices of banks conducting business with the State. However, other departments have staff forward by mail payments received at their district offices to their Sacramento-based processing units where the funds are then deposited. Due to the additional time it takes for district offices to forward payments to Sacramento for processing and deposit, the State is losing interest earnings.

The Department of Motor Vehicles and the Employment Development Department have established procedures for staff in their district offices to deposit payments received each day at local banks. Three other departments which have district offices that received revenue, including the California State Lottery Commission, the State Controller's Office, and the Board of Equalization, generally have staff forward payments to their respective Sacramento-based processing units for deposit.

Although the Department of Motor Vehicles has its district offices deposit funds at local banks, a recent report by the Office of the Auditor General identified an estimated $279,000 in lost interest to the State in fiscal year 1984-85 due to the lack of timely deposit of funds by the Department of Motor Vehicles' field offices. This occurred mainly because funds were not being deposited in a timely manner at local banks.

The review of the revenue and tax collection departments identified an estimated $17,000 in lost interest to the State resulting from delays in deposits by the California State Lottery Commission. These delays were caused by forwarding payments to Sacramento for deposit as opposed to having district offices deposit funds in local banks.

The Board of Equalization also was not depositing the funds it received at district offices in local banks. No accurate estimate could be made of the State's lost interest on these funds because the funds were being forwarded to Sacramento and mixed with the mail coming directly from the post office. However, during the course of the study, the Board of Equalization began depositing certain funds at local banks.

The State Controller's Office also collects some funds at its district office in Los Angeles which it forwards to Sacramento for processing and deposit. Due to the limited information available on the amount of funds collected at the Los Angeles office, no estimate could be made on the amount of interest lost to the State. These field offices should deposit all funds in local banks on a daily basis.

4. The Board of Equalization Could Expedite its Mail Processing by Intercepting Mail at its Point of Origin

Three of the major revenue and tax collection agencies in the State, including the Franchise Tax Board, the Employment Development Department, and the Board of Equalization, have very definitive work cycles based upon statutorily required tax payment due dates. Two of these departments, the Franchise Tax Board and the Employment Development Department, have established means of expediting mail delivery by intercepting the mail earlier during peak processing periods.

A study conducted by the Employment Development Department showed that approximately 47 percent of the funds received in Sacramento are mailed from Los Angeles, 20 percent are from San Francisco, 16 percent are from out-of-state, 5 percent are from San Diego, and the remaining 12 percent are from other parts of the State. The U.S. Postal Service's standard for delivery of mail from Los Angeles to Sacramento is two days and from San Francisco is one day. However, in practice, the mail delivered from these locations and from out-of-state locations often takes longer to get to Sacramento.

The Franchise Tax Board has established a procedure with the U.S. Postal Service for intercepting mail earlier in the post office's processing flow during peak periods. Specifically, the Franchise Tax Board has made arrangements for the post office to intercept mail at its Los Angeles and San Francisco offices during peak periods and deliver it directly to the Franchise Tax Board's Sacramento-based tax payment processing unit. This allows the Franchise Tax Board to receive payments made through the mail sooner and expedites processing.

The Employment Development Department has an agreement with the U.S. Postal Service to have mail expedited to Sacramento from locations in California, including Los Angeles and San Francisco, and from other locations in the United States, including Chicago and New York. Under this agreement, mail is intercepted at the post offices in these cities and express mailed to Sacramento. This saves at least one day for in-state mail and two or more days for out-of-state mail.

The Board of Equalization has not established a mechanism for intercepting mail during peak periods. As a result, the Board of Equalization does not expedite its receipt of payments during peak periods and does not realize potential additional interest earnings.

Our analysis indicated that the State could receive an additional $5,953,000 in interest earnings if it developed and implemented procedures for expediting all mail sent to Sacramento. Moreover, the United States Postal Service recently instituted a new group of zip codes (942_ _) for state agencies that will facilitate the State's ability to intercept mail at the point of origin.

5. <u>Certain Departments Should Establish Regional Post Office Boxes In Out-of-State Locations to Expedite Mail Payments</u>

As previously mentioned, the Employment Development Department has established an agreement with the U.S. Postal Service to have mail payments expedited to Sacramento from certain post offices in California and key out-of-state cities through the use of express mail. This agreement is relatively inexpensive and allows the department to receive payments at least one day earlier from in-state locations and two or more days earlier from out-of-state locations. The Employment Development Department's express mail agreement with the U.S. Postal Service results in an annual estimated net benefit of $2.6 million.

Other departments involved in the State's revenue and tax collection activities also could benefit by establishing similar arrangements with the U.S. Postal Service because they receive large amounts of payments from certain in-state and out-of-state locations. Specifically, the Franchise Tax Board could benefit from this type of agreement with the U.S. Postal Service for out-of-state mail, while the Board of Equalization could benefit from this type of an agreement for both in-state and out-of-state mail.

6. <u>The Employment Development Department Should Ensure that Mail is Collected From Regional Post Office Boxes More Regularly</u>

The review of the Employment Development Department's express mail agreement with the U.S. Postal Service determined that the post office boxes established in California for the express mail service are being swept, or collected, regularly by the postal service employees and the mail is being forwarded to the Employment Development Department as agreed upon. However, the post office boxes in other states are not being swept by the U.S. Postal Service with the same regularity. As a result, the mail is not being forwarded to the Employment Development Department as timely as possible.

To ensure that the State realizes the full benefits of the express mail service, the State should work more closely with the U.S. Postal Service to ensure that the post office boxes are swept regularly. If the State can not get the U.S. Postal Service to sweep these boxes regularly, the State should arrange for one of its own employees in the out-of-state locations, including Chicago and New York, to make a daily sweep of postal boxes and forward the mail to Sacramento using express mail.

7. <u>The Board of Equalization and the Department of Motor Vehicles Can Start Processing Mail Earlier by Picking it up When it is First Available From the U.S. Postal Service</u>

Some mail is available at the U.S. Postal Service's Royal Oaks branch post office in Sacramento as early as 11:00 p.m. each night, but most mail is available beginning at about 3:00 a.m. each day. Some departments have made arrangements to pick-up mail at the post office at this time so that they can begin processing payments as soon as possible. Other departments, however, do not pick up mail that early. By picking up mail as soon as it is available at the post office, departments can expand the amount of time which they have each day to process payments and ensure that payments are deposited in the bank. This is particularly critical during peak processing periods because if payments are not deposited on the day received, the State looses interest on these funds.

The Employment Development Department has instituted mail pick-ups for any mail available at 11:00 p.m. and 3:00 a.m. at the Royal Oaks Branch post office so that it can begin its processing operations earlier. Similarly, the Franchise Tax Board picks up mail at the post office shortly after 4:00 a.m. By picking up mail earlier at the post office, these departments have more hours of processing time prior to the processing cut-off time each banking day. This minimizes the amount of holdover, or payments not processed and deposited on any banking day. For example, during fiscal year 1984-85 the holdover at the Franchise Tax Board resulted in the State losing approximately $450,000 in interest earnings. However, approximately $406,000 of this amount was the result of holdover which occurred during the peak processing period the Franchise Tax Board experiences in mid-April. Similarly, holdover at the Employment Development Department resulted in the State losing approximately $397,000 due to payments which could not be processed and deposited the same banking day.

The Board of Equalization and the Department of Motor Vehicles do not pick up mail at the time when it is first available at the Royal Oaks Branch post office in Sacramento. For example, the Board of Equalization normally picks up mail at about 6:30 a.m. during regular processing periods and at 5:00 a.m. during peak periods. However, the Board of Equalization does not begin its processing shift until 7:00 a.m. during regular and peak periods. Similarly, the Department of Motor Vehicles picks up mail the about 6:30 a.m. The late pick-up of mail, along with other processing considerations, contributes to the larger amount of holdover which these departments experience. In fiscal year 1984-85, the State lost an estimated $2,456,000 in interest due to the holdover on non-exception items at the Board of Equalization and an estimated $826,000 due to holdover on non-exception items at the Department of Motor Vehicles. Non-exception items are those items that are submitted in the proper format and do not need to have special processing.

8. **The Department of Motor Vehicles and the Board of Equalization Can Increase Their Mail Processing and Cashiering Capacity Each Banking Day by Starting Their Shifts Earlier**

One of the contributing factors to certain departments being unable to process and deposit all the payments they receive in the mail each day is the fact that the departments do not start mail processing and cashiering shifts as early as possible. For example, the Employment Development Department has a night shift that works from 10:30 p.m. until 7:00 a.m. processing mail that is available at that time. In addition, it operates a day shift that begins processing mail at 5:30 a.m. Similarly, the Franchise Tax Board begins its day shift processing activities at 5:30 a.m.

Conversely, the Board of Equalization and the Department of Motor Vehicles do not begin their day shifts until 7:00 a.m. to 7:30 a.m. Thus, by starting their mail processing shifts earlier, these two departments could have more time available each day prior to bank deposit cut-off times and could reduce the lost interest to the State resulting from holdover. The late starting of mail processing at the Board of Equalization and the Department of Motor Vehicles is a contributing factor to the total of $3,282,000 in lost interest that the State experiences due to processing holdover in these departments.

9. **The Department of Motor Vehicles Can Reduce Processing Holdover by Implementing a Work Shift on Saturday or Sunday**

Three of the four major revenue and tax collection departments reviewed, the Board of Equalization, the Franchise Tax Board, and the Employment Development Department, currently operate work shifts on Saturday or Sunday, as necessary, to help ensure more timely processing of mail payments and reduce processing holdover. However, the Department of Motor Vehicles does not operate a Saturday or Sunday work shift. As a result, the Department of Motor Vehicles experiences unnecessary processing holdover and the State loses interest earnings.

The Department of Motor Vehicles Sacramento-based processing unit presently receives approximately 40 percent of its mail volume on Monday morning. This occurs because the post office is processing mail all weekend long, but the Department of Motor Vehicles does not work Saturdays or Sundays. As a result, the Department of Motor Vehicles experiences considerable processing holdover on Monday, Tuesday and even Wednesday, due to the back-up in its workload each Monday. In fiscal year 1984-85, the processing holdover at the Department of Motor Vehicles cost the State an estimated $826,000 in lost interest earnings. To a large extent, this processing holdover and the resultant lost earnings could be avoided by having the

Department change its workweek to include a Saturday or Sunday work shift. This could be accommodated with existing resources by having current staff work other than a Monday through Friday workweek.

10. **The Board of Equalization and the Employment Development Department Can Reduce the Dollar Amount of Processing Holdover by Screening Miscellaneous Mail for Large Payments**

Each of the major revenue and tax collection departments in the State, including the Board of Equalization, the Franchise Tax Board, the Employment Development Department, and the Department of Motor Vehicles are currently using various techniques to distinguish mail with payments from mail without payments. These techniques include using bar-coded and color-coded envelopes and separate post office box numbers. However, these departments also receive various pieces of miscellaneous mail, some of which also include payments. In certain departments, these miscellaneous mail payments are given a low processing priority. This can result in an unnecessarily high amount of processing holdover and lost interest earnings for the State.

Both the Board of Equalization and the Employment Development Department experience some mail holdover with respect to their miscellaneous mail payments. While these departments appropriately assign lower processing priorities to miscellaneous mail payments, the holdover from these payments can result in significant lost interest earnings to the State. For example, a judgmental sample of miscellaneous mail at the Board of Equalization showed that the average payment in a miscellaneous envelope was $7,444. Thus, to the extent to which miscellaneous mail is not processed and deposited each day, the Board of Equalization can experience considerable holdover. The study showed that the miscellaneous mail holdover at the Board of Equalization results in an estimated $590,000 per year in lost interest earnings to the State.

The Employment Development Department also experiences some holdover of miscellaneous mail payments. The average payment in a piece of miscellaneous mail at the Employment Development Department is an estimated $725. The State loses an estimated $397,000 per year in interest due to miscellaneous mail payment holdover at the Employment Development Department.

By taking measures to reduce mail processing holdover, these departments will increase their ability to process miscellaneous mail. To the extent that it is not possible for these departments to eliminate miscellaneous mail processing holdover, these departments should at least consider screening the miscellaneous mail to identify large payments. For example, during our sample of miscellaneous mail payments at departments, we found that individual payments were as large as $260,000. Screening miscellaneous mail payments could potentially identify large payments and ensure that they are processed and deposited on a priority basis.

11. **The Board of Equalization Can Reduce the Dollar Amount of Processing Holdover by Sorting its Workload Better to Ensure That Larger Payments are Given Higher Processing Priority**

The review of the Board of Equalization's processing of mail payments showed that it was not sorting its workload to ensure that large remittances are given higher processing priority than smaller remittances. This resulted in mail with relatively smaller payments being processed before mail with larger payments. Thus, on days when there was processing holdover, the amount of holdover in terms of dollar volume was greater than necessary because not all the mail with large payments was processed first.

The Board of Equalization received approximately $12.8 billion in fiscal year 1984-85 in sales and use tax payments. The Board of Equalization assigns priorities to sales and use tax payments by categorizing such payments as scheduled - those businesses operating in more than one location, or unscheduled - those businesses operating in only one location. The Board of Equalization assumes scheduled payments will be greater because larger businesses would operate more than one location. Therefore, the Board of Equalization processes scheduled payments prior to processing unscheduled payments. However, the study showed that the number of locations a business has is not always a valid indicator of how large a business' sales and use tax payments will be.

For example, a small business may have two or three locations but does a small volume of business and pays a relatively small amount of sales and use tax. On the other hand, another business may have only one location but may pay considerably more sales and use tax than the business that has two or three locations.

Based on our review of the processing priorities that it assigns to payments, the Board of Equalization initiated a project to revise its processing priorities and base them upon the historical amount of tax paid by a business, not the number of locations a business operates. Once these priorities are revised, it should ensure that larger payments are processed first and minimize the dollar volume associated with any processing holdover that the Board of Equalization experiences.

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12. **The Department of Motor Vehicles Can Better Ensure that Funds Get Deposited Each Day by Establishing Equipment Back-Up Support**

It is important in remittancing processing operations to have sufficient equipment back-up in case there is a breakdown. By having equipment back-up, a department can ensure that it can continue processing its workload if there is an equipment failure and be able to make its bank deposits.

The Department of Motor Vehicles presently uses a high-speed check sorter to perform remittance processing. However, in the event of an equipment breakdown, the Department of Motor Vehicles has made no arrangements with other departments that have similar equipment, such as the Franchise Tax Board or the State Treasurer's Office, to provide back-up support for high-speed check processing.

In August 1984, the Department of Motor Vehicle's high-speed check sorter had mechanical problems and did not operate correctly for five working days. While the Department's staff compensated by conducting additional manual processing and depositing of checks, the lack of high-speed check sorting back-up support resulted in a significant slowdown in depositing the Department's receipts at its Sacramento-based processing center. This caused an estimated $10,000 to $15,000 in lost interest to the State. Moreover, no back-up arrangement for high-speed check sorting has since been made by the Department of Motor Vehicles.

13. **Departments Can Improve Their Operations and Generate Additional Interest Earnings for the State by Purchasing Equipment That is Cost-Beneficial**

The major departments involved in the State's revenue and tax collection activities use a variety of equipment to perform their remittance processing and cashiering operations. Each department has independently assessed their equipment needs and selected equipment for their operating requirements. As a result, there is considerable variation between the equipment in use in the major departments involved in revenue and tax collection activities and some departments, both individually and collectively, are not using the most cost-beneficial equipment for their operating environment.

Exhibit III.3 provides a summary of existing mail processing and cashiering equipment in use in the departments reviewed in this study. It shows that some departments, such as the Franchise Tax Board, use relatively newer and more sophisticated equipment with higher performance capabilities (including newer encoding equipment and high speed remittance processing equipment), while other departments, such as the Board of Equalization, use older and less sophisticated equipment with more limited performance capabilities.

Moreover, the review of the individual departments' current processing environments showed that there are various pieces of remittance processing and cashiering equipment that would be cost beneficial for the State to purchase and utilize to reduce remittance processing holdover and increase interest earnings. These pieces of equipment include mail openers, high-speed reader/sorters, encoders, automated mail opener/extraction equipment, and high-speed mail handlers. Specifically, the review showed that opportunities exist to further improve the State's remittance processing equipment and its ability to make more timely deposits by doing the following:

- Procuring additional units of existing equipment to improve processing through-put capabilities;
- Upgrading equipment to improve productivity;
- Realizing economies of scale through consolidation of operations;
- Utilizing new technology to improve productivity; and
- Investigating the potential for additional automation of operations.

A combination of these actions, specifically tailored to the processing requirements of individual departments, or the State of California as a single entity, could result in improved processing capabilities and ensure that State funds are deposited in a timely manner.

It is important to note that individual departments, including the Board of Equalization and the Employment Development Department have been seeking to purchase new equipment to upgrade and improve their processing capabilities, but they have not always been able to obtain budgetary approval for their requests despite clear support based on cost/benefit analysis.

14. **Departments Can Expedite the Deposit of Funds by Separating Payments from Supporting Documents Sooner in the Processing Cycle**

The major departments involved in the State's revenue and tax collection activities process an estimated 34 million items annually. These payments generally are mailed to the State with various supporting documents, such as a one-page statement or a multi-page tax return. While it is important for the State to deposit a payment in the bank as soon as possible to maximize its interest earnings, the State must also ensure that the payment is appropriately applied to a taxpayer's account. Each of the departments reviewed in this study has its own procedures for matching a payment with supporting

EXHIBIT III.3

ANALYSIS OF EXISTING MAIL PROCESSING AND CASHIERING EQUIPMENT IN DEPARTMENTS REVIEWED

	Franchise Tax Board	Department of Motor Vehicles	State Treasurer's Office	Board of Equalization	Employment Development Department
Mail Opening	° 21 nibbler machines ° 3 slitter machines ° 2 scanners to identify data left in envelopes	° 11 Opex mail openers - 6 @ 1981 - 5 @ 1984	° N/A	° 4 semi - automatic openers - 2 @ 1978 - 2 @ 1965	° 9 Opex extraction desk opener @ 1985 ° 1 envelope opener ° 1 Pitney flats opener
Encoding and Manual Sorting	° 8 NCR multipocket manual sort select encoders @ 1981 ° 6 NCR single pocket encoders - 4 @ 1982 - 2 @ 1984	° See "other remittance processing work stations" below	° 3 NCR single pocket encoders @ 1983	° 7 NCR multi-pocket manual sort select encoders - 2 @ 1975 - 3 @ 1979 - 2 @ 1983	° 6 NCR multi-pocket sort select encoders @ 1978 ° 1 Docutronix candeling machine
High Speed Remittance Processing/Sorting	° REI Trace II 1982 ° Lundy reader/sorter 1982	° 1 ten pocket Burroughs reader/sorter	° 2 twelve pocket Burroughs reader/sorters 1980	° None	° None
Other Remittance Processing Work Stations	N/A	° 11 Burroughs Remittance processing stations (9-1978, 2-1984) - Reads and captures data coupon - Encodes and endorses check	N/A	N/A	N/A

and facilitate processing operations. To some extent, each of the remaining three departments have problems in the design, or layout, of their facilities or processing operations which inhibit their ability to perform more efficiently.

The Franchise Tax Board moved into a new facility in December 1985 which was specifically designed to meet their needs for remittance processing, cashiering, and other activities. This facility features considerable open space to allow for movement of personnel and work from one work station to another on one floor. It also was designed for an orderly flow of work from one work area directly to the next work area.

Other departments do not have facilities or work space which is designed to efficiently accommodate remittance processing and cashiering activities. For example, the Board of Equalization's remittance processing and cashiering operations are located in converted office space. Its remittance processing and cashiering operations take place on several floors and require considerable movement of large trays of mail. As a result, its space is not suited to allow for an orderly movement or flow of work from one work station to another on a single floor. Similarly, the Employment Development Department and the Department of Motor Vehicles work in converted office space which allow for somewhat better movement of work than at the Board of Equalization's facility, but which still do not accommodate all operations on a single floor, or with a continuous work flow.

During the course of our study, the Board of Equalization developed plans to relocate much of its remittance processing and cashiering operations on one floor with an improved layout. However, this will not fully solve the fundamental problem that the Board of Equalization has with its present work facility.

16. <u>The Department of Motor Vehicles Could Enhance its Processing Capacity Each Banking Day by Performing Payment Processing Until the Latest Possible Cut-Off Time</u>

The State's revenue and tax collection departments must currently have their deposits ready and must notify the State Treasurer's Office of the amount of their deposits at approximately 1:30 p.m. each banking day. To make these deadlines, three of the four revenue and tax collection departments reviewed, including the Franchise Tax Board, the Board of Equalization, and the Employment Development Department, have scheduled their work such that their processing operations complete work for a banking day's deposit at approximately 1:30 p.m. Any work done after that time is deposited the next banking day.

However, the Department of Motor Vehicles has scheduled its work such that it stops processing work for each banking day at 10:00 a.m. in order to prepare its bank deposit and have lunch. Any work done after that time is deposited the next banking day. Because the Department of Motor Vehicles has an early cut-off time for its processing operations, the State loses interest on payments that are not deposited as timely as possible.

17. The Amount of Processing Holdover Could be Reduced by Negotiating Later Deposit Cut-Off Times With Banks

The State of California, through the State Treasurer's office, currently has agreements with eight major financial institutions with which it does business to have deposits prepared by approximately 1:30 p.m. each banking day. This allows for the deposits to be picked-up at the departments and delivered to branch offices of the banks in Sacramento by 3:00 p.m. To meet this deadline, revenue and tax collections departments do not initiate the processing of any new payments after about 11:30 a.m. to 12:00 noon each banking day in order to complete the processing of work and prepare the deposit by 1:30 p.m. The study showed that there are alternatives available to the State to negotiate later delivery times with the banks so that the State could minimize processing holdover and increase interest earnings.

One alternative available to the State is to deliver the payments it processes each day directly to the central processing centers of the banks in the San Francisco area rather than at the local branch offices of the banks in Sacramento. This practice is common among private businesses. Discussions with the various banks indicate that the banks would be willing to accept deposits at their central processing centers up until their corporate deposit deadlines at approximately 7:00 p.m. to 7:30 p.m. By doing this, the State could increase the processing time available to revenue and tax collection agencies each banking day by approximately two to three hours. However, the State would have to microfilm its checks first and arrange for delivery.

Another alternative available to the State is to negotiate a later deposit cut-off time with branch offices of the banks in Sacramento. For example, discussions with the various banks with which the State does business indicate that if the State had micro-filming capability, the banks would allow the State to provide its deposits to the branch offices of the banks in Sacramento up until approximately 4:30 p.m. each banking day. Under this scenario, the major revenue and tax collection departments would be conducting the micro-filming of the checks that is currently done by the local banks in Sacramento. Again, this alternative would provide an additional two to three hours of processing time each banking day, thereby further reducing the potential for holdover and lost interest earnings for the State.

