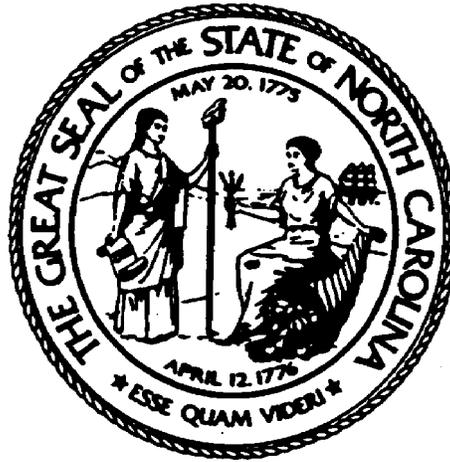


STATE OF NORTH CAROLINA

FINAL REPORT

GOVERNOR'S COMMISSION TO PROMOTE GOVERNMENT EFFICIENCY AND SAVINGS ON STATE SPENDING



December 2002

OVERVIEW

In February 2002, Gov. Mike Easley issued an executive order creating the Commission to Promote Government Efficiency and Savings on State Spending and named Mr. James B. Hyler, Jr., vice chairman of First Citizens BancShares, as its Chair. The Governor named 15 other North Carolinians with broad expertise to the Commission, which has met monthly since the onset of the Commission.

Governor Easley created the Commission in the wake of two successive years of budgeting expenditures exceeding projected revenue, General Fund expenditure reductions and midyear budget actions to address unanticipated budget gaps. General Fund revenues fell short of projections by more than \$500 million in 2000-01 (or almost four percent) and an unprecedented \$1.55 billion, or almost 11 percent, in 2001-02. The 2002-03 budget contains almost \$1 billion in spending reductions and transfers, but many of the budget-balancing techniques were one-time in nature.

The Commission notes that its work must be seen in the context of studies completed in previous administrations to make government more efficient. Governor James Holshouser, whose first Executive Order as Governor was to create an efficiency commission and who co-chaired Governor Easley's 2001 Efficiency and Loophole-Closing Commission 28 years later, addressed the Commission at its first meeting on this point. The best-known efficiency commission – the Government Performance Audit Committee (GPAC) – issued hundreds of recommendations eight years ago. Some of the recommendations of this Commission are based on that work.

The Commission was charged with the task of identifying long-run efficiencies, especially in terms of personnel, information technology, program duplication and the elimination of programs that are not part of government's core mission. In May, the Governor's recommended budget used \$25 million in savings from Commission recommendations, a figure that was ultimately adopted by the General Assembly. The Office of State Budget and Management has allocated the \$25 million across all areas of state government on a pro rata basis. However, the Commission approved several recommendations in May and June to achieve more than \$25 million in savings. These included recommendations to obtain efficiencies in utility billing and usage, accounts receivable collection, contract renegotiation, motor vehicle enforcement, legislative session limits and an efficiency grant program.

The Commission recommendations are broad in their scope and nature. In most instances, the Commission has not identified specific dollars in savings. Many of these recommendations are for the long-term sustainability of the state and will not have short-term payoffs. Rather, this report provides the foundation for further analysis of these issues that will result in necessary change throughout state government.

THE MISSION AND GOALS OF THE COMMISSION

In order to guide its work, the Commission discussed and approved a mission statement and end results. The mission statement is as follows:

Now is the time to reform government practices and refocus on the public sector's core mission. The fiscal crisis provides the crucible for needed change to happen, but North Carolina government must be efficient and effective all the time – not just when times are bad. Any recovery in the state's fiscal situation should not be an excuse for this Commission's work to fall by the wayside.

The Commission's goals for end results included the following:

1. An enterprise-wide personnel system that gives managers flexibility, rewards employees for high performance and allows the state to compete in the marketplace.
2. The use of information technology that takes advantage of economies of scale and reduces the cost of doing business.
3. The state's physical assets are well-maintained, financed with the most appropriate modern tools and constructed to minimize cost of service provision. Maximum use of space should allow the state to sell physical assets that are not needed.
4. Administrative functions (HR, IT, facility management, purchasing, public schools) are staffed at appropriate levels.
5. Public sector becomes flatter.
6. Agencies perform their core mission well. Nothing else.
7. Large program areas are reformed.
8. Progress on implementation of these reforms will be mandated, monitored and measured.

The work of previous commissions directed toward a more efficient and cost-effective government has been implemented to some degree, but the quantum changes necessary in this environment of budget gaps demand a far different, more aggressive and proactive pursuit of these and previous recommendations. Previously, substantial increases in state revenues resulting from a very favorable and growing economy obviated the need for sweeping changes in how state government conducts business. This is no longer the case.

THE PROCESSES OF THE COMMISSION

The Commission has been organized into three subcommittees: the Processes of Government subcommittee, the Structure of Government subcommittee and the Capital

Management subcommittee. Due to staff and member conflicts resulting from the length of the legislative session, most of the work in recent months has been done in full Commission meetings.