18. **The Board of Equalization Could Earn Additional Interest by Sorting and Encoding All Checks for Deposit to Banks Conducting Business with the State**

The study of the revenue and tax collection departments revealed that the Board of Equalization was not always sorting and encoding checks for deposit to banks conducting business with the State. Since the State does not get immediate fund availability from the banks on unencoded and unsorted checks, it loses interest income.

The Board of Equalization experiences a very high volume of payments on approximately two days each quarter when monthly and quarterly sales and use tax payments are also received. In addition, during the last quarter of each year the volume of payments is extremely high for about three days when annual sales and use tax payments are also received. During these rush periods, the Board of Equalization presents unencoded and unsorted payments to the bank. The study showed that the State loses an estimated $53,000 per year due to the Board of Equalization's practice of not encoding or sorting checks during peak workload periods.

Prior to the revenue and tax collection study, the Board of Equalization was encoding but not sorting payments for taxes other than sales and use tax for deposit to the banks. As a result, the State was not getting immediate availability of funds from the bank and lost interest income. Because it was not sorting taxes other than sales and use taxes for deposit to the banks, the State was losing an estimated $139,000 per year.

During the course of our study, the Board of Equalization began sorting these other payments for deposit to the eight banks with which the State conducts business.

19. **The State Could Expedite Payments and Generate Additional Interest Earnings by Making Greater Use of Electronic Fund Transfer**

State departments involved in revenue and tax collection activities experience delays in the receipt of payments sent to them through the postal system of from one to four days, or more, depending upon numerous variables that influence the speed with which the postal system can identify and deliver a payment to the State. These variables include:

- Physical location of mailing point;
- Geographic location of mailing point;

- o Condition and size of envelope;
- o Correctness and completeness of address;
- o Method of mailing;
- o Time of day of mailing; and
- o Use of zip codes.

These delays which the State experiences in the receipt of revenue and tax collection payments result in lost interest earnings to the State. By expediting the $38.3 billion that the State receives each year in revenue and tax collection payments by only one day, the State would generate an additional $9,920,000 in interest earnings.

One method available to the State to expedite the receipt of revenue and tax collection payments is to get authorization from taxpayers to use electronic funds transfer (EFT) to sweep taxpayers' bank accounts to pay taxes due to the State. Presently the only department in the State routinely using EFT is the California State Lottery Commission. It has established EFT agreements for payments by the estimated 21,000 retailers selling lottery tickets in the State.

Another opportunity to use EFT would be to allow taxpayers to pay funds due the State through direct deposit of funds in a State bank account. The federal government has established a mechanism for taxpayers to do this, but the State of California currently does not have a system in place to allow for direct deposit of funds through EFT.

The use of EFT to sweep taxpayers' bank accounts to pay taxes due to the State, and the use of EFT for direct deposit of funds, would reduce the delays which the State presently experiences with mail payments and would generate additional interest earnings. While the State should not require that taxpayers make payments through EFT, if this service is made available to taxpayers it is likely that some would use it.

20. The California State Lottery Commission Could Increase Interest Earnings by Conducting EFT Sweeps of Accounts Sooner

The California State Lottery Commission has established a system for using electronic funds transfer (EFT) to sweep retailer accounts to pay for lottery tickets which retailers have purchased. Due to its current procedures for conducting data processing, mailing invoices to retailers, and sweeping accounts using EFT, the California State Lottery Commission has an unnecessary delay in collecting payments from retailers which results in lost interest income.

Under its present system for collecting for lottery tickets, the California State Lottery Commission has the following major steps and timetable for conducting EFT sweeps of major retailers:

(1) Friday evening - process data on the week's sales of tickets to retailers.

(2) Monday - mail invoices to retailers notifying them of their account balances which are subject to being swept using EFT.

(3) Wednesday through Friday-allow retailers to examine and review invoices for accuracy.

(4) Following Monday - perform EFT sweeps of retailers bank accounts to collect payment for lottery tickets.

As these steps show, there is an elapsed time of 10 days from the time the data processing run is prepared by the California State Lottery Commission until the retailers accounts are swept and payment is made, and up to 14 days from the time the lottery tickets are obtained. Discussions with the California State Lottery Commission indicate that it has chosen, as a business practice, to allow retailers time to review invoices prior to making sweeps of their accounts for payments. Without considering the merits of this business practice, an opportunity exists to perform sweeps of retailer accounts sooner and reduce lost interest income.

For example, the California State Lottery Commission prepares its computerized invoices for lottery retailers on Friday evening. However, because it does not operate a Saturday work shift, these invoices are not mailed to retailers until Monday. As a result, retailers do not receive their invoices until mid-week. If the invoices were mailed on Saturday instead of Monday, the retailers would receive the invoices sooner. This would allow the California State Lottery Commission to continue its business practice of providing retailers time to review their invoices, but it also would allow the California State Lottery Commission to sweep retailer's accounts via EFT earlier in the next week so that funds could be deposited on the next Friday as opposed to its current practice of depositing funds on the following Monday. Thus, the elapsed time in the process would be reduced from 10 to 8 days. This procedure would allow the California State Lottery Commission to earn interest on the funds swept via EFT on major retailers accounts for three extra days. Based upon projected lottery sales, this would result in additional interest earnings of $1,652,000 per year.

AUDIT FINDINGS

21. **The State's Major Revenue and Tax Collection Departments Could Increase Audit Coverage by Jointly Conducting Field Audits**

Most of the taxes collected in California are self-assessed. This means that each taxpayer is expected to accurately determine, report, and pay his or her tax liability. One of the techniques used to encourage a high level of voluntary compliance with the self-assessment system is to conduct audits. Therefore, audits produce two benefits - a direct increase in revenue through audit assessments and an indirect increase in revenue through improved voluntary compliance.

Most of the State's major revenue agencies have audit staffs. While in many cases the departments deal with the same or similar taxpayers, the results of the audits and the percent of taxpayers audited are different, as shown in Exhibit III.4.

EXHIBIT III.4

AUDIT RECOVERY AND AUDIT PENETRATION

Fiscal Year 1984-85

Department	Audit Recovery (Dollars recovered per Dollar Spent)	Percent of Taxpayers Audited[2]
Board of Equalization[1]	$ 5.55	2.8
Franchise Tax Board[1]		
Bank and Corporate Tax	19.40	35.40
Personal Income Tax	9.29	.08
Employment Development Department	11.65	1.8[3]
State Controller's Office	17.00	35.0

(1) Weighted average of all audit categories.
(2) Based on field or detailed desk audits.
(3) Percent of subject employers taken from Governors Budget (1985-86).

Exhibit III.4 shows that one of the problems of separate departments conducting individual audit activities is that each department has a different audit recovery ratio. If the audits were coordinated or conducted jointly, it may be possible to allocate resources among the tax programs better to ensure that the most cost effective audits, either in terms of direct recovery or increased voluntary compliance, were done. In addition, taxpayers must currently deal with multiple audits. Instead of having one comprehensive audit, a taxpayer may be audited by more than one department.

Conversely, there are certain benefits in having separate audit organizations. The major benefit is the ability to specialize. For example, the Board of Equalization conducts numerous training courses on how the sales and use tax applies to specific industries. Similarly, Employment Development Department auditors concentrate on payroll issues.

In contrast to the State of California, general auditors are used in many organizations. For example, when IRS auditors conduct a comprehensive audit of a company, they review all federal taxes for which that company is responsible. Thus, an IRS auditor will review a business's compliance with income tax, social security tax, employment training tax, excise tax, and any other appropriate taxes. When the auditor comes upon a highly technical issue, the auditor can obtain expert support.

Other states also use a generalist approach to tax auditing. For example, auditors in the States of Texas, Illinois, Iowa and Mississippi currently conduct comprehensive audits of compliance with all of the state's tax programs. The State of New York is currently working toward greater consolidation in its audit responsibilities. Currently, in New York, all business and income taxes are administered by the Department of Taxation and Finance. Within this department, various divisions have responsibility for the different tax programs. Each division has an audit staff, but when they conduct an audit for their own program, they also test for compliance with other programs and share the results of their work with the other audit groups. They also conduct some joint income and sales audits. Further, New York is currently in the middle of a major reorganization which will more closely consolidate the tax divisions and will result in consolidated collections, use of a common identification number, and will most likely result in consolidated audits. Finally, the state currently conducts joint audits with the cities of New York and Yonkers.

In California, as in all states, business people are expected to be knowledgeable about many types of taxes. A small business with a few employees may have to file many returns with several State departments, and, as mentioned above, be subject to audit by each department. The information supporting those returns may be quite simple and logical. However, as stated above, this small business must deal with each taxing department and is subject to audit by each of them. Any effort to better coordinate or jointly conduct audits could make it easier for small business in dealing with State revenue and tax auditors.

documentation and then depositing the payment in the bank. However, due to the processing equipment and procedures in place, departments do not separate payments from supporting documents as soon as possible. This results in unnecessary delays in depositing funds.

Generally, when one of the major departments receives a payment from a taxpayer, the processing of the payment involves opening the envelope and matching the payment to the supporting documentation. If the payment and the document are accurate and complete, the payment and the document are then assigned an identification number. The payment, or check, is then encoded and deposited in the bank. However, if an exception is identified with the payment or the document that can not be quickly resolved, both the payment and the supporting document go through an exception processing step.

The review showed that departments do not have the same equipment capability as commercial remittance processing operations to separate payments from documents sooner in the processing cycle. For example, commercial operations make extensive use of micro-filming machines to make copies of both sides of a check prior to deposit. This allows them to refer back to a check if there is an exception noted between the check and the document. This also allows the commercial operations to deposit the check prior to resolving an exception between the amount shown on a check and the supporting document. This capability is also useful in referring to information on checks during collection activity. Currently, the departments in the State of California involved in revenue and tax collection activities do not have such micro-filming capabilities.

The delays in separating payments from supporting documents sooner in the processing cycle result in lost interest earnings to the State. For example, the study showed that the lost interest earnings for the State due to exception processing holdover is an estimated $1,974,000 per year at the Employment Development Department, $193,000 per year at the Department of Motor Vehicles, and $38,000 per year at the Board of Equalization, for a total of $2,205,000.

15. <u>The Processing of Payments Can be Expedited by Modifying the Design of Workspace and Workflow</u>

Remittance processing and cashiering activities, such as those conducted by the State's major revenue and tax collection departments, operate most efficiently if they are conducted in work environments that are designed to accommodate high-volume item processing operations. Of the four major departments conducting large remittance processing and cashiering activities, including the Franchise Tax Board, the Board of Equalization, the Employment Development Department, and the Department of Motor Vehicles, only the Franchise Tax Board has workspace that is specifically designed to accommodate

22. **The State Could Increase the Efficiency of its Audit Efforts by Expanding the Scope of Field Audits to Include Testing for Other Departments**

One problem associated with the current allocation of auditors in individual departments is that there are varying levels of audit penetration for different taxes. For example, the Franchise Tax Board is only able to audit an estimated .05 percent of personal income taxpayers. Since most of these audits are conducted on high income individuals, only limited audit coverage is applied to middle income persons. Similarly, other major revenue and tax departments, including the Board of Equalization and the Employment Development Department, only have the resources to conduct audits of 2.8 percent and 1.8 percent of the taxpayers in their respective programs.

Since a considerable amount of effort is spent in identifying auditees, conducting entrance conferences, conducting audit fieldwork, and reviewing audits results, one of the opportunities available to the individual revenue and tax departments is to perform testing for other departments while conducting an audit. This would expand the scope of the audit coverage while only requiring minimal additional audit field work by the auditors. If problems were identified, information regarding the audit findings could be forwarded to the appropriate department for action.

23. **The State Could Reduce the Tax Gap by Expanding the Scope of Field Audits to Include Testing for the Detection of the Underground Economy**

The Commission on California State Government Organization and Economy released a report in December, 1984 that identified an Underground Economy in California estimated at $40 billion per year. This report stated that the Underground Economy results in an estimated $2 billion in lost taxes to the State of California each year.

One method available to the State to reduce this problem is to have the departments involved in conducting revenue and taxation related field audits perform audit testing related to the Underground Economy. For example, field auditors for the Board of Equalization reviewing sales tax information at a business could also conduct limited reviews of employee pay records to determine if some employees were being paid in cash and not being reported to other state departments.

24. **The State Could Gain Additional Revenue by Increasing the Number of Revenue and Tax Collection Auditors**

As previously mentioned, the major revenue and tax collection departments, including the Franchise Tax Board, Employment Development

Department, and the Board of Equalization are conducting a relatively low number of audits of taxpayers. The audit recovery ratio within departments, i.e., the amount of dollars paid back for each dollar spent conducting audits ranges from $5.55 to $44.98 in these departments. These ratios indicate it is cost-beneficial for the State to spend additional funds on revenue and tax collection audit staff.

The proposed Governor's budget for fiscal year 1986-87 calls for an increase in audit staff of 76 personnel years at the Franchise Tax Board and 60.2 personnel years at the Board of Equalization. While these additional audit positions will cost an estimated $9.5 million, they are projected to result in additional audit recoveries of $70 million. While these additional audit positions will assist the Franchise Tax Board and the Board of Equalization in performing their mandated responsibilities, there is still a need for additional audit positions not only to collect additional revenues but to help combat the underground economy.

25. <u>The Potential Exists to Reduce Costs by Encouraging the Co-Location of District Offices</u>

The Franchise Tax Board, Board of Equalization, and the Employment Development Department each operate district offices throughout the State to conduct their tax administration responsibilities. Since these departments conduct related activities, such as audit and collections, and because they often provide service to the same businesses and individuals, potential exists to co-locate the operations of the district offices. Moreover, through co-location of district offices, potential exists to reduce space requirements and costs.

Exhibit III.5 shows the location of the district offices operated by the Franchise Tax Board, the Board of Equalization, and the Employment Development Department in California. This exhibit shows that these departments operate a total of 110 district offices in 66 different cities in California. Furthermore, district offices are operated by two of these departments in 18, or 16 percent, of the cities, while district offices are operated by three departments in 14, or 13 percent of the cities.

The economic benefits, or potential cost savings, in the various district office locations are dependent upon many locally specific variables, including space requirements, space availability, and length and condition of current leases. Furthermore, co-location of facilities could result in increased and better coordinated service to taxpayers, as well as between departments.

EXHIBIT III.5

COMPARISON OF LOCATIONS OF DISTRICT OFFICES
OPERATED BY REVENUE AND TAX COLLECTION DEPARTMENTS

California Field Offices	Board of Equalization	Franchise Tax Board	Employment Development Department	Cities With Two Departments	Cities With Three Departments
Arcadia	X				
Auburn	X				
Bakersfield	X	X	X		X
Bishop	X				
Chico	X		X	X	
Concord			X		
Covina	X				
Cresent City	X				
Culver City	X				
Downey	X		X	X	
El Centro	X				
El Monte		X	X	X	
Escondido			X		
Eureka	X		X	X	
Fresno	X	X	X		X
Hayward	X				
Hollywood	X		X	X	
Laguna Hills			X		
Lakewood	X				
Long Beach		X	X	X	
Los Angeles		X	X	X	
Marysville	X				
Merced	X		X	X	
Modesto	X		X	X	
Monterey			X		
Nevada City	X				
Oakland	X	X	X		X
Ontario	X				
Oroville	X				
Palmdale	X				
Placerville	X		X	X	
Pleasant Hill	X				
Quincy	X				
Rancho Mirage	X				
Riverside			X		
Redding	X		X	X	
Sacramento	X	X	X		X
Salinas	X				
San Bernadino	X	X	X		X
San Diego	X	X	X		X
San Francisco	X	X	X		X
San Jose	X	X	X		X
San Luis Obispo	X		X	X	
San Marcos	X				
San Mateo	X		X	X	
San Rafael	X		X	X	
Santa Ana	X	X	X		X
Santa Barbara	X	X	X		X
Santa Cruz	X		X	X	
Santa Maria	X				
Santa Monica			X		
Santa Rosa	X	X	X		X
Sonora	X				X
South Lake Tahoe	X				
Stockton	X	X	X		X
Susanville	X				
Torrance	X				
Ukiah	X				
Vallejo	X		X	X	
Van Nuys	X	X	X		X
Ventura	X		X	X	
Visalia	X		X	X	
West Los Angeles		X			
Woodland	X				
Yreka	X				
Yuba City			X		
Totals	55	17	38	18	14

- The case backlog of the court system ensures that litigation of a tax appeal will involve a long period of time. During this period, the taxpayer will not have access to the disputed tax amount which was paid as a prerequisite for filing suit in court.

Due to these issues about the access to the courts, there is concern regarding the current appeals process available to taxpayers.

Based upon the concerns regarding the independence of the current appeals process, the qualifications of the persons deciding the appeals, and access to the courts, the study identified significant concerns regarding the current appeals process. As a result, the State should give serious consideration to establishing an independent tax appeals body. The establishment of an independent tax appeals body would allow for an administrative law procedure to be used to independently hear the cases by qualified tax professionals.

Finally, another concern that has been expressed regarding the State's tax appeal process is the State's potential elimination of the unitary tax method that it now employs. The elimination of the unitary tax method would result in the State adopting "waters-edge accounting", that is, business entities operating in more than one state would only be subject to taxation in California for their California operations. Under California's present system of taxation, appeals at the Board of Equalization take approximately one-half hour. However, appeals at the federal level pertaining to the Internal Revenue Service Code Section 282, which deal with waters-edge accounting cases, frequently take a minimum of two to three weeks of testimony to decide due to the complexity of the issues involved. Thus, the present appeals process at the Board of Equalization is not equipped to handle this workload. Therefore, an independent tax appeals body, such as an administrative appeals board, or a tax court, would be more effective.

COLLECTION FINDINGS

27. The State's Collection Activities Could be Performed More Efficiently through the Expanded Use of Automated Systems

Six of the departments reviewed in this study are involved in assessment and receipt of revenue and taxes due the State. Since each of these departments is responsible for receiving revenues due to the State, they also are involved in collection activities, including identifying, tracking, and collecting accounts receivable.

These departments devote considerable staff resources to their collections functions. Exhibit III.6 presents a summary of the number of personnel years and the cost of the collection functions.

EXHIBIT III.6

SUMMARY OF RESOURCES
DEVOTED TO COLLECTION ACTIVITIES

Fiscal Year 1984-85

Department	Personnel Years	Cost
Board of Equalization	320.4	$ 13,601,000
Franchise Tax Board	514.5	22,998,000
Employment Development Department	259.7	12,420,000
Department of Motor Vehicles	33.0	700,000
California State Lottery Commission(1)	N/A	N/A
State Controller's Office	9.0	450,000
Totals	1136.6	$ 50,169,000

Note: (1) The California State Lottery Commission did not begin operations until fiscal year 1985-86.

Due to the number of taxpayers and the amount of revenue received by the State of California, the collection activities performed by the departments reviewed in this study represent a significant undertaking and commitment of resources by the State. Therefore, it is important that the State operate its collection function efficiently to minimize the cost of performing these activities. Moreover, since the ultimate collection of accounts receivable is dependent upon timely collection actions, it is extremely important that the State have systems in place to ensure that the necessary collection actions are taken when appropriate. Finally, an effective collection function puts delinquent taxpayers on notice that the State is actively pursuing delinquent accounts.

The review showed that each of the six departments studied operates a collections function. It also revealed that there is considerable diversity in the type and relative sophistication of the collection systems in place in the departments. For example, the Franchise Tax Board operates a highly automated collections system which is used to identify, track, age, generate billings, and assess fines and penalties. Using this automated system, the Franchise Tax Board can send routine follow-up notices to delinquent tax payers at set time intervals and determine when more severe collection actions should be taken. The Department of Motor Vehicles also has an automated system in place for sending routine delinquency notices to motorists prior to taking more severe collection actions.

Conversely, the other four departments reviewed rely considerably on manual systems for conducting their collection activities. For example, the Board of Equalization, the Employment Development Department, the California State Lottery Commission, and the State Controller's Office, track delinquent taxpayers' accounts and manually prepare and send delinquency notices. In addition, the Board of Equalization and the Employment Development Department extensively use contacts by field office personnel with taxpayers to conduct collection activities.

The use of manual processes by departments has a negative impact on the timeliness, accuracy and efficiency of the collections functions. Recognizing this negative impact on the collections function, the Employment Development Department is currently in the process of developing and implementing an automated system to perform its collection function in its tax accounting branch.

28. <u>The State Could Generate Additional Revenue by Using Private Collection Agencies for Certain Accounts</u>

The Department of Motor Vehicles is the only State revenue and tax collection department that we reviewed which is using private collection agencies for delinquent in-state accounts. Specifically, the Department of Motor Vehicles uses private collection agencies to collect delinquent in-state accounts ranging from $25 to $99. Private collection agencies are used for these accounts because it is not cost-effective for the State to take collection action on these accounts. The Department of Motor Vehicles pays fees equal to approximately 35 percent of the collections made. During fiscal year 1984-85, the Department of Motor Vehicles realized a net benefit of approximately $144,000 through the use of private collection agencies from overdue accounts that might otherwise have been written off as bad debts.

The Franchise Tax Board is currently using private collection agencies to collect delinquent out-of-state accounts. In addition, the State Board of Equalization is currently negotiating a contract for the use of private collection agencies for certain accounts. Based upon the success which the Department of Motor Vehicles and the Franchise Tax Board have had using private collection agencies for certain accounts which are not cost-effective for the State to collect, other revenue and tax collection departments should consider using private collections agencies.

29. **The State Could Enhance its Collection Capability by Expanding its Inter-Departmental Offset Program**

Since each of the revenue and tax collection departments conduct their own collection activities, the coordination of collection activities is difficult. One area where this is apparent is in the minimal use of offsets to tax refunds due to taxpayers from the State of California. For example, various state departments participate in an Interagency Contractors Enforcement (ICE) program to identify contractors who are paying employees in cash to avoid paying taxes. The Franchise Tax board is presently cooperating with the departments in the ICE to help identify contractors circumventing income taxes.

While the ICE agreement is an example of the type of coordination that can occur between departments in tax collection, the study of the six departments involved in revenue and tax collection activities showed that such cooperative arrangements were not routinely established and used for tax collection activities. For example, the Franchise Tax Board has established a procedure to offset personal income tax refunds for amounts due the State for overpayments in certain entitlement programs, such as Aid for Dependent Children. However, no mechanism has been set up to offset personal income tax refunds for certain other taxes or fees due the State, such as motor vehicles fees.

In contrast to the State of California's minimal use of offsets in its collection activities, the IRS automatically tracks collectibles on taxes under its jurisdiction and automatically intercepts any payments or refunds due a taxpayer until all of a taxpayers' past due taxes are paid. By instituting an expanded offset program, the State could ensure that no tax refunds are made to an individual or business until a taxpayer's obligations to the State have been satisfied.

30. **The Major Revenue and Tax Collection Departments Could Reduce Duplication of Effort and Improve Collections by Jointly Conducting Collection Activities**

There is considerable duplication of collection activity in the departments reviewed because each operates its own collections function. This also causes problems with respect to collection activities relating to individual delinquent taxpayers because separate departments may be conducting collection activities relating to the same individual or business. The ultimate objective of the State's collection activities is to ensure that all funds owed to the State are paid by taxpayers. However, because each of the six departments reviewed have separate collection systems in place, there is limited coordination of tax collection functions.

Presently, the various departments involved in revenue and tax collection activities maintain separate data bases on taxpayer information. There is no single tax collection data base, or overall agreements for sharing information between departments involved in tax collections activities. As a result, if a taxpayer owes delinquent taxes to one department, another department is not aware of it. Thus, duplicate collection efforts can occur among departments relating to the same taxpayer.

In contrast to the lack of coordination of tax collection activities in California, the U.S. Internal Revenue Service maintains a central data base on all taxpayers owing taxes to the federal government. Within the IRS, all collectable accounts, regardless of the type of taxes owed, are handled as one account with one collector assigned to collect all taxes.

31. The Major Revenue and Tax Collection Departments Could Recover A Greater Portion of the Cost of Their Investigation and Collection Activities by Adopting Recoupment Policies

Individual departments have different policies regarding charging for the time and expense incurred by the State to make collections. For example, the Department of Motor Vehicles charges up to $250 for investigator's time expended in making collections. No other departments reviewed charged for the cost of collection time. Instead, other departments, such as the Board of Equalization, impose penalties as a means of trying to recoup the cost of making collections. While the statutes differ between departments regarding what types of late fees and penalties can be assessed, individual departments should develop policies, to the extent allowable under the law, to charge for the time and expense that they incur performing investigations and making collections. This should generate additional revenue to the State to help offset the cost of investigations and collections.

32. The State Could Clarify Collection Procedures by Having Consistent Statutes Regarding Postmarked Date of Payment

State statutes require the Board of Equalization and the Franchise Tax Board to use the postmark date as a basis for determining whether or not certain tax payments are late. Conversely, State statutes require the Employment Development Department to use the date of "posting" as the basis for determining if employer tax payments are late. Since the date of "posting" or placing a tax payment in the mail can differ from the date of postmark, there is a statutorily established ability to access and use taxpayer information available from other departments.

FORECASTING FINDING

34. The Department of Finance and the Commission on State Finance Revenue Forecasts Would be More Useful If They Were Performed on Consistent Time Periods

There are two state departments with responsibility for revenue forecasting. The Department of Finance produces two major forecasts and two revisions each year. It produces one forecast in January for preparation of the Governor's Budget, and a May revision. It also issues a September forecast which updates May's forecast by including revised national income data, and a March forecast which is an interim forecast in preparation of the May revision. The Commission on State Finance issues quarterly general fund forecasts.

By their nature, these forecasts are estimates and differ due to the relative weighting given the factors used as a basis. As shown in Exhibit III.7, there are some minor differences between the two forecasts. The Office of the Legislative Analyst studied the inaccuracies inherent in revenue forecasting in November, 1984, and concluded that little can be done to make the estimates more accurate, but that more frequent updates and more comprehensive information would be beneficial.

TABLE III.7

COMPARISON OF GENERAL FUND REVENUE PROJECTIONS

Fiscal Year 1985-86
(Amounts in Millions)

	Commission on State Finance	Department of Finance
Major Taxes and Licenses		
Retail Sales and Use	$ 10,350	$ 10,275
Personal Income	11,450	11,350
Bank and Corporation	3,890	4,100
Inheritance and Gift	245	236
Insurance	695	745
Cigarette	187	175
Alcoholic Beverages	138	134
Horse Racing	126	119
Totals	$ 27,081	$ 27,134

Having two departments producing forecasts may be a duplication of effort; however, since revenue forecasts are estimates based on various assumptions, and since these departments use somewhat different assumptions, there is value in having this duplication. As currently structured, the two departments provide alternative forecasts for use by the Governor, the Legislature, and the public.

However, the two departments do not issue their forecasts regarding the same time periods. To ensure that these forecasts provide maximum benefit to policy makers, it would be useful if the Department of Finance issued projections on a quarterly basis that was consistent with the Commission on State Finance. In addition, the Department of Finance could produce other forecasts that are needed at specific times in the State budgetary process.

OTHER FINDINGS

35. The State Could Improve the Operation and Performance of Cash Collection and Reporting Activities by Establishing Central Responsibility for Managing These Activities

The State's revenue and tax collection departments operate in a dynamic environment. Virtually all of the factors which impact the efficiency of revenue and tax collection systems are subject to rapid change. Therefore, no matter how effectively a system is established initially, it could soon be out-dated if management is not vigilant and aggressive in anticipating or reacting to changes in the environment. Establishing and sustaining this kind of management involvement will require certain changes in the way the State approaches its revenue and tax collection function.

Currently, there is no department with on-going responsibility for managing the cash collection and deposit activities performed by all departments conducting revenue and tax collection activities. While some departments track mail or payment holdover, it is usually done from a production management rather than a cash management perspective. Periodically, the Department of Finance and the Office of the Auditor General perform spotchecks or post audits of cash management activities, but there is no established responsibility in place to manage cash collection and depositing activities on a daily basis. Without such responsibility, the State will not be able to identify opportunities for improvements in cash collection and depositing and ensure that its revenue and tax payments are being processed and deposited in a timely manner.

There are two departments where this responsibility could be placed. One department is the State Treasurer's Office. Given the critical role that the State Treasurer's Office plays in the State's cash management, and its working relationship with each of the departments' cashiering and depositing of funds, the State Treasurer's Office would be a logical entity to assume the central responsibility for managing the State's cashiering and depositing activities. The second department which could have the central responsibility for managing the State's cash collection and depositing activities is the Department of Finance. The Department of Finance currently has general oversight responsibility in this area.

36. <u>The State Can Better Assess the Performance of Department Cash Collection and Depositing Activities by Establishing and Requiring the Use of Standard Performance Indicators</u>

To ensure that individual departments are performing their cash management activities properly, the State should require that these departments establish and use consistent cash collection and monitoring performance indicators. This would provide the department with overall responsibility for managing these activities with critical management information regarding individual departments, but it would also allow departments to monitor their own performance.

The performance indicators and monitoring system for departments involved in cash collection and depositing activities should measure, track and monitor at least the following:

o Mail availability profile at the post office;

- Percentage of dollars processed and deposited on the same day they were available from the post office;
- Percentage of dollars which incur a day or more of processing float, weighted by the number of days of float incurred; and
- Bank or clearing float experienced at each depository bank.

The purpose of this system would be to allow management to measure the opportunity cost of cash collection and depositing float and to track trends. It would provide the quantitative input necessary for on-going incremental cost/benefit decisions.

37. The State Can Improve the Performance of Its Revenue and Tax Collection Departments by Placing Greater Emphasis on Cost/Benefit Analysis Regarding the Use of Available Resources and Technology

The opportunity cost of remittance processing float, and the benefits of float reduction, should play as prominent a role in management decision-making as any other cost (such as salaries or equipment). Currently, however, within each revenue collection department, float costs are dealt with on a largely subjective basis. There is a general recognition that accelerated processing of payments can result in benefits to the State. But, since these benefits are not quantified and reported, they seem less "real" and less "pressing" than budgeted costs. This attitude results in a haphazard approach to investment in production improvements which reduce float since such improvements must typically be justified on benefits other than improving float.

Furthermore, operating decisions are often made on the basis of lowest cost to process the transactions. This approach results in, among other things:

- Shift staffing and scheduling which results in holdover of remittances. For example:
  - Single daily shift operations for most departments;
  - Limited weekend shifts (thus exaggerating Monday volume peaks); and
  - Mid-morning, rather than early morning, shift start times for most departments;
- Continued use of out-dated equipment since more efficient equipment is usually justified on processing cost savings alone; and
- Continued use of facilities which impose inefficient workflows and thus contribute to processing delays and increased float.

By recognizing the whole range of cost/benefit factors that have an impact on the State's management of its revenue and tax collection structure, particularly in the remittance processing area, the State will be able to improve its processing of these funds and the State's earnings.

inconsistency for the basis used by the Board of Equalization and the Employment Development Department to determine if tax payments are late and should be assessed late fees or penalties. Moreover, because the date of posting can differ from the date of postmark, the Employment Development Department has difficulty determining which tax payments are late. By making the statute relating to employer tax payments consistent with those relating to other departments, the State will help ensure more timely payment of employer tax payments and generate additional interest earnings.

DATA PROCESSING FINDING

33. **The State can Improve its Revenue and Tax Collection Operations by Working Toward the Development of More Compatible Automated Data Processing Systems and Applications**

The major revenue and tax collection departments, including the Franchise Tax Board, the Board of Equalization, and the Employment Development Department, operate separate automated data processing systems to maintain their taxpayer information.

For these systems to be most useful, it should be possible to easily determine any information that has been recorded on any of the systems regarding a given entity. System maintenance is also greatly simplified if changes in data on any system are automatically, accurately, and appropriately reflected on all other systems. These objectives are commonly addressed through the use of unique identifiers for taxpayers and the minimization of data redundancy regarding taxpayers. There are various means for making changes to all affected areas within systems that can be designed into the application systems. A particularly effective means for dealing with this problem has been the use of Data Base Management Systems (DBMS).

The Board of Equalization, the Employment Development Department, and the Franchise Tax Board are developing new systems to take advantage of database management systems. However, taxed entities may have more than one identification number, and no statewide identification number for taxed entities exists. Any attempt to integrate the systems would be further complicated because the systems of the three departments use different hardware and DBMS packages. The Board of Equalization systems currently run on Sperry-Univac equipment, while the Employment Development Department and the Franchise Tax Board systems run on IBM equipment. The new Employment Development Department systems are being designed to use the IDMS DBMS, and new Board of Equalization systems are being designed to use other data base technology.

As the State's major revenue and tax collection departments proceed with information system development, they should continue to emphasize data integration to ensure that individual departments have the

IV. ANALYSIS OF ALTERNATIVES AVAILABLE FOR IMPLEMENTING CHANGES IN REVENUE AND TAX COLLECTION DEPARTMENTS

This chapter presents three major alternatives available to the State to implement changes to address the study findings regarding the State's major review and tax collection departments. These alternatives include:

- o Alternative I - Take specific actions within individual departments to improve revenue and tax collection and cash management activities;
- o Alternative II - Functional consolidation of certain revenue and tax collection and cash management activities; and
- o Alternative III - Consolidate the State's major revenue and tax collection functions and cash management activities into a Department of Revenue.

This chapter defines each alternative, identifies its cost/benefit, and discusses the advantages and disadvantages of each alternative.

ALTERNATIVE I - TAKE SPECIFIC ACTIONS WITHIN INDIVIDUAL DEPARTMENTS TO IMPROVE REVENUE AND TAX COLLECTION AND CASH MANAGEMENT ACTIVITIES

Chapter III of this report identified 37 findings related to the activities performed by the State's major revenue and tax collection departments. These findings were summarized in Exhibit III.1. It also identified which findings applied to each department. Essentially, Alternative I involves each department undertaking the necessary actions to address the findings specifically pertaining to it. Under Alternative I, each department would be separately responsible for ensuring that the appropriate actions are implemented. Specifically, individual departments would be responsible for taking actions to do the following:

- o Expedite mail handling practices;
- o Improve payment processing;
- o Enhance equipment, facilities, and operations;
- o Expedite availability of deposited funds;
- o Enhance audit activities;
- o Improve collections efficiency;
- o Improve the State's management of revenue and tax collection activities; and
- o Make other improvements to enhance operating efficiency.

Exhibit IV.1 summarizes the benefits, costs, and net financial impact of implementing Alternative I. It shows that the implementation of Alternative I will result in an estimated $37.071 million in benefits to the State and cost approximately $1.665 million to implement. Thus, the net benefit to the State is an estimated $35.406 million. The major benefits from Alternative I result from improved cash management practices and redirecting staff savings in collections activities into audit activities. Implementing Alternative I also will require some additional

EXHIBIT IV-1

SUMMARY of the COST/BENEFIT IMPACT of IMPLEMENTING ALTERNATIVE I

	Amounts in Millions
BENEFITS	
Expedited Receipt of Mail	$2.562
Reduced Processing Holdover	6.853
Improved Banking Practices	1.844
Additional Savings	1.500
Increased Audit Recovery (1)	24.312
Personnel Savings	0.000
TOTAL BENEFITS	$37.071
COSTS	
Personnel Costs	$ .320
Equipment Costs	1.345
TOTAL COSTS (2)	$1.665
NET BENEFITS	$35.406
One-Time Transition Costs	0.000

Notes: (1) Assumes 117 Personnel Years Will Be Redirected From Collection to Audit Activities
(2) Does Not Include The Cost of Establishing An Independent Tax Appeals Body

staff and equipment costs, such as personnel to monitor the State's cash management activities and additional remittance processing equipment in some departments.

In addition to the financial impact of implementing Alternative I, there are various advantages and disadvantages of implementing this alternative which must be taken into consideration. Exhibit IV.2 summarizes these advantages and disadvantages. It shows that the major advantages of implementing Alternative I are that it would be the easiest alternative to implement because it requires only limited modification of the legal and administrative structure currently in place. Furthermore, since each department would be responsible for implementing specific recommendations pertaining to it, there would be direct accountability and responsibility for making changes and only limited inter-departmental coordination or cooperation required.

While Alternative I is easy to implement, there are some significant drawbacks to it. The major disadvantage to Alternative I is that it does not take advantage of available economies of scale because it assumes that each department would independently establish, staff, and conduct its revenue and tax collection functions. Since many of the revenue and collection functions are production-oriented, they potentially offer significant economies of scale, such as joint-use of equipment, staffing and facilities.

EXHIBIT IV-2

Summary of the Advantages and Disadvantages of Implementing Alternative I

Advantages

- Little modification of the legal and administrative structure in place to provide current services.
- Easier to immediately implement specific recommendations within departments having authority for making needed changes.
- Minimal disruption of current activities and services.

Disadvantages

- Fragmented responsibility and control over revenues and tax collection and cash management activities.
- Inability to allocate and use staff most efficiently between departments.
- Limited staff training and development opportunities, such as upward mobility and cross-training.
- Limited economies of scale for purchasing and using equipment and automating operations.
- Continues unnecessary duplication of operations in major revenue and tax collection and cash management functions.
- Limited operating efficiencies due to decentralized operations in individual departments.
- Limited sharing of taxpayer information between departments.
- Multiple departments providing services and having contact with taxpayers.
- Inability to combine taxpayers's accounts for offsets and collections of funds due the State.

ALTERNATIVE II - FUNCTIONAL CONSOLIDATION OF CERTAIN REVENUE AND TAX COLLECTION AND CASH MANAGEMENT ACTIVITIES

The study showed that there are certain revenue and tax collection and cash management activities that are presently being duplicated by each of the major revenue and tax collection departments. Under Alternative II, there would be a functional consolidation of those revenue and collection activities that offer significant benefits through joint conduct of activities now performed by individual departments. Specifically, departments would jointly conduct the cashiering, auditing and collection functions. However, the individual departments would maintain responsibility for administering their own revenue and tax collection programs. To implement Alternative II, the following actions would have to be taken:

- Create a State-run lock-box facility that functionally consolidates remittance processing and cashiering operations;
- Purchase state-of-the-art equipment;
- Design an efficient operating system that improves remittance processing and enhances State revenues;
- Establish a pilot project to perform joint field audits;
- Establish a functionally consolidated collection operation;
- Establish an independent tax appeals body; and
- Have individual departments implement other findings related to their operations that are not affected by functional consolidation.

Exhibit IV.3 summarizes the benefits, costs and net financial impact of implementing Alternative II. It shows that the implementation of Alternative II will result in an estimated $45.591 million in benefits to the State and cost approximately $4.138 million to implement. Thus, the net benefit to the State is an estimated $41.453 million. The major benefits from Alternative II result from improved cash management practices and redirecting staff savings from collections activities into audit activities. In addition, there are personnel savings that would occur through jointly conducting cashiering, auditing, and collections activities. There also will be some additional staffing, equipment and facilities costs associated with functionally consolidating these activities.

Besides the financial considerations involved in implementing Alternative II, there are numerous other advantages and disadvantages which should be considered. Exhibit IV.4 summarizes these considerations. This exhibit shows that the primary advantages of Alternative II are that this alternative allows the State to realize savings due to the economies of

EXHIBIT IV-3

SUMMARY of the COST/BENEFIT IMPACT of IMPLEMENTING ALTERNATIVE II

	Amounts in Millions
BENEFITS	
Expedited Receipt of Mail	$2.562
Reduced Processing Holdover	7.259
Improved Banking Practices	1.844
Additional Savings	2.000
Increased Audit Recovery (1)	24.312
Personnel Savings	7.614
TOTAL BENEFITS	$45.591
COSTS	
Personnel Costs	$ .230
Equipment Costs	1.475
Facilities Costs (2)	2.433
TOTAL COSTS (3)	$4.138
NET BENEFITS	$41.453
One-Time Transition Costs	$ .508

Notes: (1) Assumes 117 Personnel Years Will Be Redirected From Collection to Audit Activities
(2) Facilities Costs Net Out The Savings From Old Facilities No Longer Needed
(3) Does Not Include The Cost of Establishing An Independent Tax Appeals Body

EXHIBIT IV-4

Summary of the Advantages and Disadvantages of Implementing Alternative II

Advantages	Disadvantages
o Ability to allocate and use staff more efficiently between departments.	o Maintains fragmentation in the legal and administrative structure for conducting revenue and tax collection and cash management activities.
o Improved economies of scale for purchasing and using equipment and automating operations.	o Limited staff training and development opportunities, such as upward mobility and cross-training.
o Eliminates redundant operations in major revenue and tax collection functions.	o More difficult to immediately implement specific recommendations within departments.
o Increased operating efficiencies due to consolidated and streamlined operations.	o Taxpayers still must deal with various departments performing revenue and tax collection and cash management activities.
o Results in a leveling of remittance processing and cashiering workload.	
o Improved sharing of taxpayer information between departments in areas that are functionally consolidated.	
o Fewer departments providing services and having contact with taxpayers within consolidated functions.	
o Ability to combine taxpayer's accounts for offsets and collections of funds due to State.	
o Allows for improved cashiering processing.	
o Provides central cash management control.	

scale available in the cashiering, auditing and collections functions. Specifically, Alternative II will allow the departments involved in revenue and tax collection and cash management activities to allocate equipment and staff resources more efficiently, utilize improved technology that is cost-beneficial in a large-scale production environment, and eliminate unnecessarily redundant operations currently performed by these departments.

The major disadvantages of Alternative II is that it will be somewhat more difficult to implement than Alternative I because it involves combining certain activities presently performed by a number of different departments. In addition, it will require modifying the legal and administrative structures presently in use to perform revenue and tax collection and cash management activities.

ALTERNATIVE III - CONSOLIDATE THE STATE'S MAJOR REVENUE AND TAX COLLECTION FUNCTIONS AND CASH MANAGEMENT ACTIVITIES INTO A DEPARTMENT OF REVENUE

Alternative III involves the creation of one department to be responsible for the State's major revenue and tax collection and cash management activities. This alternative would consolidate the responsibilities for revenue and tax collection and cash management activities now performed by the Franchise Tax Board, the Board of Equalization, and the Employment Development Department. It would require that these activities be removed from their respective departments and be placed in a newly created department of revenue. To implement Alternative III, the following actions would have to be taken:

- Create a new department that consolidates all of the revenue and tax collection activities currently performed by three major departments;
- Initiate a merger of departments by functional consolidation of key areas;
- Initiate activities to merge the organization and administrative functions;
- Purchase state-of-the-art equipment; and
- Incorporate other findings not related to functional consolidation in other departments.

Exhibit IV.5 summarizes the benefits, costs and net financial impact of implementing Alternative III. It shows that the implementation of Alternative III would result in an estimated $60.969 million in benefits to the State and cost approximately $8.728 million to implement. Thus, the net benefit to the State is an estimated $52.241 million. The major

EXHIBIT IV-5

SUMMARY of the COST/BENEFIT IMPACT of IMPLEMENTING ALTERNATIVE III

	Amounts in Millions
BENEFITS	
Expedited Receipt of Mail	$2.562
Reduced Processing Holdover	7.259
Improved Banking Practices	1.844
Additional Savings	2.000
Increased Audit Recovery (1)	24.312
Personnel Savings	22.992
TOTAL BENEFITS	$60.969
COSTS	
Personnel Costs	$ .230
Equipment Costs	1.475
Facilities Costs (2)	7.023
TOTAL COSTS (3)	$8.728
NET BENEFITS	$52.241
One-Time Transition Costs	$ .955

Notes: (1) Assumes 117 Personnel Years Will Be Redirected From Collection to Audit Activities
(2) Facilities Costs Net Out The Savings From Old Facilities No Longer Needed
(3) Does Not Include The Cost of Establishing An Independent Tax Appeals Body

benefits from Alternative III result from improved cash management practices and redirecting state savings from collection activities into audit activities. In addition, there are significant personnel savings by consolidating the revenue and tax functions and cash management activities performed by the Franchise Tax Board, the Board of Equalization, and the Employment Development Department. Alternative III also will result in some additional costs for staffing, equipment and facilities.

Besides the financial impact of implementing Alternative III, there are other advantages and disadvantages that must be taken into consideration. These are summarized in Exhibit IV.6. This exhibit shows that the major advantage of Alternative III is that it places the authority and responsibility for conducting revenue and tax collection and cash management activities under a single department. This should result in more efficient operations, more effective use of staff and resources, and improve economies of scale for the purchase and use of equipment. Moreover, taxpayers would have the added convenience of only having to deal with one state taxing agency.

While Alternative III offers considerable benefits, it also would require major modifications of the existing legal and administrative structure currently used to provide revenue and taxation and cash management activities in the State. Due to the magnitude and extent of the consolidation effort, it also would require a significant reorganization and consolidation of the activities presently performed by the Franchise Tax Board, Employment Development Department, and the Board of Equalization and require a significant transition period and funding.

SUMMARY OF THE COST/BENEFIT IMPACT OF THE ALTERNATIVES

This chapter identified three major alternatives for the State to take action to address the study findings, and discussed the cost/benefit impact of each alternative. It also presented the different advantages and disadvantages of each alternative. Exhibit IV-7 summarizes and compares the cost/benefit impact of the three alternatives. It shows that the net cost/benefit of implementing the different alternatives ranges from $35.406 million to $52.241 million.

EXHIBIT IV-6

Summary of the Advantages and Disadvantages of Implementing Alternative III

Advantages

- Unifies responsibility and control over major revenue and tax collection functions in one department.
- Provides ability to allocate and use staff most efficiently.
- Creates additional staff training and development opportunities including upward mobility and cross-training.
- Improves economies of scale of purchasing and using equipment and automating operations.
- Eliminates costly duplication of operations in major revenue and tax collection functions.
- Increases operating efficiencies due to consolidated and streamlined operations.
- Establishes one department with the responsibility for collecting, maintaining and utilizing taxpayer information.
- Focuses taxpayer contact on one department.
- Combines taxpayer's accounts for offsets and collections of funds due the State.