Subcommittees have received input from state agencies, local government associations and officials, representatives of the business community and other interested members of the public.

THE COMMISSION'S RECOMMENDATIONS

Processes of Government

1. *Personnel*

The Processes of Government subcommittee convened a public-private Steering Committee chaired by Chris Rolfe of Duke Energy. The Steering Committee has completed a more detailed backup report. The Committee found that North Carolina's human resources system and practices are dispersed, uneven and are designed and supervised by legislators or others without human resources expertise.

North Carolina state government employs over 285,000 workers – about 7 percent of total employment in the state. Approximately half of these workers are public school teachers or public university employees. Most state employees received a \$625 increase in 2001 and no pay increase in 2002. State employees did, however, receive a one-time additional two weeks of vacation in 2002.

The Commission emphasizes that these recommendations are not an attempt to balance the budget on the backs of the state workforce. Nor can these recommendations be implemented in a piecemeal fashion. Finally, the Commission fully recognizes that some of the items that are recommended to be changed can only be done prospectively.

The Commission recommends the following:

- **Eliminate special pay increases (GPAC).** Currently Highway Patrol officers, magistrates and some other court officials receive automatic pay increases. This practice creates a disparity with other state employees that is not necessarily justified. This practice needs to be evaluated in the context of competitive salary grades to attract and retain employees.
- **Prospectively eliminate longevity pay and fund additional pay for excellent performance (GPAC).** The provision of additional pay based on years of

service does not necessarily reward excellent performance. The original GPAC report recommended that savings from the elimination of longevity pay should be used for salary increases for employees performing above expectations. The Commission recommends that longevity pay be eliminated prospectively, with those currently receiving longevity pay having it folded into their regular salary. As employees receiving longevity pay retire, an increasing amount of savings can be used to reward performance.

- **Allow retirees with special expertise to return to work without penalty.** Recent media accounts have documented problems with retired employees returning to perform similar tasks while employed by a private contractor. Just as public schoolteachers are permitted to return to work, so too should retirees in other hard-to-fill areas be permitted to return. This practice must be closely documented to assess the effects on the retirement system. This change will reduce orientation and training costs and maintain valuable expertise. Some agencies hire former retirees for temporary work now and work them to the maximum dollar amount allowed for them to retain retirement benefits.
- **Achieve economies of scale through consolidated bids on optional benefits.** Currently each agency has a committee that issues bids for optional medical benefits. This practice is not cost-efficient and increases the difficulty for an employee or an agency division to move to another agency, as the optional benefit package may not be the same. Administrative and operational efficiency demands that this practice be centralized through elimination of the committees and requiring the Flexible Benefits plan to administer all these programs.
- **Change eligibility standards for retiree health insurance and retirement benefits to mirror practices in the private sector.** A state employee with five years of service becomes entitled to health benefits upon retirement. Retirees that have not yet reached the age of Medicare eligibility are among the most expensive for the State to provide health care coverage and are a primary reason for the recent increase in health care costs and premiums. The Commission recommends that the state increase the amount of time that an employee is required to serve to be eligible for retiree health benefits. The state should establish a minimum age to receive retirement benefits and retiree health coverage.

An actuarial analysis is needed to determine the fiscal impact of paying the insurance for retirees that are ineligible for Medicare as well as determining what a reasonable vesting period is for a paid health benefit at retirement.

- **Restructure health care pricing (GPAC).** The state pays the entire cost of the health care premium for employees and none of the cost of the premium for dependents. As a result, many employees cannot afford to pay for dependent health care coverage.

In order to broaden the risk pool for the state health plan, the Commission recommends that employees share in the cost of their own health care premiums and the State partially defray the cost of dependent health care coverage. This change would more closely match up with private sector practices. The State should also enhance existing wellness programs to increase the health of its employees, which will result in long-term health care savings.

The Commission recommends the consideration of a plan to allow state employees to choose how they would like to spend their fringe benefit amounts, in order to maintain equity across employees.

- **Consider flexible work arrangements.** Private sector organizations have met with success through permitting job sharing or three-quarters time positions. The state may consider adopting such practices to aid in recruitment and retention of employees, as some agencies allow this.
- **Modernize personnel governance.** The personnel system should have discrete roles for agency staff, the Office of State Personnel, and the legislature.
- **Modernize personnel administration.** Personnel administration should maximize the use of technology to reduce errors and improve productivity.
- **Require use of the Return to Work Program.** State employees who receive workers' compensation deserve the opportunity to return to employment as soon as possible. The Return to Work program has a proven record of success in North Carolina and other states. States that mandate its use in all agencies experience cost savings. The Commission recommends that the program be made mandatory, rather than optional.