Disadvantages

- Requires major modification of the legal and administrative structure used to provide current services.
- Most difficult to implement.

EXHIBIT IV-7

SUMMARY of the COST/BENEFIT IMPACT of IMPLEMENTING ALTERNATIVES

(All Amounts in Millions)

	ALTERNATIVE I Action by Departments	ALTERNATIVE II Functional Consolidation	ALTERNATIVE III Consolidation
BENEFITS			
Expedited Receipt of Mail	$2.562	$2.562	$2.562
Reduced Processing Holdover	6.853	7.259	7.259
Improved Banking Practices	1.844	1.844	1.844
Additional Savings	1.500	2.000	2.000
Increased Audit Recovery (1)	24.312	24.312	24.312
Personnel Savings	0.000	7.614	22.992
TOTAL BENEFITS	$37.071	$45.591	$60.969
COSTS			
Personnel Costs	$ .320	$ .230	$ .230
Equipment Costs	1.345	1.475	1.475
Facilities Costs (2)	0.000	2.433	7.023
TOTAL COSTS (3)	$1.665	$4.138	$8.728
NET BENEFITS	$35.406	$41.453	$52.241
One-Time Transition Costs	0.000	$ .508	$ .955

Notes: (1) Assumes 117 Personnel Years Will Be Redirected From Collection to Audit Activities
(2) Facilities Costs Net Out The Savings From Old Facilities No Longer Needed
(3) Does Not Include The Cost of Establishing An Independent Tax Appeals Body

V. CONCLUSIONS AND RECOMMENDATIONS

This chapter presents the general conclusions of the study of the organization and operation of the State's major revenue and tax collection functions and cash management activities. It also presents detailed recommendations to address problems identified during the study.

CONCLUSIONS

The State of California's major revenue and tax collection agencies are responsible for collecting more than $38 billion per year. The State's revenue and tax collection operations are well-respected by other states in the country for how it performs these functions. For example, California is the only state that jointly collects all payroll-based taxes, including unemployment insurance, disability insurance, and income tax withholding. However, the study showed that California does not have a single revenue and tax collection department like other states and the federal government.

Although California is a leader in certain aspects of its revenue and tax collection activities, the study identified certain problems and opportunities which exist pertaining to how the State conducts these operations. By addressing these problems, the State could generate additional revenue and cost savings which, conservatively stated, could range from $35 million to $52 million annually.

One of the major problems identified in the study is the unnecessary duplication of major functions that exists in the State's major revenue and tax collection agencies. For example, each of the major departments, including the Board of Equalization, the Franchise Tax Board, and the Employment Development Department, conduct very similar functions in the areas of cashiering, auditing and collections. As a result, the State fails to take advantage of available economies of scale and does not conduct these functions as efficiently as possible.

Another major problem is the fragmented responsibility for cashiering, auditing and collections functions that exists between the State's revenue and tax collection departments. Since each of the departments performs its functions independently, one department is not aware of what other departments are doing. This can result in more than one department taking the same action against a taxpayer, such as initiating collection action on a delinquent taxpayer.

There is also a lack of central accountability and control for cash management within the State's major revenue and tax collection departments. Under the present organizational arrangement, each department is responsible for receiving, processing, and depositing its revenue and tax receipts. This results in a significant variation in policies, procedures and practices relating to cash management and in lost interest earnings to the State.

In addition, the departments involved in California's revenue and tax collection activities are not using state-of-the-art equipment to perform mail sorting and processing activities. For example, the Fresno Service Center of the Internal Revenue Service, which collects approximately $18 billion per year, is presently using a high-speed mail sorting machine that dramatically increases its mail processing productivity and helps enable the service center to deposit all checks on the same day that they are received. Conversely, the departments conducting mail sorting and processing in the State of California, which process more than $38 billion annually, do not use this equipment because they do not conduct centralized remittance processing which would make it economical to purchase such equipment. The failure to use state-of-the-art equipment in these operations results in lost interest earnings for the State.

Besides not using state-of-the-art equipment, the major revenue and tax collection departments are not taking advantage of available economies of scale. For instance, each of the major departments individually staffs, equips, and provides facilities for its cashiering, auditing, and collection activities. Thus, the individual departments unnecessarily duplicate each others activities and do not take advantage of potential savings available through consolidating activities, leveling workload, and using high-speed equipment designed for high-volume operations. This results in lost interest earnings to the State due to less timely and efficient processing and to increased costs of operation.

Another problem that exists in the State's conduct of its major revenue and tax collection functions is the limited sharing of information and resources between departments. Presently, there is only limited sharing of audit leads and only limited collection offset activity taking place between these departments. A contributing factor to this problem is the independent information systems that each of the major departments maintain and the lack of a common taxpayer identification system. However, during the past year, the major revenue and tax collection departments have increased their efforts to work together to improve the sharing of information and resources between departments.

There is also a perceived lack of independence in the tax appeals process. Two of the members of the Franchise Tax Board, the State Controller and the Chairman of the Board of Equalization, also are members of the Board of Equalization, which hears appeals for both the Franchise Tax Board and the Board of Equalization. As a result, our study determined that taxpayers are concerned with the lack of independence in tax appeals cases.

Finally, the study revealed that taxpayers within the State must deal with multiple revenue and tax collection departments regarding their personal and business taxes. This can result in confusion on the part of the taxpayers and in duplicative services being provided by the State's multiple revenue and tax collection departments.

RECOMMENDATIONS

On March 20, 1985, the Little Hoover Commission held a public hearing on the study of the organization of the State's revenue and tax collection departments and their cash management activities. After hearing public testimony, the Commission adopted the recommendations presented in this section. These recommendations were based upon alternatives presented by Peat, Marwick, Mitchell & Co. which were developed in cooperation with the Study Advisory Committee.

The unnecessary duplication of functions and the fragmentation of responsibility within the State of California's major revenue collection departments result in operational inefficiencies and lost interest earnings for the State. While the Commission on California State Government Organization and Economy supports the general concept of creating a single revenue and tax collection department, it recognizes the significant political and institutional barriers to the full consolidation of the State's revenue and tax collection departments. In addition, it is concerned about the potential disruption of services that might occur in a large-scale consolidation.

To realize the potential cost savings and additional revenue identified in this study, and to provide an opportunity to accommodate future growth and promote further efficiency, the Commission recommends a functional consolidation of certain revenue and tax collection operations currently performed by state departments. The Commission also recommends that the individual departments in the State that are responsible for revenue and tax collection activities take certain actions to improve their operation and performance. Specifically, the Commission recommends the following:

1. Create a state-run lock-box facility that functionally consolidates remittance processing and cashiering operations. This would allow for the functional consolidation of the remittance processing and cashiering operations now performed by the Franchise Tax Board, the Board of Equalization, and the Employment Development Department. Under this arrangement, the individual departments would contract with one department to perform all remittance processing and cashiering activities. However, each department would retain its separate identity and maintain the responsibility for processing the revenue and tax return documents once the central lock-box facility had deposited the funds in the bank. In this way, the State would achieve the additional interest earnings through expedited processing of payments and reduce remittance processing costs by combining operations and taking advantage of available economies of scale.

   The state-run lock-box facility should be established at the Franchise Tax Board's new facility in Sacramento because it has new space designed for a remittance processing operation. It also has room for adding additional space at this location if more space is needed. Since the state-run lock-box facility will be located at the

Franchise Tax Board's facility, the Franchise Tax Board should be responsible for its day-to-day operations. Thus, the State Board of Equalization and the Employment Development Department should contract with the Franchise Tax Board for remittance processing services.

The state-run lock-box facility should be responsible for the initial receipt, check processing, and depositing of funds. Once the funds are deposited, the accompanying revenue and tax collection documents should be forwarded to the responsible departments for processing. Initially, the staff for the state-run lock-box facility should be drawn from the three participating departments. Subsequently, the Franchise Tax Board should be responsible for staffing decisions.

2. Purchase additional remittance processing equipment to improve production capabilities. The state-run lock-box facility would centralize the remittance processing equipment now in use at the Franchise Tax Board, the Board of Equalization, and the Employment Development Department. By housing this equipment in one location, the State will be better equipped to handle the combined workload of these departments due to the workload leveling that will occur in a consolidated operation. However, to further improve production capabilities, the State should purchase two high-speed mail sorting machines like the ones currently in use by the Fresno Service Center of the Internal Revenue Service and add microfilm capabilities to its high-speed check reader/sorter machines.

3. Have district offices deposit funds in local banks. The departments involved in the receipt and processing of revenue and tax payments should ensure that their district offices are depositing funds in local banks. This will eliminate the forwarding of these payments to Sacramento for processing and deposit, expedite the deposit of funds received at district offices, and generate additional interest earnings for the State.

4. Make expanded use of mail intercept at the point of mail origin. The State should implement an expanded mail intercept program which covers the Franchise Tax Board, the Board of Equalization, and the Employment Development Department. Specifically, the State should intercept mail at the Los Angeles and San Francisco post offices during monthly, quarterly and annual peak periods and have the mail delivered directly to the state-run lock-box facility. This will allow the State to begin processing the mail sooner, deposit it in the bank quicker, and generate additional interest earnings.

5. Expand the use of regional post office boxes in out-of-state locations to expedite mail payments. The practice of using regional post office boxes in out-of-state locations to expedite mail payments, as is currently done by the Employment Development Department, should be expanded to include the Franchise Tax Board and

the Board of Equalization. This will ensure the expedited receipt of payments from out-of-state locations and increase the State's interest earnings.

6. Work with the United States Postal Service to ensure that mail is collected from out-of-state post office boxes more regularly. The management of the new state-run lock-box facility should work with the United States Postal Service to ensure that mail in out-of-state post office boxes is collected on a regular basis. If the State cannot get satisfactory service from the United States Postal Service, then the State should consider having its own employees located in key out-of-state cities, including New York and Chicago, collect mail at these post offices and have it express mailed by the United States Postal Service to Sacramento. Alternatively, the State could arrange for a courier service to collect the mail at these post offices. Each of these methods would ensure that mail from out-of-state post offices arrives in Sacramento on a timely basis.

7. Ensure that mail is picked up earlier at the main post office in Sacramento. The State should ensure that the mail is picked up at the main post office in Sacramento when it is first available. Generally speaking, the majority of the mail processed by the State's major revenue and tax collection departments is available between 3:00 a.m. and 4:00 a.m. each day.

8. Match mail processing shifts to mail availability. The State should ensure that mail processing operations are scheduled so that the shifts begin when mail is first available from the post office. This will ensure that the State maximizes the number of hours of mail processing time prior to the bank cut-off time for deposit each banking day.

9. Institute work shifts on week-ends. The major departments involved in remittance processing should institute work shifts on weekends to process mail available at the post office on the weekend and eliminate any processing holdover on Mondays associated with large volumes of mail accumulating over the weekend. This recommendation currently applies to the Department of Motor Vehicles and may apply to the state-run lock-box facility once it is established.

10. Screen miscellaneous mail for large payments. The creation of a state-run lock-box facility and the purchase of high-speed mail sorting equipment should enable the State to screen mail for payments better than it is currently doing. Until such a facility and equipment is in place and operational, the departments involved in remittance processing should establish procedures to screen miscellaneous mail for large payments. This will ensure that large payments are deposited on the same day that they are received by the State.

11. **Sort remittance processing workload better to ensure that large payments are given higher processing priority.** Under its current organizational configuration and in the proposed functionally consolidated remittance processing operation, the State should ensure that appropriate workload processing priorities are established to ensure that large payments are given higher processing priority. This will allow the State to ensure that it deposits the largest payments received each day.

12. **Establish equipment back-up support for remittance processing operations.** The State should ensure that the major departments involved in remittance processing have established equipment back-up support. These back-up support arrangements will enable the State to continue its processing operations and deposit payments in the bank even if some of its remittance processing equipment is temporarily out of service. This back-up support should exist in all departments using remittance processing equipment.

13. **Separate payments from supporting documents sooner in the processing cycle.** The major departments involved in remittance processing should establish operating procedures to allow for the separation of payments from supporting documents sooner in the processing cycle. Presently, the operating procedures used in departments generally keep checks with supporting documents until any exceptions are resolved. Once the state-run lock-box facility is established and the State purchases microfilming equipment, the State will have the capability to separate checks from supporting documents sooner and have an audit trail for resolving any payment exceptions after the checks have been deposited. By separating checks from supporting documents earlier in the payment processing cycle, the State will generate additional interest earnings.

14. **Improve the work space and the design of work flow in remittance processing operations.** Remittance processing operations are production oriented and perform best when the work space and the work flow are designed to allow for the movement of a large volume of items from one processing step to another. To enhance the State's remittance processing capabilities, the proposed state-run lock-box facility should be designed to meet these needs. In addition, the Department of Motor Vehicles, which processes a high volume of items but would not initially be part of the functionally consolidated state-run lock-box facility, should modify and improve its workspace and the design of its work flow to enhance its remittance processing operation. However, once the state-run lock-box facility is in operation, the Department of Motor Vehicles remittance processing operations should be considered for functional consolidation.

15. **Perform remittance processing until the latest possible cut-off time.** The state-run lock-box facility and other departments

involved in remittance processing, including the Department of Motor Vehicles, should ensure that they perform remittance processing until the latest possible cut-off time to ensure that the State deposits as many payments as possible each day.

16. <u>Negotiate later deposit cut-off times with banks</u>. This study has recommended various actions for the State to take to improve its remittance processing capability and eliminate processing holdover in departments. Once these actions are carried out, and if the State is still experiencing processing holdover, the State Treasurer's Office should negotiate later deposit cut-off times with the banks. This would include having the State perform its own microfilming of checks and deliver checks to banks in Sacramento at approximately 4:30 p.m., or directly to bank processing centers in the Bay Area at approximately 7:00 p.m. By negotiating later deposit cut-off times with banks, the State would have more time to process payments received each day, and therefore reduce holdover.

17. <u>Ensure that major departments performing remittance processing are sorting and encoding checks for deposit to banks</u>. To ensure that the State maximizes its interest earnings and minimizes its banking charges, the functionally consolidated state-run lock-box operation and the Department of Motor Vehicles should ensure that all checks processed in their remittance processing centers are properly sorted and encoded for deposit to banks doing business with the State.

18. <u>Initiate a pilot project to make electronic fund transfer available to taxpayers</u>. Electronic fund transfer is used extensively by the federal government and private industry to conduct business operations. While the State of California is not in the position to require taxpayers to make their payments via electronic fund transfer, this method of payment is becoming more widely used in business. Therefore, the State should initiate a pilot project to make electronic fund transfer available on a voluntary basis to certain taxpayers and to determine the feasibility of expanding the use of electronic fund transfer to other taxpayers.

19. <u>Perform More Frequent Electronic Fund Transfer Sweeps of Retailer Accounts with the California State Lottery Commission</u>. The California State Lottery Commission is the only state agency that is using electronic fund transfer to collect payments. The Commission should make its electronic fund transfer sweeps of major retailers accounts sooner so that funds are deposited in the bank on Fridays, as opposed to the current practice of depositing funds in the bank on Mondays, to increase the interest earnings on lottery ticket sales.

20. <u>Expand the scope of field audits to include testing for other departments</u>. Each of the major departments currently involved in revenue and tax collection in the State currently conducts separate field audits for its own programs. To make better use of existing

field audit personnel and increase audit penetration, the Franchise Tax Board, the Board of Equalization, and the Employment Development Department should expand the scope of their field audits to include selected testing for other revenue and tax collection departments. Any problems detected in the selected testing should be referred to the responsible department for follow-up and detailed field audit, if appropriate.

21. Expand the scope of field audits to include testing for the detection of the underground economy. The recent study by the Little Hoover Commission revealed that the underground economy in California may be resulting in the State losing as much as $2 billion annually in tax revenue. To help combat the underground economy, the State's major revenue and tax collection departments should expand the scope of their field audits to include testing for the detection of the underground economy. Any problems identified should be referred to the responsible department for follow-up and detailed field audit, if appropriate.

22. Increase the number of revenue and tax collection auditors. The current number of revenue and tax collection auditors in the State does not allow the State to perform the level of auditing necessary to deter tax avoidance and ensure the full integrity of California's self-assessment taxation system. This is evidenced by the high ratio of audit assessment dollars returned to dollars spent that the major departments are experiencing. To help ensure the integrity of California's self-assessment taxation system and to capture additional revenue, the State should increase the number of revenue and tax collection auditors.

23. Conduct a more detailed review of the potential for the co-location of district offices. This study identified that there is potential cost savings and other benefits, such as improved sharing of information and audit leads, available to the State through co-locating revenue and tax collection district offices presently maintained by the Franchise Tax Board, the Board of Equalization, and the Employment Development Department. Since the potential cost savings available through co-location of district offices is dependent on various locally specific variables, such as terms of existing leases or space availability, the State should conduct a more detailed review of the potential for co-location of district offices in those cities in the State where two or more departments maintain district offices.

24. Establish an independent tax appeals board. The current appeals process used within the Franchise Tax Board and the Board of Equalization presents the appearance of a lack of independence since two persons who are members of the Franchise Tax Board, the State Controller and the Chairman of the Board of Equalization, sit on both the Franchise Tax Board and the Board of Equalization. To eliminate

the appearance of the lack of independence, the State should create an independent tax appeals board to hear appeals from these departments. Such an appeals board would also provide the State with the capability to handle tax appeals cases better if the State rescinds the unitary tax method.

25. Expand the use of automated collection systems. The use of automated collection systems has allowed the Franchise Tax Board to increase the productivity of staff involved in collections activities. Both the Employment Development Department and the Board of Equalization are in the process of automating their collection activities. The State should encourage and provide resources to these departments to continue to implement automated collection systems.

26. Make greater use of private collection agencies. The State is making only limited use of private collection agencies to collect delinquent accounts receivable that are not profitable for the State to pursue. The State should encourage revenue and tax collection departments to use private collection agencies to collect these smaller delinquent accounts which the State has been unable to collect through regular collection activities. Generally speaking, delinquent accounts between the amounts of $25 and $250 should be considered for referral to private collection agencies.

27. Expand the use of the State's inter-departmental offset program. The State has established an inter-departmental offset program to offset certain funds owed by a taxpayer from any returns due a taxpayer, including back due child support or welfare payments. This inter-departmental offset program should be expanded to include the full-range of taxes collected by the State's revenue and tax collection agencies to ensure that no tax payment refunds are sent to taxpayers who owe the State back taxes.

28. Establish a central state collection agency. The State should establish a state collection agency for collecting delinquent accounts receivable which individual departments have been unable to collect through normal means, such as sending delinquency notices and making follow-up telephone calls. The central state collection agency would be responsible for taking additional collection actions on these delinquent accounts. By using collection specialists and conducting joint collection of multiple accounts receivable due from taxpayers, the central state collection agency could help the State collect more funds, reduce collection costs, and help avoid the large write-off of uncollectible accounts that the State experiences each year.

29. Establish a consistent state policy for recouping the costs of departmental investigation and collection activities. The individual departments involved in revenue and tax collection

activities have differing policies regarding recouping the costs of investigation and collection activities associated with delinquent accounts. To ensure that the State is reimbursed for a larger portion of such costs, it should adopt a consistent policy for recouping the costs of investigations and collections for all departments.

30. Adopt consistent statutes regarding postmark dates of payment. An inconsistency exists between the Employment Development Department's statute relating to tax payments and the statutes for other departments. The Employment Development Department's statute says that payments must be "posted", i.e., put in the mail, by a certain date to avoid being delinquent. The statutes for other departments requires that payments be postmarked by a certain date to avoid being delinquent. Since it is difficult to prove when a payment was "posted", or put in the mail, it is difficult for the Employment Development Department to enforce its tax payment deadlines. To eliminate this inconsistency and facilitate the Employment Development Department's collection efforts, the statute relating to the payment of employer taxes should be changed to require payments to be postmarked by a certain date.

31. Work toward the development of more compatible automated data processing systems and applications. To avoid the unnecessary duplication of information maintained by individual departments regarding taxpayers, the State should continue its efforts to have individual revenue and tax collection departments work toward the development of automated data processing systems and applications which allow departments to share information more readily. This includes the development of an improved taxpayer identification numbering convention and more compatible data processing environments and architecture.

32. Perform state revenue forecasts on consistent time periods. The Department of Finance and the Commission on State Finance should perform their revenue forecasts on consistent time periods so that this information is more useful to state policy makers. Specifically, these revenue forecasts should be prepared on a quarterly basis that allows for direct comparison of estimates between these two departments.

33. Establish central responsibility for managing the operation and performance for cash collection and depositing activities by state departments. To improve the operation and performance of the cash collection and depositing activities conducted by state departments, the State should establish central responsibility for managing these activities. Initially, this responsibility should be placed in the State Treasurer's Office. Once the state-run lock-box facility is established, the responsibility can be shifted to it. By

APPENDIX C

MEMBERS OF THE STUDY ADVISORY COMMITTEE

This Appendix provides a list of the individuals who served on the study advisory committee for this project.

The following individuals provided the Commission with insight to the issues involved with cash management and revenue collection. The individuals participated in three committee meetings and provided additional assistance individually as needed. However, the findings and recommendations contained in this report are those of the Commission on California State Government Organization and Economy. Although these findings and recommendations were discussed with the Committee, the committee members do not necessarily endorse each of them.

Members of the Commission on California State Government Organization and Economy:

Mr. Haig Mardikian, Chairperson, Study Advisory Committee
Mr. Albert Gersten
Mr. Lester Oshea

Other members:

The Honorable Kenneth Cory
State Controller
(Represented by Mr. Walter Harvey, Deputy Controller, Taxation)

Mr. A.A. (Del) Pierce, Director
Department of Motor Vehicles
(Represented by Mr. Loyd Forrest)

Mr. Gerald Goldberg, Executive Officer
Franchise Tax Board

Mr. Jesse Huff, Director
Department of Finance
(Represented by Mr. LaFenus Stancell, Program Budget Manager)

Mr. Michael E. Kassan
The Law Officers of Magasinn, Andelson, Kassan, Kurtz, Kutrow and Zolla

Mr. Kaye R. Kiddo, Director
Employment Development Department

Mr. Robert Livsey
Brobeck, Phlegar & Harrison
(Representing the California State Bar)

establishing central responsibility, the State will be able to better monitor and control its cash collection and depositing activities.

In addition, the Department of Finance, in its role as an overall state control agency, should monitor the State Treasurer's Office's day-to-day operations of cash collection and depositing activities and ensure that state guidelines are adhered to in this areas. Moreover, during the annual budget process, the Department of Finance should ensure that departments are committing sufficient resources to cash collection and depositing activities.

34. Develop and use standard performance indicators for cash collection and depositing activities. To better monitor and control the cash collection and depositing activities performed by departments, the State should develop and require departments to use standard performance indicators relating to their activities. These standard indicators should include statistics relating to the number of items and amount of dollars received, deposited, or heldover each day by individual departments.

35. Place greater emphasis on cost/benefit analysis regarding the use of available resources and technology. There are various types of remittance processing and other related equipment available to the State for use in its revenue and tax collection operations. To ensure that the State performs these activities as efficiently and cost-effectively as possible, greater emphasis needs to be placed on providing departments the resources and technology that are cost-beneficial for the State.

APPENDIX A

DETAILED DESCRIPTION OF MAJOR STATE DEPARTMENTS INVOLVED IN REVENUE AND TAX COLLECTION FUNCTIONS AND CASH MANAGEMENT ACTIVITIES

APPENDIX A

DETAILED DESCRIPTION OF MAJOR STATE DEPARTMENTS INVOLVED IN REVENUE AND TAX COLLECTION FUNCTIONS AND CASH MANAGEMENT ACTIVITIES

This appendix provides background information on the revenue and tax collection functions of the departments that were reviewed during this study. The departments reviewed include:

- State Board of Equalization;
- Employment Development Department;
- Franchise Tax Board;
- Department of Motor Vehicles;
- California State Lottery Commission;
- State Controller's Office;
- State Treasurer's Office;
- Department of Finance; and
- Commission on State Finance.

An overview of the major revenue and collection and cash management functions performed by these departments follows.

STATE BOARD OF EQUALIZATION

The State Board of Equalization (BOE) collects the largest amount of revenue of any state department. The BOE is constitutionally established, and consists of the State Controller and four other board members who are elected from geographic districts. Each geographic district represents one-fourth of the State's population, or approximately 6 million people.

The BOE's total operating budget for 1985-86 is approximately $123 million. About $32 million of this total is funded by reimbursements collected from local agencies that share in the proceeds from the sales and use tax. It employs over 2,700 persons, and maintains 55 business tax field offices and 8 property tax field offices throughout California. The BOE also maintains offices in New York, Chicago and Houston. These offices provide local facilities where taxpayers can register and obtain assistance in meeting their filing responsibilities. These offices also house audit and collection staff.

RESPONSIBILITIES AND ACTIVITIES

The BOE is responsible for a wide variety of business taxes, and is constitutionally and statutorily responsible for the administration of local property taxes. In addition, the BOE has certain quasi-judicial responsibilities. A description of the BOE's activities in each of these areas follows:

Business Taxes

Overall, the BOE is responsible for the collection of 13 different taxes, the largest of which is the sales and use tax. A description of the business taxes collected by the BOE follows:

Sales and Use Tax

The sales and use tax is imposed on retailers for the privilege of selling tangible personal property in California. The law authorizes the retailer to pass this tax on to the consumer. The sales tax was enacted in 1933, and was supplemented two years later by the use tax, which was designed to protect California merchants against tax-free competition from out-of-state.

Sales and use tax is levied on most retail sales, on leases of tangible personal property, and on purchases from out-of-state retailers for use in California. Principal exemptions apply to sales of food for home consumption and prescription drugs. The cost of services or other labor is also exempted from this tax.

The current state sales and use tax rate is 4.75 percent. The city and county local sales and use tax rate is 1.25 percent, bringing the total rate to 6 percent in most counties. Both counties and cities use 1 percent to support their general operations, but the counties additional ¼ of 1 percent is designated only for transportation purposes, such as road maintenance and operation of transit systems. The counties have been receiving this additional transportation revenue since 1972 when local government's share of the sales and use tax was increased by ¼ of 1 percent following the imposition of sales tax on gasoline.

In 1970, the Board began administering transit district transactions (sales) and use taxes for transit districts which impose these taxes. A tax of ½ of 1 percent is currently imposed in the San Francisco Bay Area Rapid Transit District (Alameda, Contra Costa, and San Francisco Counties), the Santa Clara County Transit District, the Santa Cruz Metropolitan Transit District, the San Mateo County Transit District, and the Los Angeles County Transportation Commission. In these counties, the total sales and use tax rate is 6½ percent, except for Santa Clara County which also has a ½ of 1 percent tax rate for its traffic authority that makes its combined tax rate 7 percent.

Annually the Board collects about $9.8 billion in sales taxes for the state, about $2.1 billion for cities and counties, and about $1.0 billion for transit districts.

Motor Vehicle Fuel License Tax

The Motor Vehicle Fuel License Tax is imposed on gasoline at the rate of 9 cents per gallon on the first distribution of fuel in this state. This tax is levied on sales by distributors to retail outlets, brokers, and certain other distributors. It is collected by the BOE and deposited in the transportation tax fund to be used for highway construction and maintenance, and for public mass transit construction and operation.

The Aircraft Jet Fuel Tax is imposed on dealers at 2 cents per gallon. All money collected is deposited in the aeronautics fund and is used for the maintenance of local airports.

Collections for these taxes in fiscal year 1984-85 totaled $1,055 billion.

Use Fuel Tax

The state tax on diesel fuel and compressed natural gas is 7 cents per 100 cubic feet; on liquefied petroleum gas and liquid natural gas, it is 6 cents per gallon. As of January 1, 1976, users of liquefied petroleum gas, liquid natural gas, and compressed natural gas were given the option of paying an annual flat rate in lieu of that tax. This was a money-saving incentive designed to encourage motorists to convert their vehicles to use these fuels whose pollutant emission levels are lower than those of gasoline. Revenues collected by the BOE from the use fuel tax are deposited in the transportation tax fund. In fiscal year 1984-85, these tax revenues totaled $131 million.

Alcoholic Beverages Tax

State alcoholic beverage excise taxes began in 1933 when prohibition was repealed, and were imposed on "3.2 beer" at the rate of 2 cents per gallon. In 1959 that rate was increased to 4 cents per gallon. Table wines are taxed at 1 cent per gallon, dessert wines at 2 cents per gallon, and sparkling wines at 30 cents per gallon. The highest excise tax is imposed on distilled spirits at $2 per gallon, and on distilled spirits over 100 proof at $4 per gallon. This tax yielded over $135 million in fiscal year 1984-85 for the state General Fund.

Cigarette Tax

Cigarette taxes are applied at 10 cents per package. Thirty percent of the revenue (less cost of administration) is returned to county and city governments by a formula based on local distribution of state-administered local sales and use taxes and population. This tax produced approximately $263 million in fiscal year 1984-85, of which about $79 million was distributed to counties and cities.

Insurance Tax

The administration of the Insurance Tax is shared by three state departments. The Department of Insurance regulates insurers and determines the correct amount of tax. Upon recommendation from the Department of Insurance, the Board of Equalization issues the tax assessments. The BOE also considers petitions for redetermination and claims for refund, and grants oral hearings to petitioners. The tax is collected by the State Controller.

Insurance companies are assessed at the rate of 2.33 percent of their gross premiums from most insurance. Annuities, however, are taxed at the rate of ½ of 1 percent. Ocean marine insurers pay 5 percent on their average net underwriting profits on ocean marine insurance for the most recent three-year period.

Approximately $656 million in assessments were issued by BOE in fiscal year 1984-85, with revenues going to the State General Fund.

Energy Resources Surcharge

An energy resources surcharge is imposed on the consumption of electricity to fund the activities of the State Energy Commission. The surcharge is collected from the consumers of electrical energy primarily by the electric utility companies operating in California. The rate is $.0002 per kilowatt-hour. The surcharge is collected by the BOE and produced about $34 million in fiscal year 1984-85.

Emergency Telephone Users Surcharge

A telephone users surcharge has been levied on charges for intrastate telephone communication services since July 1, 1977. The surcharge rate is determined annually by the State Department of General Services, which notifies the BOE of the new rate. The BOE confirms the rate and notifies the telephone services suppliers who bill the surcharge to telephone users.

The rate is calculated to raise sufficient revenue to pay for the costs of implementing and operating the statewide 911 emergency telephone assistance program. The current rate is ½ of 1 percent on intrastate telephone service. The Board collected about $30 million in fiscal year 1984-85 from this tax.

Universal Telephone Service Tax

The Universal Telephone Service Tax is imposed upon each designated service supplier in the State, measured by the gross revenues received from intrastate telecommunications service. The tax rate, which is determined annually by the Public Utilities Commission, was set at 4 percent. This rate, which is the maximum allowed by law, has been retained for the 1985-86 fiscal year.

Universal telephone service is designed to meet minimum residential communications needs. The service allows access by the elderly, the handicapped, the infirmed, and low-income persons to telephone service for emergency communications with public agencies and private medical services and for the maintenance of necessary social contacts. The service is available at a substantially discounted rate.

At the direction of the Public Utilities Commission, the proceeds from the tax are redistributed by the State Controller to the local telephone companies to defray the costs of providing basic universal telephone service. The BOE collected approximately $58 million from this tax in fiscal year 1984-85.

Hazardous Waste Taxes

The BOE collects a monthly hazardous waste tax, which is imposed upon persons who operate hazardous waste dump sites and upon persons who dispose of hazardous wastes on property owned or leased by them. The current tax rate is $4 per ton, up to a maximum of $10,000 per month, for each site at which hazardous wastes are produced.

The monthly hazardous waste tax rate is established by the State Director of Health Services at a level which will provide sufficient revenues to cover all costs incurred by that department in the administration of Chapter 6.5 of the Health and Safety Code. That section deals with the regulation, control, and monitoring of the storage, processing, transportation, and disposal of hazardous wastes.

In addition to the monthly tax, the BOE collects an annual hazardous waste tax which is imposed upon persons who dispose of hazardous wastes on property owned or leased by them, and upon persons who deliver or ship hazardous wastes to an off-site disposal facility. The BOE collected approximately $13 million from this tax in fiscal year 1984-85.

Hazardous Substance Tax

The Hazardous Substance Tax, generally known as the state superfund tax, is imposed on the generators of hazardous wastes who dispose of the substances in California. Each generator is required to register with the BOE and file an annual report by March 1, detailing the hazardous wastes disposed of in the preceding year.

The report must show the total tonnage of hazardous waste disposals in each of four categories based on the nature of the substance and the method of disposal. A report is made by the Board and certification of the total tons of hazardous waste disposal in each category is prepared for the Governor by April 15.

Data from the annual hazardous waste disposal reports are used by the Board to compute the basic tax rate under the formula prescribed by law. Tax assessments are determined by applying the tax rate to quantities of wastes reported to generate sufficient revenue for the $15 million superfund. The assessments are made on May 1 and must be paid by July 1. The monies are deposited in the general fund and credited to the hazardous substance account. Each $1 million of funds collected by the Board is matched with $9 million from the federal government to be used for cleanup of toxic spills and abandoned dump sites.

Exhibit A.1 displays all of the taxes collected by the BOE along with the total revenue collected per tax.

EXHIBIT A.1

TAXES COLLECTED BY THE BOARD OF EQUALIZATION
FISCAL YEAR 1984-85(1)

Tax	# of Registrants	Revenue (in thousands of dollars)(2)
Sales and Use Taxes	817,145	
State portion		$ 9,797,612
Local portion		3,077,142
Motor Vehicle Fuel License Tax	910	1,055,748
Use Fuel Tax	73,415	131,214
Alcoholic Beverages Tax	2,705	135,787
Cigarette Tax	416	262,870
Energy Resources Surcharge	79	34,432
Emergency Telephone Users Surcharge	176	30,190
Universal Telephone Service Tax	98	57,637
Hazardous Waste Tax	131	13,030
Hazardous Substance Tax	4,121	11,761
Private Railroad Car Tax (assessers)	246	3,377
Timber Yield Tax	2,200	13,131
Fees		531
Total state revenues collected by BOE		$ 14,624,462

Notes: (1) Sources: Board of Equalization 1984-85 Program Analysis, Governor's budget for Fiscal Year 1985-86, and Board of Equalization Annual Report for 1984-85.

(2) As shown, $3,077,142,000 of the revenues collected by the BOE of sales and use taxes are collected for local entities, such as cities and counties. While the majority of remaining revenue goes to the General Fund, some of it is restricted for specific purposes. For example, the Universal Telephone Service Tax is distributed to local telephone companies to defray the costs of

providing basic telephone service to the elderly, the handicapped, the infirm, and low-income persons.

Property Taxes

In addition to business taxes, the BOE also has certain responsibilities in regard to property taxes. The constitutional responsibilities include assessing all property owned by public utilities. The assessment of public utility property is considered a state function since many utilities own property located in more than one county. One of the BOE's other responsibilities in relation to property taxes includes monitoring county assessors' compliance with the provisions of Proposition 13. This effort consists of a county sampling program where the BOE's staff reappraises a small sample of properties within each county and compares the results to the assessor's appraisals.

Quasi-Judicial Responsibilities

In addition to its tax related responsibilities, the BOE has certain quasi-judicial responsibilities. The BOE serves as the appellate body in hearing and adjudicating appeals on final actions of the Franchise Tax Board under the State's bank and corporation tax, personal income tax, and the senior citizens property tax assistance laws. The BOE is also the appeals body for redetermination of business taxes assessments and for insurance tax appeals. In property taxes, the BOE considers appeals of assessments made by county assessors on lands, water rights, and certain improvements on properties owned by local governments but located outside their boundaries. The BOE also considers appeals by utility companies, railroads, and private railroad car firms of assessments of their properties set by the board.

DESCRIPTION OF WORK CYCLE

The BOE's cashiering operation is heavily influenced by the frequency with which a business must remit sales and use tax. The basic filing requirements are listed below:

Filing Requirement	Due Date	Filing Criteria
Annual	The last day of the month following the year (usually January 31)	Monthly tax of $0 - $12.50
Quarterly	The last day of the month following the quarter	Monthly tax of $12.01 - $250.00
Monthly	The last day of the following month	Monthly tax of $250.00 - $1,000.00
Quarterly Prepay	Two prepayments are due each quarter. The first is due on the 24th day of the month following the first month of the quarter. The second prepay is due the 24th day of the month following the second month of the quarter. The quarterly return and balance due for the quarter is due the last day of the month following the quarter.	Taxable measure of sales over $17,000 per month. (Based on statutory mandate).

Because of these due dates, the BOE cashiering unit experiences numerous peaks. For example, there is a workload peak at the end of each month. On the four months when quarterly and quarterly prepay returns are filed, there are bigger peaks. Finally, the largest peak is January 31 when returns are due from all taxpayers.

Because of these peaks, there is a certain amount of hold-over, or payments that cannot be processed and deposited on the same day as received. However, the BOE does not routinely keep information on the amount of money left unprocessed each day.

ANALYSIS OF KEY FACTORS

The sales and use tax program is by far the biggest program administered by the BOE. Thus it is understandable that the BOE devotes the majority of its resources toward this program. Over 80 percent of the BOE's resources are devoted to the administration of the sales and use tax.

BOARD OF EQUALIZATION PROFILE

Exhibit A.2, the Board of Equalization Profile Sheet, presents additional factual information on the BOE's revenue and tax collection and cash management functions.

EXHIBIT A.2

BOARD OF EQUALIZATION PROFILE SHEET

Location of Central Office: Sacramento

Number of Field Offices:

- Business taxes field offices -- 55
- Property taxes field offices -- 8
- Out of State offices -- 3

Budget (Fiscal year 1985-86)	Personnel Years	Dollars (In Thousands)
Total agency budget	2,756	$ 122,881
Return Processing	576	28,153
Auditing	1,072	48,917
Appeals on FTB cases	18	1,017
Collections	320	13,601

Workload (Fiscal year 1984-85)

	Annual	Monthly Average	Peak Month
Cashiering Items Processed	3,001,512	250,126	414,751
Dollars Deposited	$ 13,884,217,722	$ 1,157,018,143	$ 1,863,770,163
Number of Audits	22,488		
Audit Assessments	$ 253,814,360		
Collections:			
Amount Collected	$ 134,385,867		
Outstanding Balance (6/30/85)	$ 312,166,865		
Number of Appeals Filed:			
FTB Cases:	1,202		
BOE Cases:			
- State Assessed Property (Calendar year 1984)	99		
- Business Taxes	1,921		

FRANCHISE TAX BOARD

The Franchise Tax Board (FTB) is composed of the State Controller, the Chairman of the State Board of Equalization, and the Director of the Department of Finance. The Board appoints an Executive Officer who implements the policies of the Board.

The FTB is primarily responsible for administering the Personal Income Tax (PIT) and Banking and Corporation Tax (B&C) programs. The FTB's budget for fiscal year 1985-86 totaled nearly $122 million, which supports approximately 3000 personnel years.

The FTB maintains 17 district offices throughout the State. These offices are primarily responsible for providing information and tax forms to taxpayers, and conducting field audit and collection activities. In addition to the district offices located in the State, the FTB also maintains three out-of-state offices, located in Chicago, Houston, and New York. These offices are primarily responsible for auditing and collecting taxes from corporations located out-of-state which conduct business, or have operations in California, and are therefore subject to certain California tax laws.

BASIC RESPONSIBILITIES AND ACTIVITIES

The FTB is responsible for the overall administration of the PIT and B&C tax programs. The following sections provide a description of these taxes and the FTB's administrative activities regarding each tax program.

Personal Income Tax

The Personal Income Tax provides the second largest source of revenue to the General Fund. The PIT is essentially a tax on individual, estate, and trust income. Since the PIT is a self assessed tax, the FTB relies on taxpayers to voluntarily comply with the tax laws and to correctly assess and pay their tax liabilities.

The FTB is responsible for the overall administration of the PIT program. Despite this overall responsibility, however, the FTB shares some of its basic duties in regard to the PIT program with the Employment Tax Branch of the Employment Development Department (EDD). The majority of state revenue collected under the PIT is withheld from workers' wages. EDD is responsible for collecting and depositing funds withheld from workers' wages. During fiscal year 1984-85, EDD collected approximately $7.5 billion in PIT revenue withheld from workers' wages.

The FTB is responsible for the other aspects of the PIT program. These responsibilities include return processing, auditing, collections, and filing enforcement. In addition, the FTB is responsible for collecting and depositing PIT revenues that are not withheld from workers' wages. These funds include any additional taxes a person may owe the State due to underwithholding from wages. In addition, these funds also include any money paid by taxpayers who file quarterly wage estimates. Overall, the FTB collected and deposited approximately $4 billion during fiscal year 1984-85.

Bank and Corporation Tax

The Bank and Corporation Tax is a tax on corporations doing business in California or having income from California sources. It provides the third largest source of revenue to the General Fund, accounting for nearly $3.6 billion in fiscal year 1984-85.

Under this program, the FTB is responsible for collecting franchise taxes on corporations doing business in California and income taxes on corporations not located in California, but having income from California sources. The FTB accomplishes this by administering B&C self assessment, audit, collections and filing enforcement programs.

Exhibit A.3 summarizes the taxes collected by the FTB along with the total revenue collected per tax.

EXHIBIT A.3

TAXES COLLECTED BY THE FRANCHISE TAX BOARD
FISCAL YEAR 1984-85

TAX	REVENUE (000's)
Personal Income Tax (Direct Payments to FTB)	$ 4,096,000
Bank and Corporation Tax	3,525,000
Total	$ 7,621,000

Other Duties

In addition to the administration of the PIT and B&C tax programs, the FTB is also responsible for the administration of the Homeowners' and Renters' Assistance Program, which provides partial repayment of property taxes or rent paid by eligible senior citizens, disabled or blind persons. The FTB also conducts audits and field investigations on non-federal campaigns and lobbyists reports that have been filed with the Secretary of State. The results of these audits are forwarded to the Fair Political Practices

Commission and the Attorney General who evaluate the audits for violation of any applicable laws.

DESCRIPTION OF WORK CYCLE

The FTB's cashiering unit is heavily influenced by the dates on which tax returns and estimates are due. The basic filing requirements are as follows:

Filing Requirement	Due Date
Personal Income Tax:	
Returns	January 1 through April 15
Estimates (Quarterly)	January 15, April 15, June 15, September 15
Bank and Corporation Tax:	
Returns	Within 2½ months of the end of the business' fiscal year
Estimates	Quarterly (depending on firm's fiscal year)

As a result of these deadlines, the FTB's workload experiences numerous peaks. The FTB's greatest workload occurs from February through May. This peak period primarily encompasses the tax return filing periods for individuals who file under the PIT program and firms that file under the B&C tax program. The bulk of FTB's workload during this period includes the processing of PIT returns; consequently, the FTB's busiest month of the year is April, the month when PIT returns are due.

The 15th day of each month is also a peak period for the FTB. Quarterly PIT wage estimates and payments are due on the 15th day following the close of each calendar quarter, on the due dates indicated above. Corporations are also required to file estimates and pay taxes due on the 15th day of the month following the end of a quarter. However, firms are allowed to establish their own quarterly calendar. Since the fiscal years of many firms end at different times, B&C quarterly estimates arrive at the FTB throughout the year. Nevertheless, the days surrounding the 15th of each month mark a period of increased workload for the FTB.

ANALYSIS OF KEY FACTORS

A number of factors should be taken into consideration in regard to the cash management and revenue collection functions of the Franchise Tax Board. These factors include the following:

- Though the Franchise Tax Board is responsible for the overall administration of the Personal Income Tax program, the Board is only partially responsible for the collection of Personal Income Tax revenues. The majority of Personal Income Tax revenues is derived from the withholding of taxes from workers' wages. This function, which netted approximately $7.5 billion in Personal Income Tax revenues for fiscal year 1984-85, is conducted by the Employment Development Department. However, the Franchise Tax Board did receive approximately $4 billion in direct Personal Income Tax payments during fiscal year 1984-85. These direct payments came primarily from income estimates and yearly tax returns.

- The Franchise Tax Board recently relocated its central offices to a new facility. The Board's 1985-86 budget included approximately $5.2 million for relocation and other expenses related to this new facility.

FRANCHISE TAX BOARD PROFILE

Exhibit A.4, the Franchise Tax Board Profile Sheet, provides additional information on the FTB.

EXHIBIT A.4

FRANCHISE TAX BOARD PROFILE SHEET

Location of Central Office: Sacramento

Number of Field Offices

In State: 17
Out-of-State: 3

Budget (FY 1985-86)	Personnel Years	Dollars (in Thousands)
Total agency budget	2,956.5	$ 121,779
Cashiering	261.5	5,070
Auditing	906	41,388
Appeals(1)	14	600
Collections	528.8	25,111
Data Processing	198	5,334

Workload	Annual	Monthly Average	Peak Month
Items Processed	11,495,073	501,111	2,910,036
Dollars Deposited(2)	$ 5,678,451,823	$ 473,204,318	$ 2,639,415,908
Number of Audits	14,845		
Audit Assessments	$ 367,025,157		
Collections:			
Amount Collected	$ 734,526,162		
Outstanding balance (6/30/85)	$ 895,551,275		
Number of Appeals and Protests Filed	2,945		

Notes: (1) Indicates the resources allocated to the Protest Section which initially reviews and handles protest cases "in-house" before they are referred to the Board of Equalization.

(2) Central cashiering only.

EMPLOYMENT DEVELOPMENT DEPARTMENT

The Employment Development Department (EDD), California's employment security agency, is responsible for administering California's employment services program. EDD provides the State with comprehensive statewide and local manpower planning, identifies and creates employment opportunities, provides individuals with training and education in "demand" occupations, and provides qualified job applicants to employers.

EDD's major revenue collection responsibilities include the collection of employee and employer contributions to the Unemployment and Disability Insurance programs (EDD is also responsible for paying benefits under these programs) and the collection of Personal Income Tax (PIT) withholding funds. These three taxing functions combine to make EDD one of the State's major revenue collection agencies.

The EDD's total budget for 1985-86 is approximately $3.5 billion. Approximately 6,073 personnel years are allocated to support EDD's Tax Collections and Benefits Payment Program which conducts EDD's revenue collection activities. EDD maintains a central office in Sacramento and 38 field offices throughout the state that are involved in tax collections and payroll auditing for withholding compliance.

BASIC RESPONSIBILITIES AND ACTIVITIES

EDD's revenue collection activities primarily include the withholding of Personal Income Tax funds from workers' wages, and the collection of Unemployment Insurance and Disability Insurance taxes. EDD's activities in each of these areas is discussed below.

Personal Income Tax

The Personal Income Tax is essentially a tax on the wages of California workers. Most California employers are required to deduct a portion of a worker's annual tax bill from the worker's wages during each pay period. EDD is responsible for collecting the PIT withheld from worker's wages and also performs the activities necessary to ensure that employers comply with the legal provisions of the PIT withholding program.

It is important to note that the overall responsibility for the administration of California's PIT program belongs to the Franchise Tax Board. EDD is responsible for collecting the funds withheld from employee's wages during each pay period. The Franchise Tax Board is responsible for the remaining aspects of the PIT program, including the processing of tax returns, filing enforcement, audit activities and collections. The Personal Income Tax Law provides the second largest source of income to the State, accounting for approximately 40 percent of

General Fund revenues. EDD, by administering the PIT withholding program, collects about 80% of PIT revenues.

Unemployment Insurance Taxes

Unemployment Insurance (UI) taxes are collected from employers on an eighth monthly, monthly, or quarterly basis to support California's unemployment insurance program. The program pays benefits to individuals who become unemployed through no fault of their own in order to partially compensate for a worker's lost wages and to minimize his/her personal suffering.

Approximately 90 percent of the State's labor force is covered by either state or federal unemployment programs. Annually, approximately one of twelve protected workers receives benefits from the State's unemployment insurance program. EDD is responsible for all aspects of the UI program, including the collection of UI taxes from employers, maintenance of wage records, and payment of benefits.

Disability Insurance

Taxes for Disability Insurance (DI) are used to pay benefits to individuals who are disabled because of a nonoccupational illness or injury and are therefore unable to work. The DI program is divided into two components, one covering private sector employees who work in California and the other covering state employees.

EDD is responsible for most aspects of the DI program, including tax collection, benefits payment, providing staff support and appeals.

Employment Training Fund

EDD collects revenue for the Employment Training Fund (ETF). This fund provides individuals with training and skills that are in high demand by local employers. This recently created program (Chapter 1075, Statutes of 1982) will exist until January 1, 1987.

Exhibit A.5 displays the taxes collected by EDD along with the total revenues collected per tax.

EXHIBIT A.5

TAXES COLLECTED BY THE EMPLOYMENT DEVELOPMENT DEPARTMENT FISCAL YEAR 84-85

Tax	Revenue Collected (000)
Personal Income Tax Withholding	$ 7,581,000
Unemployment Insurance Funds	1,874,000
Disability Insurance Funds	1,017,000
Employment Training Fund	55,000
	$ 10,527,000

ANALYSIS OF KEY FACTORS

The following should be taken into account in regards to EDD's tax collection activities:

- o The overall administration of the PIT program is the responsibility of the Franchise Tax Board. EDD is responsible for the withholding of PIT revenues from employees' wages.

EMPLOYMENT DEVELOPMENT DEPARTMENT PROFILE

Exhibit A.6, the EDD's profile sheet, provides additional basic information on the Employment Development Department.

EXHIBIT A.6

EMPLOYMENT DEVELOPMENT DEPARTMENT
AGENCY PROFILE SHEET

Location of Central Office: Sacramento

Number of Field Offices: 39 (Employment Tax Branch District Offices)

Budget (Fiscal Year 1985-86)	Personnel Years	Dollars (In Thousands)
Total agency budget[1]	6,073.1	$ 276,703[2]
Cashiering	105	3,460
Auditing	330	15,806
Appeals	10.9	699
Collections	259	12,419
Data Processing	55.3	2,569

Workload	Annual	Monthly Average	Peak Month
Items Processed	5,738,767	478,230	667,360
Dollars Deposited (000's)	$ 10,472,000	$ 872,666	$ 1,596,409
Number of Audits	13,319		
Audit Assessments	$ 38,118,788		
Outstanding Collectibles	$ 118,901,669		
Number of Appeals	1,568[3]		

Notes: (1) Figures on this line are for EDD's Tax Collections and Benefits Payments Program only.

(2) This figure does not include $2,723,513,000 in benefit payments.

(3) Total number of unresolved appeals.

Workload Information

The workload of EDD's cashiering unit is heavily influenced by the periods during which deposits of UI, DI and PIT deposits are due. UI insurance taxes are collected from employers on an eighth monthly, monthly, or quarterly basis. UI taxes are collected quarterly. DI and PIT withholding are collected on an eighth monthly, monthly, or quarterly basis. The due dates for the remittances EDD receives are as follows:

REMITTANCE		DUE DATES
Quarterly Deposits		Returns are considered delinquent if not filed by: April 30 (for 1st Quarter returns) July 31 (for 2nd Quarter returns) October 31 (for 3rd Quarter returns) Jan 31 (for 4th Quarter returns)
Eighth-Monthly		Deposits must be mailed within three banking days following these dates. The 3rd, 7th, 11th, 15th, 19th, 22nd, 25th and last day of each month.
Monthly Deposits	(1)	Deposits for the first month of the quarter are due on or before the 16th day of the second month of the quarter.
	(2)	Deposits for the second month of the quarter and/or the first 19 days of the third month of the quarter are due within three banking days following the 19th day of the third month of the quarter.

As a result of these deadlines, EDD's cashiering workload experiences a sharp increase during the last week of the first month of each quarter (right before the previous quarter's quarterly deposits become delinquent), and during the first two weeks of the second month of each quarter (when the previous month's monthly deposits are due). This three week period marks the cashiering units busiest time during each quarter.

DEPARTMENT OF MOTOR VEHICLES

The Department of Motor Vehicles' (DMV) best known responsibility is the registration of vehicles and drivers. However, DMV is also responsible for:

- o Recording the ownership (certificate of title) of registered vehicles;
- o Maintaining driving records (convictions and accidents) of licensed drivers;
- o Issuing identification cards for individuals;
- o Registering and recording vessel ownership;
- o Licensing and regulating driving schools and their instructors, vehicle manufacturers, remanufacturers, transporters, dealers, distributors, vehicle salespeople, and dismantlers;
- o Administering the Financial Responsibility Law;
- o Accrediting traffic violator schools;
- o Investigating consumer complaints, and other motor vehicle related laws;
- o Maintaining records in accordance with the law; and
- o Collecting fees, which in fiscal year 1984-85 amounted to approximately $2.3 billion.

The numerous DMV field offices provide citizens the opportunity to conduct their business in person rather than through the mail. Each field office employs personnel for vehicle registration, driver licensing, and cashiering services. Many field offices also provide space for investigators. Approximately one-half of all funds received by DMV are cashiered at field offices.

BASIC REVENUE COLLECTION RESPONSIBILITIES AND ACTIVITIES

The DMV collects a variety of vehicle and vessel fees. DMV charges a $10 fee to renew a drivers license, which must be done every four years, and $7 to register a vessel, which must be renewed each year. The annual fee for renewing a vehicle registration is $23, but DMV also collects a vehicle license fee which is in lieu of the personal property tax on vehicles. This fee is passed on to local government agencies and is based on the value of the vehicle. It averaged $52 in fiscal year 1984-85. DMV also collects various other taxes and fees, including truck apportionment fees, use taxes, and fines and penalties. Exhibit A.7 shows the fiscal year 1984-85 volume of cashiering operations.

EXHIBIT A.7

CASHIERING OPERATIONS
DEPARTMENT OF MOTOR VEHICLES
FISCAL YEAR 1984-85

Type of Transaction	Number of Transactions (in 000)	Fee	Total Receipts (in $ 000) (1)
Vehicle Registration:	22,129		
- Registration Fee		$23	$ 508,978
- License Fee		10	1,210,242
Drivers License Renewal (and associated fees)	6,044	10	60,437
Vessel Registration	629	7	4,405
Others			
- Truck Weight Fees	N/A(2)	Variable	283,702
- Trailer Coach Fees	N/A	Variable	10,485
- Use taxes	N/A	Variable	
-- Vehicles			183,217
-- Vessels			11,909
- Identification Card Fees	N/A	Variable	4,003
- Miscellaneous	N/A	Variable	197,260
Totals			$ 2,474,637

Notes: (1) Numbers may not add up to totals due to rounding.
(2) N/A stands for information that is not available.

DEPARTMENT OF MOTOR VEHICLES PROFILE SHEET

Exhibit A.8, the Department of Motor Vehicles Profile Sheet, provides additional basic information on the Department of Motor Vehicles.

EXHIBIT A.8

DEPARTMENT OF MOTOR VEHICLES PROFILE SHEET

Location of Central Office: Sacramento

Number of Regional Offices: 14
Number of Field Offices : 158

Budget (Fiscal Year 1985-86)	Personnel Years	Dollars (in Thousands)
Total agency budget	7,156	$ 286,476
Registration	3,467	159,473
Driver Licensing	2,732	107,777
Occupational Licensing	380	18,300

Workload (Fiscal Year 1984-85)	Annual
Items Processed[(1)] (Calendar year 1985)	13,119,950
Dollars Deposited[(1)] (Calendar year 1985)	$ 962,383,512
Collections	
- Amount collected (Fiscal year 1984-85)	$ 6,414,682
- Outstanding Balance (as of 6/30/85)	
-- Dollars	$ 407,900
-- Items	2,956

Note (1) Central Cashiering only. Represents approximately 39 percent of the Department's total revenue.

CALIFORNIA STATE LOTTERY COMMISSION

The California State Lottery Commission (Commission) has the responsibility for operating the California State Lottery. The Commission consists of five commissioners appointed by the Governor and an Executive Director. The first game of the California State Lottery commenced on October 1, 1985.

To carry out its responsibilities, the California State Lottery has six operating divisions and an executive group. These operating divisions are:

- o Security;
- o Electronic Data Processing Operations;
- o Finance and Administration;
- o Retail Support;
- o Field Operations; and
- o Marketing.

The Lottery's Field Operations Division is responsible for the direct contact with the Lottery's estimated 21,000 retailers. The Division is organized into four regions and has 12 districts, each with a district office.

The Commissions district offices provide direct contact with lottery retailers in their respective areas. This includes distributing tickets to retailers and, in the case of retailers who have had non-sufficient funds for EFT payments or who walk-in to the district office to purchase lottery tickets, includes the collection of cashiers checks or certified checks for payment for lottery tickets.

Two of the district offices, Sacramento and Whittier, provide warehouses for game tickets. However, each of the district offices acts as a distribution outlet for retailers within its respective area.

BASIC RESPONSIBILITIES AND ACTIVITIES

The Commission has the overall responsibility for the administration of the California Lottery, including ticket sales and the conduct of games.

Based on Commission revenue for the three months of operation, October 1, 1985 through December 31, 1985, and the experience of the sales curve of lotteries in four other western states, the Commission is predicting total lottery revenues of $1.768 billion in fiscal year 1985-86. By law, 50 percent of this revenue will be used for prize payments, 34 percent will be available for transfer to the California State Lottery Education Fund, and up to 16 percent will be available for lottery operation and administration.

To collect payment for lottery tickets from the more than 21,000 retailers, the Commission has contracted with the Bank of America to provide Electronic Fund Transfer (EFT) Services. Under this agreement, the Commission provides Bank of America with account information regarding each retailer using the EFT services. Then, the Commission furnishes Bank of America with a magnetic tape of payments due and the Bank carries out the settlement of the payments due via EFT with each retailers bank account. Presently, the Commission is collecting approximately 98.7 percent of payments for lottery tickets via EFT.

In addition to using EFT, the Commission collects cashiers checks and certified checks from some retailers and payment for lottery tickets. These include retailers who the Commission has had problems with non-sufficient funds on the EFT processing of payments, or retailers who are purchasing lottery tickets through "walk-in" at district offices. Currently, the Commission is collecting approximately 1.3 percent of its payments for Lottery tickets via cashiers checks and certified checks.

DESCRIPTION OF WORK CYCLE

Although the volume of lottery ticket sales has been twice the amount that the Commission originally predicted, sales are now at a relatively constant and stable level. If sales follow the pattern experienced by other western states operating lotteries, ticket sales should decrease somewhat over time.

The response to the California State Lottery has exceeded that in all other states and has been nearly doubled the Commission's original estimates. As a result, the Commission's workload, staffing requirements, and operating budget have been greater. The revised fiscal year 1985-86 budget for the Commission is approximately $82.2 million, including $23.8 million for personal services. The Commission has 800.4 permanent positions and 51 temporary help positions budgeted for fiscal year 1985-86.

ANALYSIS OF KEY FACTORS

The California State Lottery is responsible for collecting revenues from more than 21,000 retailers who are authorized to sell lottery tickets. The Commission contracts with the Bank of America for Electronic Fund Transfer (EFT) services that it uses as its primary means of collecting lottery revenues.

CALIFORNIA STATE LOTTERY COMMISSION PROFILE

Exhibit A.9, the California State Lottery Commission Profile Sheet, provides additional information on the California State Lottery Commission.

EXHIBIT A.9

CALIFORNIA STATE LOTTERY COMMISSION PROFILE SHEET

Location of Central Office: Sacramento

Number of Field Offices: 12

Budget (Fiscal Year 1985-85)	Personnel Years(1)	Dollars (In Thousands)
Total agency budget	851.4	$ 82,186
Executive	35.8	3,162
Finance and Administration	194.8	14,993
Marketing	20.0	1,986
Retail Support	111.6	6,397
Field Operations	315.4	12,113
Security	71.0	7,077
EDP	102.8	35,957
Commission	0.0	241

Workload (Fiscal year 1985-86)(2)

	Annual	Monthly Average	Peak Month
Items Processed	47,500	15,833	N/A(3)
Dollars Deposited	$ 538,393,555	$ 179,464,518	N/A(3)
Outstanding Collectibles	$ 735,195		

Notes: (1) Estimated personnel years for fiscal year 1985-86.

(2) Total workload for first three months of operation, October 1, 1985 through December 31, 1985.

(3) Indicates not available.

STATE CONTROLLER'S OFFICE

The State Controller's Office is responsible for providing sound fiscal control over the receipt and disbursement of public funds. As part of its responsibilities, it reports on the financial operations and conditions of the State and local government. In addition, the State Controller's Office assures that money due the State is collected and provides for equitable, effective and economical tax administration. It also administers the State's unclaimed property laws.

The State Controller is an elected State official whose powers, duties, and functions are established in Article XVI, Section 7 of the State Constitution. The State Controller serves as a member of the Board of Equalization and the Franchise Tax Board, and has additional powers and responsibilities that have been conferred by the Legislature.

BASIC RESPONSIBILITIES AND ACTIVITIES

The State Controller's Office has statutory responsibility for administering the estate, inheritance and gift tax laws. With the passage of Proposition 6 in the June 8, 1982 election, the State's inheritance and gift tax laws were repealed and replaced with the estate tax. However, the State Controller's Office still collects and anticipates that it will continue to collect inheritance and gift taxes for many years due to late returns that continue to be filed and the liquidation of accounts receivable.

In addition to administering and collecting estate, inheritance and gift taxes, the State Controller's Office maintains accounts and collects delinquencies for four taxes assessed by other agencies. These include the motor vehicle fuel license tax, the taxes on insurance companies (premium tax and retaliatory tax), petroleum and gas charges, and subsidence abatement charges.

A description of the taxes and delinquencies collected by the State Controller's office follows:

- Estate Tax - this tax is levied as a credit against the Federal Inheritance Tax on estates above a minimum size, $500,000 in 1986 and $600,000 in 1987 and thereafter. It is a self-assessed tax filed by representatives of estates.

- Inheritance Tax - this tax was repealed in the June 8, 1982 election; however, collection activities continue on the accounts receivables and on the approximately 10,000 reports yet to be filed.

o Gift Tax - this tax was also repealed in the June 8, 1982 election. It was a self-assessed tax due quarterly when gifts were made. There are less than 500 returns that remain to be audited and less than 20 new returns a month are being filed.

o Tax Collections - the State Controller's Office maintains the accounts for four taxes assessed by other agencies. Although the other agencies collect their own taxes, the State Controller's Office collects delinquencies for the taxes. In addition, it collects delinquent inheritance, gift and estate taxes. The delinquencies which the State Controller's Office collects for taxes assessed by other agencies include:

- Motor Vehicle Fuel License Tax;

- Taxes on Insurance Companies;

- Petroleum and gas charges; and

- Subsidence abatement charges.

DESCRIPTION OF WORK CYCLE

The State Controller's Office, Division of Tax Administration, has a relatively stable and constant workload with respect to the taxes it collects. The Division processes approximately 1300 receipts each month.

ANALYSIS OF KEY FACTORS

The following factors should be considered in regard to the State Controller's Office's revenue collection activities:

o The State Controller's Office, Division of Tax Administration, is responsible for the direct receipt of estate, gift and inheritance taxes which is administers. It also directly receives insurance taxes (retaliatory tax) and receives payments on delinquencies for taxes assessed by other agencies, including the State Board of Equalization, for which the State Controller's Office maintains accounts.

o The State Controller's Office historically has maintained the accounting records for certain taxes assessed and collected by the State Board of Equalization. As a result, the State Controller's Office has assumed the responsibility for collecting delinquencies on these taxes, since it maintains the accounts receivable information for the State Board of Equalization regarding the taxes.

STATE CONTROLLER'S OFFICE PROFILE SHEET

Exhibit A.11, the State Controller's Office Profile Sheet, provides additional basic information relating to the State Controller's Office.

EXHIBIT A.11

STATE CONTROLLER'S OFFICE PROFILE SHEET

Location of Central Office: Sacramento

Number of Field Offices: Tax Administration Field Office in Los Angeles

Budget (Fiscal year 1985-86)	Personnel Years	Dollars (In Thousands)
Total agency budget	1,197.4	$ 63,217
Estate Tax	19	967
Gift Tax	20.7	923
Inheritance Tax	-	-
Tax Collections	10.7	339

Workload (Fiscal year 1984-85)

	Annual	Monthly Average	Peak Month
Items Processed	16,613	1,384	1,559
Dollars Deposited	$ 294,701,000	$ 24,558,000	$ 60,886,000
Number of Audits	720		
Audit Assessments	$ 635,604		
Outstanding Collectibles			
Dollars	$ 157,367,000		
Items	14,476		
Number of Appeals	No Information Available		

STATE TREASURER'S OFFICE

The State Treasurer is an elected state official. The State Treasurer also is a member of the Pooled Money Investment Board (along with the State Controller and the Director of the Department of Finance), which is responsible for overseeing the investment of state monies.

The State Treasurer's Office maintains three offices, including offices located in Sacramento, San Francisco, and Los Angeles. The Sacramento office is the administrative headquarters for the State Treasurer. The San Francisco office is the location of the District Securities Commission. The Los Angeles office provides administrative support for the State Treasurer in Southern California.

BASIC RESPONSIBILITIES AND ACTIVITIES

The state Treasurer's Office is responsible for providing banking services for State government. The State Treasurer's Office provides custody for all money and securities belonging to the State. It also invests temporarily idle state funds and pays warrants and checks drawn by the State Controller. In addition, the State Treasurer's Office prepares, sells and redeems the State's general obligation and revenue bonds and prevents the issuance of unsound securities by irrigation, water storage, and certain other districts.

To carry out its responsibilities, the State Treasurer's Office conducts the following programs: administration, investments, cash management, trust services, and the District Securities Commission. Each of these programs is briefly discussed below:

- Administration Program - provides executive direction, planning, and the administrative functions for the State Treasurer's Office and financing authorities. Among the support activities that the program provides are accounting, budgeting, personnel, data processing and bank reconciliation;

- Investment Program - manages the Pooled Money investment portfolio of approximately $14 billion with daily investment transactions of approximately $567 million. The primary objective of this program is to maximize the return on investable funds consistent with safe and prudent treasury management. The portfolio is comprised of all pooled money in the State Treasury. This program makes the State Treasurer's Office the fourth largest revenue producing entity within California State Government;

- Cash Management Program - handles the disbursement of state funds to pay state expenditures. This program is responsible for the daily banking transactions and the security of documents within the securities vault of the State Treasurer's Office. The four major objectives of this program are to ensure that the State's cash is fully invested, banks are fairly compensated, securities remain secure, and all forgeries are investigated;

- o Trust Services Program - handles the scheduling and sale of general obligation and revenue bonds. In calendar year 1984, this program scheduled and sold approximately $4.6 billion in general obligation and revenue bonds. The Trust Services Program also is responsible for the safekeeping of all securities and other personal property owned by, or pledged to, the State. As of June 30, 1985, this program was responsible for over $51 billion in securities; and

- o District Securities Commission - provides supervision of certain fiscal proposals and physical operations of irrigation districts, water districts, water storage districts, and other types of districts and local entities of the State of California.

The State Treasurer's Office, as part of its cash management program, negotiates depository agreements with California banks. Presently, eight major California banks have depository agreements for services with the State Treasurer's Office. These include: Bank of America, Wells Fargo Bank, Crocker National Bank, First Interstate Bank, Security Pacific National Bank, Lloyds Bank of California, Union Bank, and Bank of California. The rates that the State will pay these banks for banking services are established by the Pooled Money Investment Board. In addition to the service agreements established by the State Treasurer's Office, individual state departments can contract with banks for special services, such as armored car or courier services.

DEPARTMENT OF FINANCE

The Department of Finance (DOF) has numerous and diverse responsibilities. It is responsible for preparing the Governor's Budget each year. It also assists in the enactment of the Budget. In addition, the DOF advises the Governor on the fiscal condition of the State, evaluates state programs for efficiency and effectiveness, and provides economic, financial, and demographic information. The DOF also supervises all matters concerning the financial and business policies of the State (including oversight and control of the budgets for the State's cash management and revenue collection agencies), oversees the operations of the California Fiscal Information System (CFIS), and coordinates and controls the majority of electronic data processing throughout state government.

Although the DOF does not have any direct responsibilities for cash management or revenue collections, it does have a cash forecasting responsibility. The DOF Economic Research group prepares economic forecasts four times each year. Alternative (high and low) forecasts and long-term projections are prepared twice a year. The Financial Research unit provides estimates of revenue for use in preparing the Governor's Budget and the so-called "May Revision," which updates the estimates used in the Budget.

These two groups total about ten employees, and their combined fiscal year 1985-86 budget totaled approximately $762,000.

COMMISSION OF STATE FINANCE

The Commission on State Finance was created to be the responsible state agency for forecasting state revenues and expenditures. The Commission consists of the following seven members: the President pro Tempore of the Senate, the Speaker of the Assembly, the Senate Minority Floor Leader, the Assembly Minority Floor Leader, the Director of the Department of Finance, the State Controller, and the State Treasurer.

The Commission's objective is to aid the Legislature and the Governor in establishing an appropriate, timely and coordinated fiscal policy for the State by providing them and the public with forecasts of state revenues, current year expenditures, and the expected surplus or deficit at least four times a year.

The Commission's fiscal year 1985-86 budget was $609,000, and included eight personnel years.

BASIC RESPONSIBILITIES AND ACTIVITIES

The Commission's primary responsibilities include: (a) providing quarterly forecasts of state revenues, current-year expenditures, and an estimate of the general fund surplus or deficit; (b) determining on June 10 of each year the amount of any reductions in local assistance payments required under existing law; and (c) issuing monthly cash flow reports. The Commission is also required to produce annual long-range forecasts of general fund revenues and expenditures for each of the four years immediately following the budget year, as well as for the ninth year beyond the budget year.

OTHER REVENUE AND TAX COLLECTION AGENCIES

Other agencies are responsible for administering some of California's other taxes and fees. For example, the Department of Food and Agriculture is responsible for the pesticide mill tax and the Horse Racing Board collects parimutuel license fees. In addition, the various boards and bureaus within the Department of Consumer Affairs collect fees.

The following list presents some of the other revenue sources in the State of California:

REVENUE SOURCES	DOLLARS COLLECTED (000's)
Food and Agriculture	$ 45,418
Horse Racing Board	140,426
Consumer Affairs	107,193
Fish and Game	50,037
Public Utilities Commission	53,518
Real Estate Department	19,101
Health Care Deposit Fund	335,653
Oil and Gas Revenues	524,398
Penalties on Traffic Violations and Criminal Convictions	118,479

As discussed in the scope section of this report, Peat Marwick did not study these departments and did not evaluate their cash management and revenue collection activities. However, we believe that many of the recommendations in this report may also apply to these other departments.

APPENDIX B

PARTIAL LISTING OF PREVIOUS REVENUE AND TAX COLLECTION, COORDINATION, AND CONSOLIDATION STUDIES

APPENDIX B

PARTIAL LISTING OF PREVIOUS REVENUE AND TAX COLLECTION, COORDINATION, AND CONSOLIDATION STUDIES

This Appendix provides a list of the studies that have been conducted in the past regarding the need for consolidating the State's revenue collection activities.

A partial list of these studies includes:

1927 -- Report of the California Tax Commission.

1936 -- Griffenhagen Reports.

1941 -- Final Report, Interim Committee of Twenty-five of the California Conference on Government and Taxation.

1945 -- Legislative Analyst's Recommendations to the Joint Legislative Budget Committee.

1947 -- Report of the Senate Committee on Governmental Reorganization.

1947 -- Report of the Assembly Interim Committee on State and Local Taxation.

1951 -- Report of the Assembly Committee on Governmental Reorganization.

1951 -- Report of the Senate Committee on Governmental Reorganization.

1955 -- Report of the Subcommittee of The Assembly Interim Committee on Government Organization to the 1955 General Session of the California Legislature, "The Need for a Department of Revenue in California".

1964 -- Report prepared by the State Board of Equalization, "A Proposal for Consolidation of Major California State Revenue Responsibility in One Agency: The State Board of Equalization".

1964 -- Recommendation for consolidation of revenue administration by the Little Hoover Commission.

1964 -- A Proposed Structure for a Department of Revenue and a Tax Appeals and Equalization Board in California prepared by the Office of Legislative Analyst.

1965 -- Assembly Interim Committee on Government Organization, California Legislature, "California's Tax Administration: The Need for a Central Revenue Department".

1979 -- A report of the Little Hoover Commission, "The Tax Appeals System in California".

1985 -- The final report of the Tax Reform Advisory Commission.

APPENDIX C

MEMBERS OF THE STUDY ADVISORY COMMITTEE

Mr. M. Mark Michalko, Director
California State Lottery Commission
(Represented by Mr. James Barnett, Deputy Director)

Mr. Mik Mikkelson
Lautze & Lautze
(Representing the California State Society of Certified Public Accountants)

The Honorable Richard Nevins, Chairman
State Board of Equalization

Mr. Theron Polivka, Director
Fresno Service Center, Internal Revenue Service

Mr. Manning Post
Former member, Commission on California State Government Organization and Economy and Chairman of the District's Security Advisory Commission

The Honorable Jesse Unruh
State Treasurer
(Represented by Mr. Bill Sherwood, Chief, Cash Management Division)

Mr. Kirk West, President
California Chamber of Commerce
(Represented by Fred Main)

APPENDIX D

CASHIERING WORKLOAD INFORMATION

APPENDIX D

CASHIERING WORKLOAD INFORMATION

This Appendix provides information on the weekly cashiering workload of the major revenue and tax collection departments reviewed in this study. It presents information on the number of items (checks) and the amount of funds that were processed each week. Specifically, it provides information regarding the following departments:

- o Franchise Tax Board;
- o Board of Equalization;
- o Department of Motor Vehicles; and
- o Employment Development Department.

This information is presented beginning on the next page.

ITEMS CASHIERED BY
MAJOR REVENUE AGENCIES

(First Half of Calendar Year 1985)

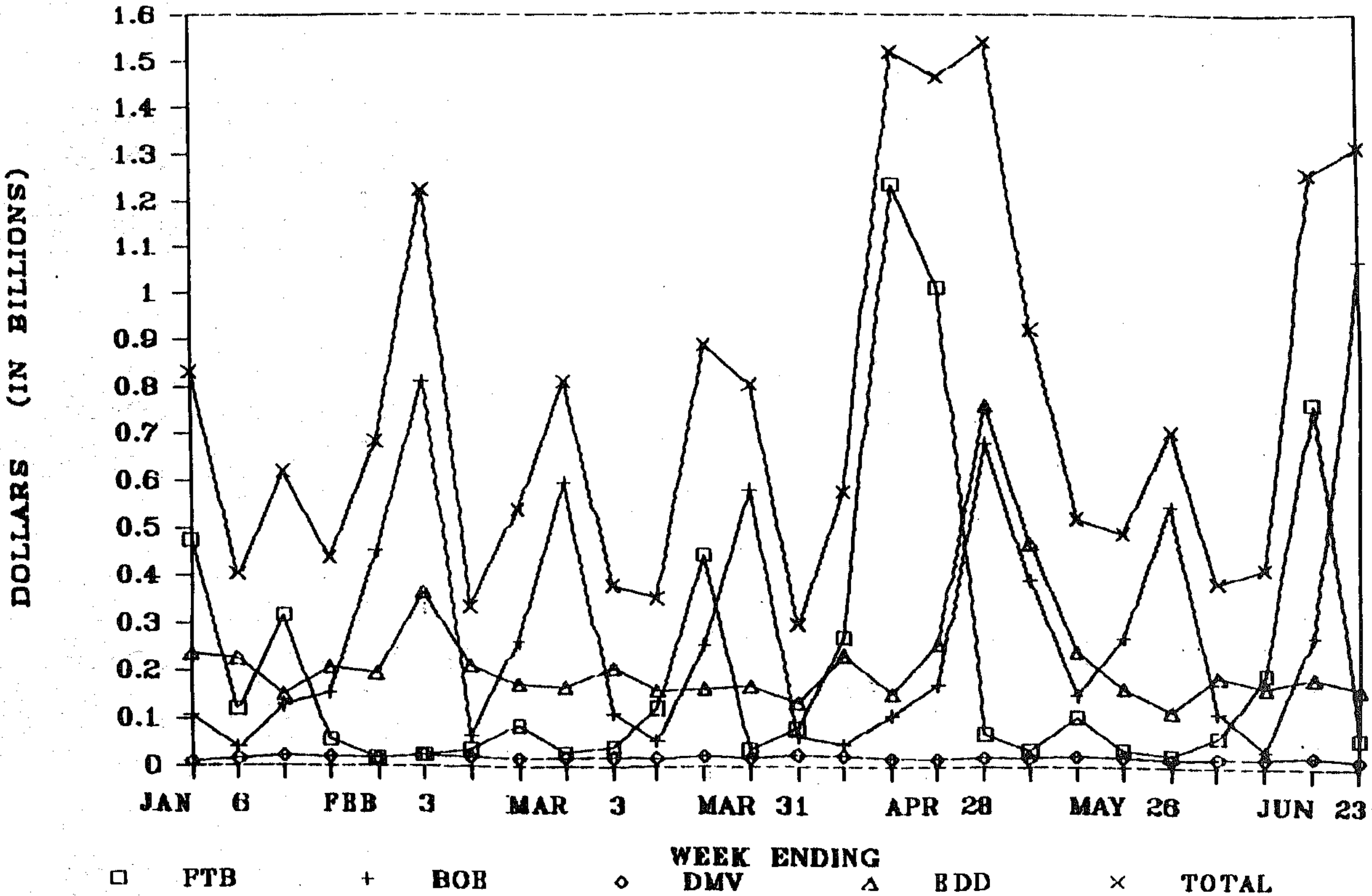
WEEK ENDING	FTB	BOE	DMV	EDD	TOTAL
JAN 6	155,357	53,254	147,211	60,749	416,571
JAN 13	198,530	36,156	216,998	103,622	555,306
JAN 20	360,972	40,689	307,998	92,863	802,522
JAN 27	85,637	50,359	252,942	127,626	516,564
FEB 3	44,441	122,518	249,457	230,902	647,318
FEB 10	55,415	237,754	311,940	234,239	839,348
FEB 17	69,051	38,880	269,446	166,325	543,702
FEB 24	79,490	30,628	225,756	112,701	448,575
MAR 3	88,218	70,783	257,493	74,536	491,030
MAR 10	96,533	64,709	268,378	98,504	528,124
MAR 17	134,028	18,152	249,840	71,875	473,895
MAR 24	197,495	27,677	288,723	99,011	612,906
MAR 31	146,690	71,480	253,969	71,105	543,244
APR 7	250,438	65,110	304,066	79,001	698,615
APR 14	612,333	26,373	352,297	113,620	1,104,623
APR 21	1,095,107	22,175	197,106	90,938	1,405,326
APR 28	888,586	46,910	231,746	196,118	1,363,360
MAY 5	135,633	135,288	258,411	208,629	737,961
MAY 12	82,640	154,392	272,055	230,684	739,771
MAY 19	81,465	19,956	278,447	171,027	550,895
MAY 26	58,230	35,741	249,260	88,438	431,669
JUN 2	52,299	58,865	190,209	51,745	353,118
JUN 9	165,703	61,728	276,264	93,351	597,046
JUN 16	295,864	15,632	237,778	78,777	628,051
JUN 23	502,124	25,894	287,878	100,303	916,199
JUN 30	105,247	77,948	247,110	81,856	512,161
TOTAL	6,037,526	1,609,051	6,682,778	3,128,545	17,457,900

DOLLARS CASHIERED BY
MAJOR REVENUE AGENCIES

(First Half of Calendar Year 1985)
(Dollars in Thousands)

WEEK ENDING	FTB	BOE	DMV	EDD	TOTAL
JAN 6	$476,258	$108,288	$9,910	$237,287	$831,743
JAN 13	$121,208	$40,821	$15,174	$226,997	$404,200
JAN 20	$317,791	$129,225	$21,152	$151,932	$620,100
JAN 27	$57,012	$154,586	$18,961	$208,440	$438,999
FEB 3	$18,110	$453,625	$16,884	$196,500	$685,119
FEB 10	$24,405	$812,736	$23,273	$364,648	$1,225,062
FEB 17	$36,427	$66,600	$20,023	$212,996	$336,046
FEB 24	$86,944	$263,090	$17,256	$174,617	$541,907
MAR 3	$28,858	$598,813	$18,033	$168,482	$814,185
MAR 10	$41,786	$112,825	$19,018	$209,114	$382,743
MAR 17	$123,514	$54,815	$18,263	$160,704	$357,295
MAR 24	$447,568	$256,879	$22,085	$164,608	$891,140
MAR 31	$36,123	$583,227	$17,859	$169,510	$806,719
APR 7	$80,329	$62,517	$23,862	$133,913	$300,620
APR 14	$274,029	$46,490	$22,175	$236,794	$579,487
APR 21	$1,238,904	$110,032	$16,885	$154,197	$1,520,018
APR 28	$1,014,673	$173,845	$16,171	$261,541	$1,466,231
MAY 5	$71,459	$684,489	$19,728	$763,795	$1,539,472
MAY 12	$35,983	$395,586	$18,648	$473,478	$923,694
MAY 19	$106,410	$151,484	$22,627	$243,868	$524,388
MAY 26	$35,587	$272,545	$19,655	$165,258	$493,045
JUN 2	$24,335	$548,894	$15,232	$118,094	$706,555
JUN 9	$63,556	$116,391	$19,166	$190,471	$389,584
JUN 16	$197,033	$34,887	$18,541	$168,950	$419,411
JUN 23	$766,655	$278,538	$23,968	$190,738	$1,259,899
JUN 30	$61,952	$1,070,282	$16,122	$167,295	$1,315,651
TOTAL	$5,786,908	$7,581,510	$490,669	$5,914,226	$19,773,313

WEEKLY CASHIERING WORKLOAD
OF DOLLARS PROCESSED
JANUARY 30, 1985 THROUGH JUNE 30, 1985



APPENDIX E

DATA PROCESSING PROFILES OF MAJOR REVENUE AND TAX COLLECTION DEPARTMENTS

APPENDIX E

DATA PROCESSING PROFILES OF MAJOR REVENUE AND TAX COLLECTION DEPARTMENTS

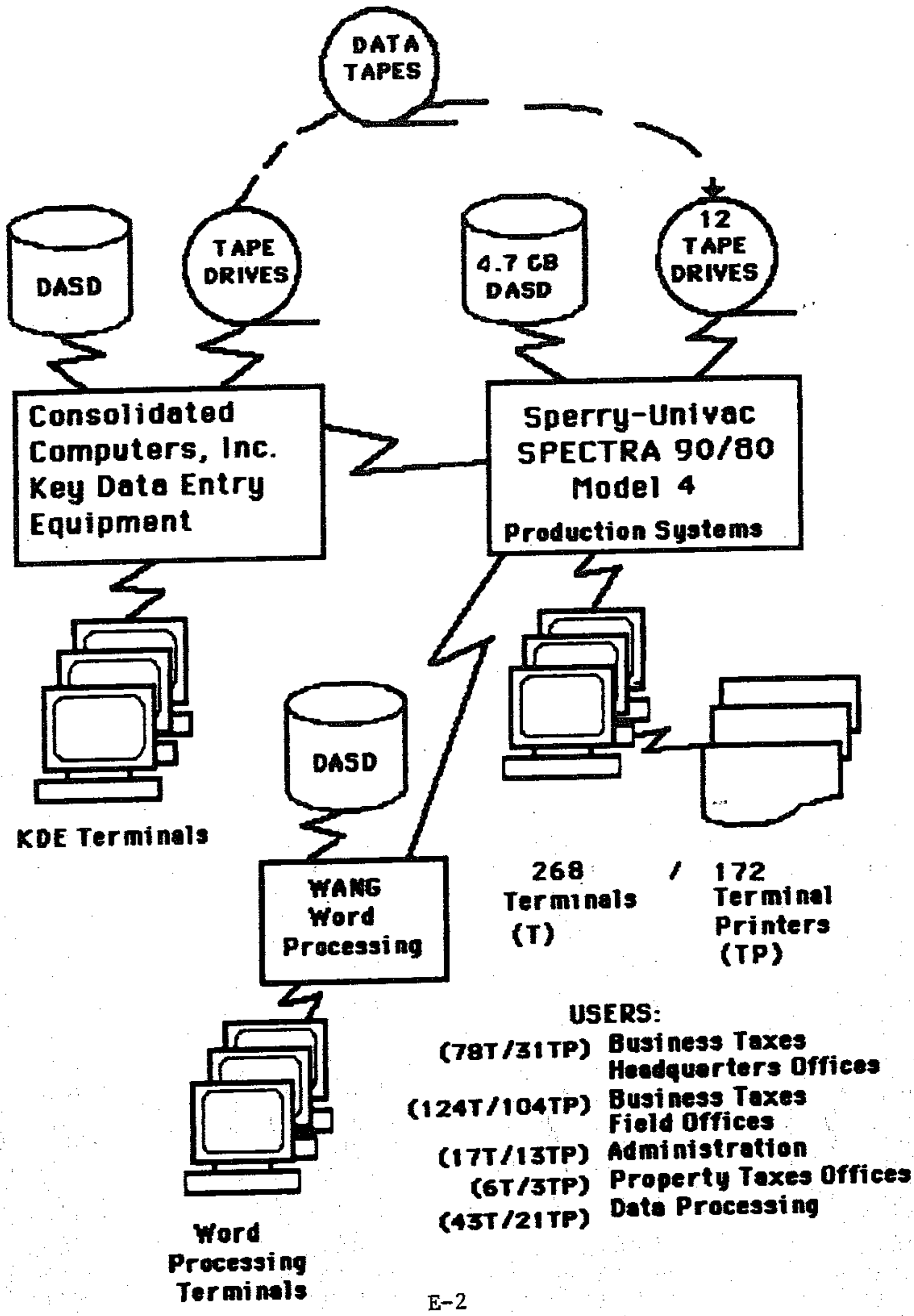
This Appendix contains profiles of the data processing equipment utilized by the Board of Equalization, the Employment Development Department, and the Franchise Tax Board. These profiles contain the following information:

- Summary level diagram of the hardware configuration presently in use; and

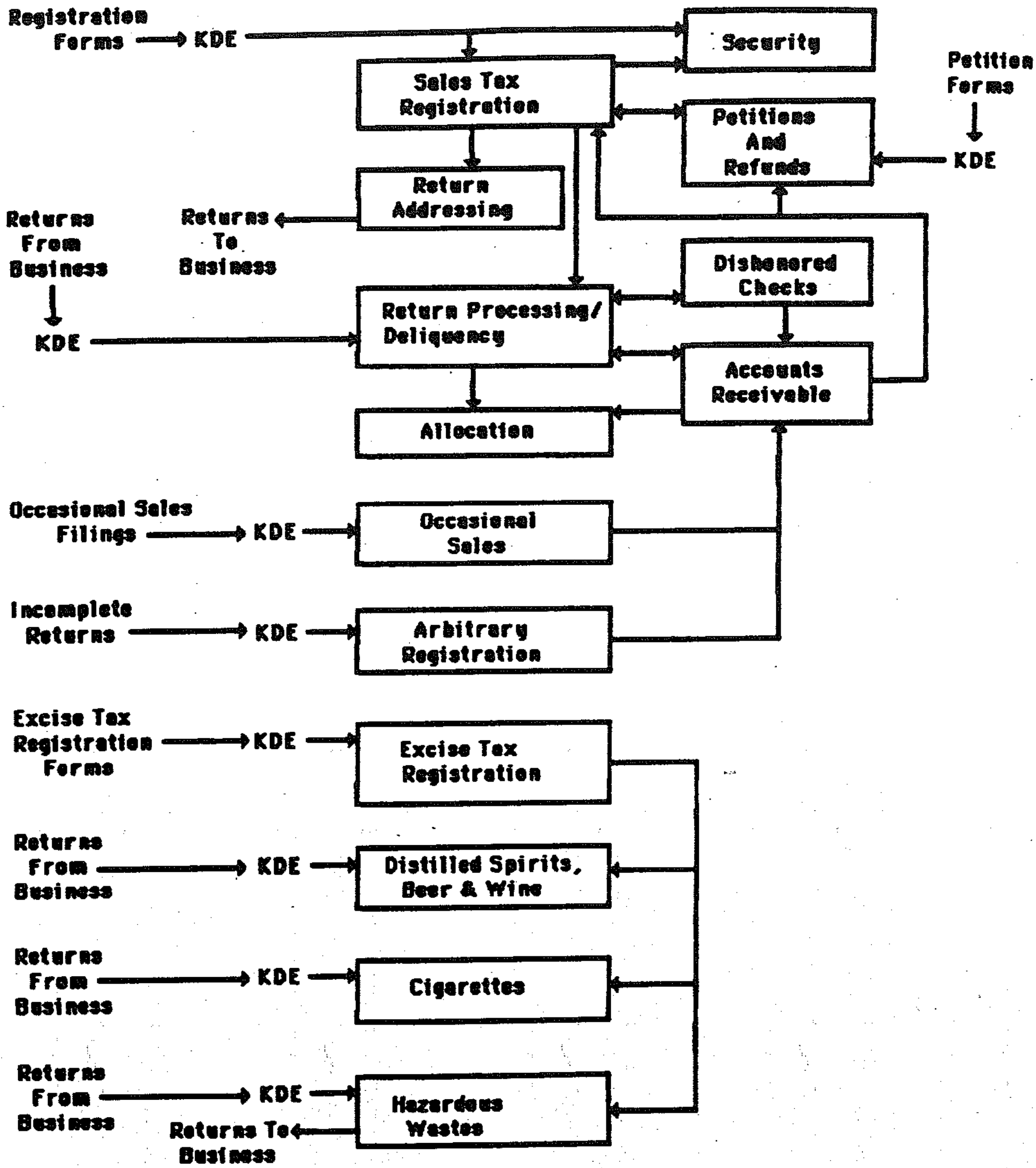
- Overview of tax and revenue collection systems in place.

This information provides a general description of the major systems and applications currently used by these departments.

BOARD OF EQUALIZATION
HARDWARE CONFIGURATION

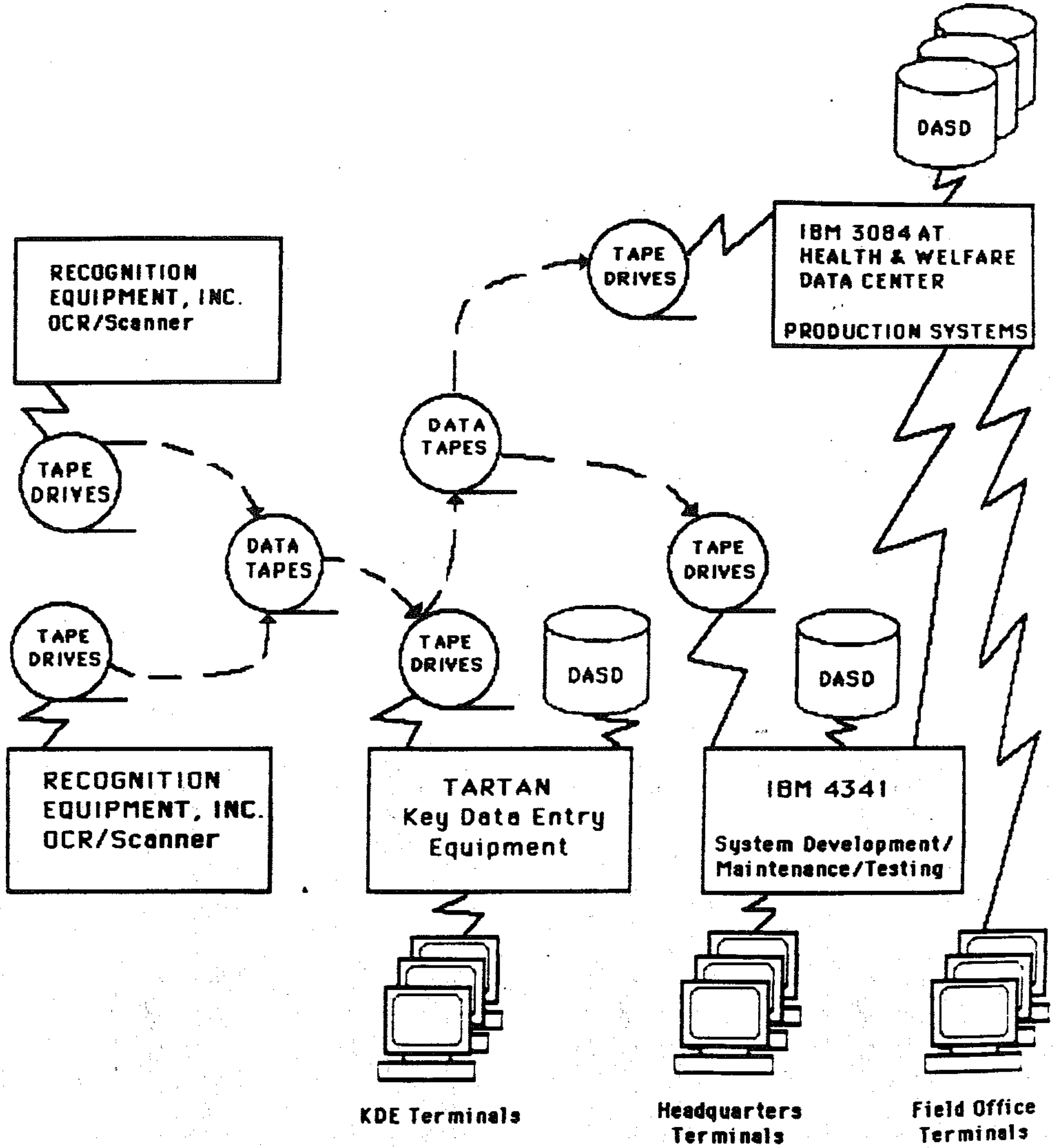


BOARD OF EQUALIZATION
TAX AND REVENUE COLLECTION



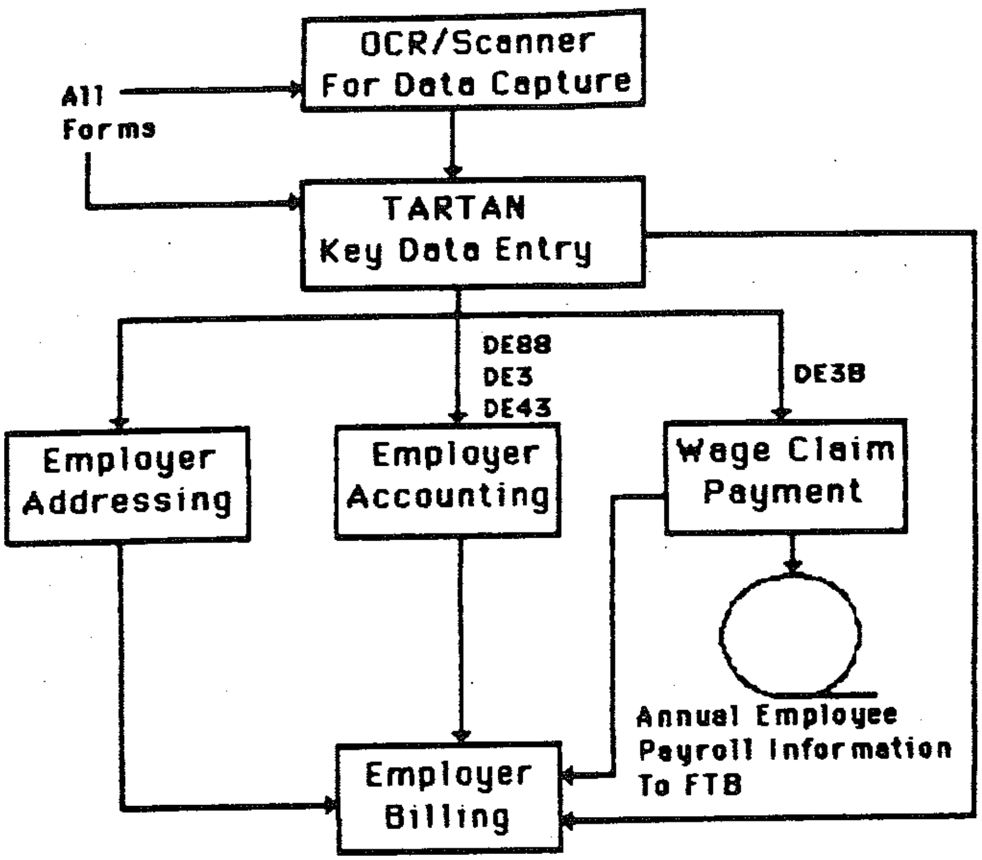
NOTE: Business Taxes Consolidated Information System (BTCIS) provides on-line query and reporting for all systems.

EMPLOYEMENT DEVELOPMENT DEPARTMENT
HARDWARE CONFIGURATION



EMPLOYMENT DEVELOPMENT DEPARTMENT
TAX AND REVENUE COLLECTION

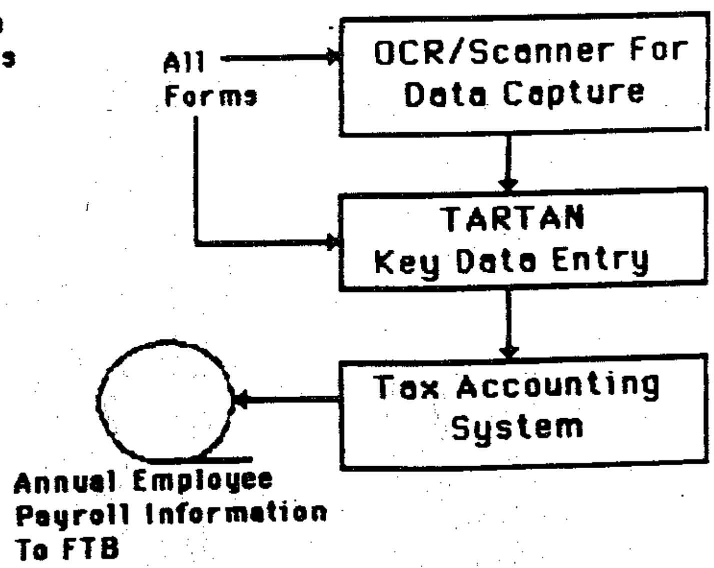
Current System



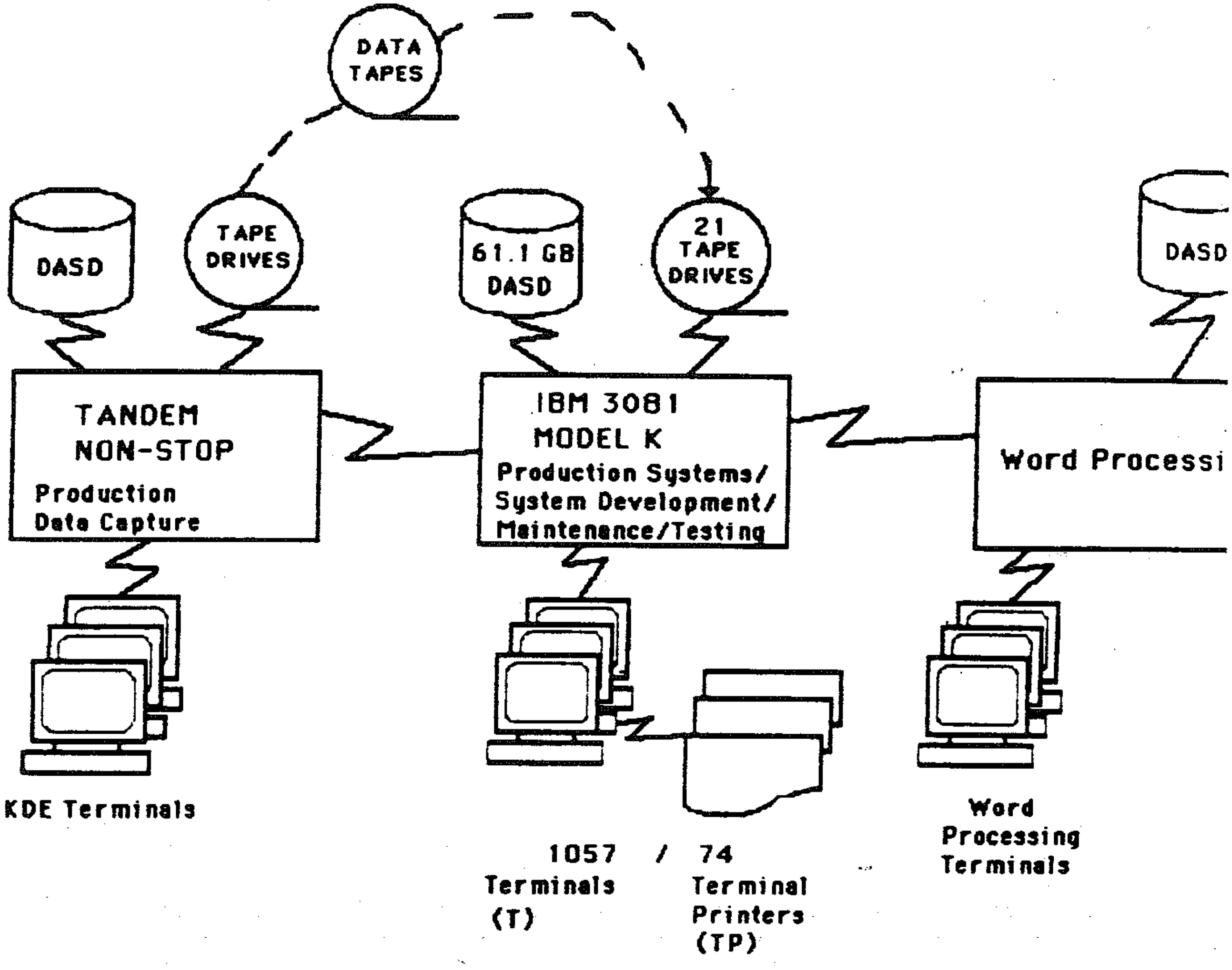
NEW SYSTEM
(Scheduled Installation July, 198

NOTE: Forms Are:

- DE3 - Quarterly Tax Returns With Employer Withholding Totals
- DE3B Quarterly Payroll By Employee
- DE43 - Annual Reconciliation Of Employer Filing Totals For Employee Withholding
- DE88 - Periodic (up to 8 months) Employer Withholding Summary Statements

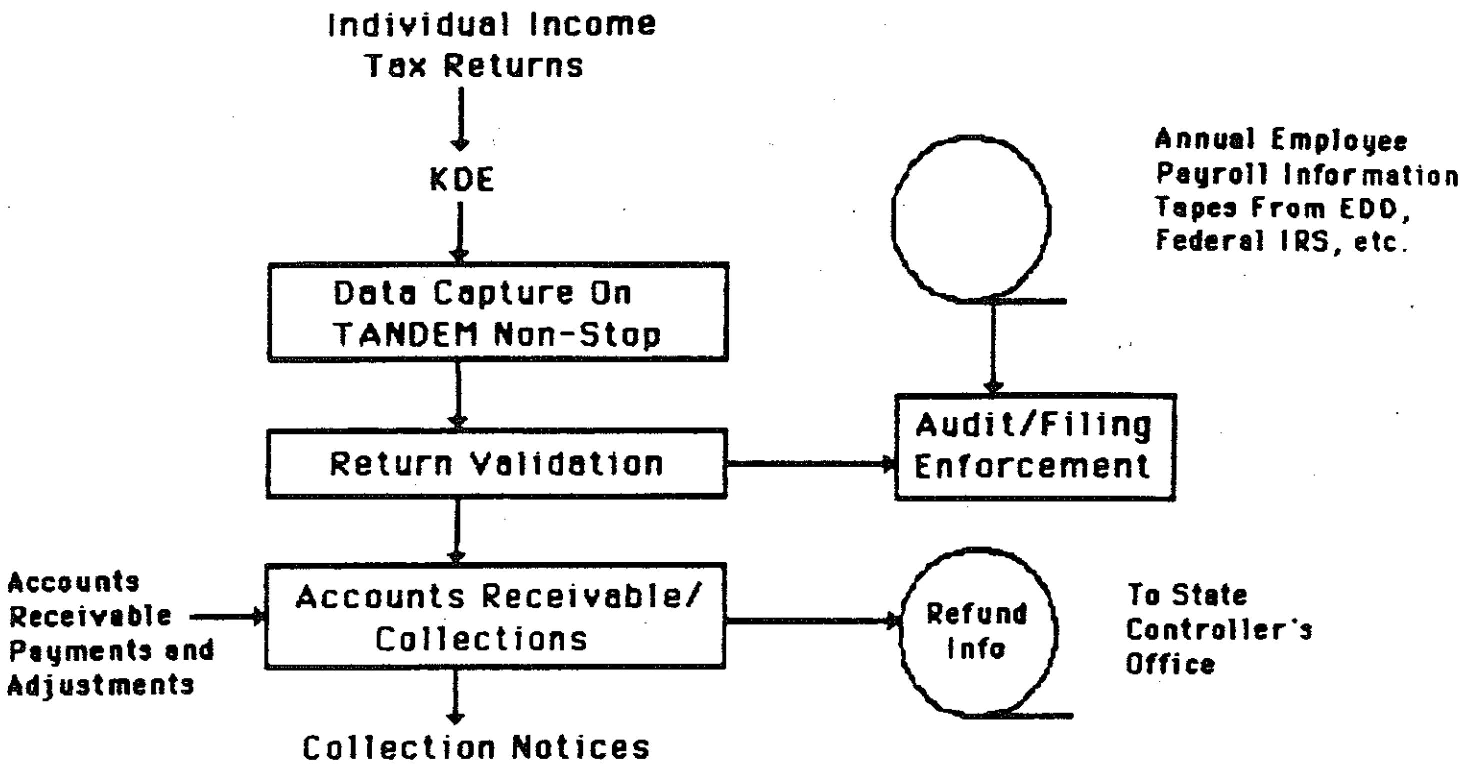


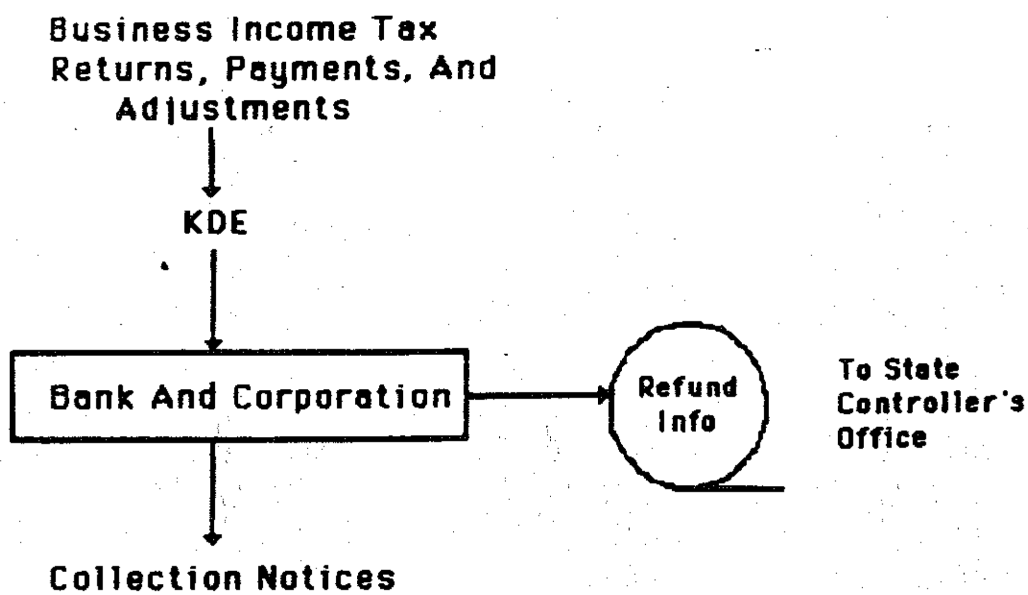
FRANCHISE TAX BOARD
HARDWARE CONFIGURATION



Video:	713(T)	Local	25(TP)
	337(T)	Remotes (In-State)	46(TP)
	3(T)	Remotes (Out-Of-State)	3(TP)
Hardcopy:	4(T)	Remotes (In-State)	

FRANCHISE TAX BOARD
TAX AND REVENUE COLLECTION





APPENDIX F

SUMMARY LISTING OF STUDY FINDINGS

EXHIBIT III.1

SUMMARY OF MAJOR FINDINGS

Findings	Franchise Tax Board	Board of Equalization	Employment Development Department	Department of Motor Vehicles	California State Lottery Commission	State Controller's Office	State Treasurer's Office	Department of Finance	Commission on State Finance
1. Substantial duplication of functions exists in the State's major revenue and tax collection departments.	X	X	X						
2. Neither the federal government nor other states have fragmented their revenue, tax collection, and cash management functions like California.	X	X	X						
3. Certain departments could generate additional interest earnings for the State by having their district offices deposit funds in local banks.		X			X	X			
4. The Board of Equalization could expedite its mailing processing by intercepting mail at its point of origin		X							
5. Certain departments should establish regional post office boxes in out-of-state locations to expedite mail payments.	X	X							
6. The Employment Development Department should ensure that mail is collected from regional post office boxes more regularly.			X						

EXHIBIT III.1 - Continued

SUMMARY OF MAJOR FINDINGS

Findings	Franchise Tax Board	Board of Equalization	Employment Development Department	Department of Motor Vehicles	California State Lottery Commission	State Controller's Office	State Treasurer's Office	Department of Finance	Commission on State Finance
7. The Board of Equalization and the Department of Motor Vehicles can start processing mail earlier by picking it up when it is first available from the U.S. Postal Service.		X		X					
8. The Department of Motor Vehicles and the Board of Equalization can increase their mail processing and cashiering capacity each banking day by starting their shifts earlier.		X		X					
9. The Department of Motor Vehicles can reduce processing holdover by implementing a work shift on Saturday or Sunday.				X					
10. The Board of Equalization and the Employment Development Department can reduce the dollar amount of processing holdover by screening miscellaneous mail for large payments.		X	X						
11. The Board of Equalization can reduce the dollar amount of processing holdover by sorting its workload better to ensure that larger payments are given higher processing priority.		X							
12. The Department of Motor Vehicles can better ensure that funds get deposited each day by establishing equipment back-up support.				X					

EXHIBIT III.1 - Continued

SUMMARY OF MAJOR FINDINGS

Findings	Franchise Tax Board	Board of Equalization	Employment Development Department	Department of Motor Vehicles	California State Lottery Commission	State Controller's Office	State Treasurer's Office	Department of Finance	Commission on State Finance
13. Departments can improve their operations and generate additional interest earnings for the State by purchasing equipment that is cost-beneficial.	X	X	X						
14. Departments can expedite the deposit of funds by separating payments from supporting documents sooner in the processing cycle.	X	X	X	X	X				
15. The processing of payments can be expedited by modifying the design of workspace and workflow.		X	X	X	X				
16. The Department of Motor Vehicles could enhance its processing capacity each banking day by performing payment processing until the latest possible cut-off time.				X					
17. The amount of processing holdover could be reduced by negotiating later deposit cut-off times with banks.							X		
18. The Board of Equalization could earn additional interest earnings by sorting and encoding all checks for deposit to banks conducting business with the State.		X							

SUMMARY OF MAJOR FINDINGS

Findings	Franchise Tax Board	Board of Equalization	Employment Development Department	Department of Motor Vehicles	California State Lottery Commission	State Controller's Office	State Treasurer's Office	Department of Finance	Commissi on Stat Finance
19. The State could expedite payments and generate additional interest earnings by making greater use of electronic fund transfer.	X	X	X						
20. The California State Lottery Commission could increase interest earnings by conducting EFT sweeps of accounts sooner.					X				
21. The State's major revenue and tax collection departments could increase audit coverage by jointly conducting field audits.	X	X	X						
22. The State could increase the efficiency of its audit efforts by expanding the scope of field audits to include testing for other departments.	X	X	X						
23. The State could reduce the tax gap by expanding the scope of field audits to include testing for the detection of the underground economy.	X	X	X						
24. The State could gain additional revenue by increasing the number of revenue and tax collection auditors.	X	X	X						
25. The potential exists to reduce costs by encouraging the colocation of district offices.	X	X	X						

EXHIBIT III.1 - Continued

SUMMARY OF MAJOR FINDINGS

Findings	Franchise Tax Board	Board of Equalization	Employment Development Department	Department of Motor Vehicles	California State Lottery Commission	State Controller's Office	State Treasurer's Office	Department of Finance	Commission on State Finance
26. The establishment of an independent tax appeals board or tax court would enhance the credibility of the State's tax appeals process.	X	X							
27. The State's collection activities could be performed more efficiently through the expanded use of automated systems.		X	X			X			
28. The State could generate additional revenue by using private collection agencies for certain accounts.	X	X	X		X	X			
29. The State could enhance its collection capability by expanding its inter-departmental offset program.	X	X	X	X	X	X			
30. The major revenue and tax collection departments could reduce duplication of effort and improve collections by jointly conducting collection activities.	X	X	X	X	X	X			
31. The major revenue and tax collection departments could recover a greater portion of the cost of their investigation and collection activities by adopting recoupment policies.	X	X	X		X	X			
32. The State could clarify collection procedures by having consistent statutes regarding postmarked date of payment.			X						