- **Modify payment rules for those leaving state service.** The state's current severance pay system contains an age factor, which is not commonly used in severance pay calculations. The Commission recommends that the state move to a best practices model of severance pay based on years of service.

Also, the payroll systems make it difficult for the state to pay employees who leave service for less than a full month. As a result, the state has to attempt to recoup this pay from these employees, which has been time consuming. The Commission recommends that the state pursue alternatives to recover unearned pay.

- **Reduce duplicative personnel systems.** The Commission found that the state has over 40 personnel systems. Within the University system, for example, there are three systems – one for most non-faculty employees; one for senior academic, administrative, instructional and research personnel; and one for the faculty. Consolidating personnel systems where appropriate will result in substantial administrative savings. The Commission recommends that the Office of State Personnel evaluate these systems, especially the University, with a goal toward reducing inefficient structures and costs while ensuring accountability and competitiveness.
- **Reduce headcount in a smart manner.** Personnel costs are the single biggest state expense. To achieve personnel savings and mitigate the need for layoffs, the Commission recommends a much tighter scrutiny over positions that become vacant. Agencies and departments should be required to justify the critical need for the position. If it is critical, then the agency or department should assess the possibility of distributing the duties of the position to others. The savings should be split between the general fund and the agency, either to provide salary increases for those taking on more work or other investments to improve efficiencies.

The Commission recognizes that many vacancies have been eliminated or gone unfilled over the past three years. Clearly the recent experience in individual departments or agencies must be considered when this evaluation is undertaken. The potential for savings and reinvestments is substantial. In 2001-02, there were approximately 10,000 vacancies created through retirement and other departures from service, not including corrections, the University and the public

schools. If one-half of those positions were eliminated at an average salary of \$30,000, approximately \$180 million in savings and reinvestments might have been made.

The Commission notes that many agencies have used the savings from unfilled positions to fund other items. The State Budget Office and the agencies should identify these other items and include them in the continuation budget, rather than provide backdoor support through the use of reverted salaries.

2. Information Technology

The state currently relies heavily on legacy systems with numerous business infrastructure systems, especially for payroll. The Office of State Controller estimates total state information technology costs at almost \$700 million for FY 2001-02, with \$411 million from General Fund sources. The Processes Subcommittee has written a white paper (that is attached) detailing the important issues surrounding the state's use of information technology.

The Commission recommends the following:

- **Establish clear roles for the Office of Information Technology Systems (ITS) and for the agencies for IT.** ITS should concentrate on areas of enterprise-wide importance. These issues include network, security, email and data-sharing platforms across agencies. ITS needs the authority to enforce agency compliance to enterprise-wide standards. One agency made more than 170 modifications to a software package it used, making it non-standard and not interoperable. The costs of the modification, long-term support and maintenance were substantial.

ITS should relinquish support of agency-specific programs and services. The new NC NET initiative should fully explore this recommendation.

Duplication on different technical platforms and the lack of seamless integration currently exists and must be remedied.

- **Streamline information technology oversight.** The state Chief Information Officer (CIO) should, and does, report to the highest senior management level.

This person is the logical one to handle the planning, initiation and management of the consolidation processes necessary to attain a shared services environment. The consolidation strategy for enterprise support should include manpower, processes, development, budgeting and procurement. There are other important functions that need to be performed that go beyond the day-to-day management of ITS. These include economic development and development of a vision for information technology in North Carolina.

The Commission notes that the current CIO responsibilities are varied and enormous and must be evaluated to ensure that enough support is provided to do all these things well. At the same time, responsibility for IT governance is diffuse and overlapping. The Commission recommends an independent evaluation of the role and relationship of the State CIO, IRMC, the ITMAC, and the CIOC. Duplication of staff roles in these entities should be eliminated.

- **Identify and summarize information technology costs.** Significant IT expenditures are scattered throughout unit budgets, making global prioritization more difficult. This practice limits the ability of the state to aggregate requirements to leverage volume discounts and structure a cost-effective, enterprise-level IT organization that provides support across boundaries. The Commission recommends that ITS be empowered to take the appropriate steps to provide transparency on IT spending and employment.

Moreover, the Commission recommends that OSBM establish a budget analyst position to review IT spending from an enterprise level to include all state agencies, departments and the education systems.

- **Provide centralized purchasing authority.** Currently, there are no centralized funds for the purpose of purchasing statewide software licenses. Software and maintenance costs would be reduced. The Commission recommends centralization of this function.
- **Support IT infrastructure through multiyear funding (GPAC).** The state needs a multiyear plan, similar to a capital planning budget, to finance technological improvements on a timely basis. Private sector and local governments already use such techniques. The Commission also recommends

that the state explore the use of financing to pay for large-scale infrastructure investments.

The Commission also finds that funding some information technology investments on an annual basis discourages lower cost alternatives. This practice reduces the ability to save through multi-year leasing of hardware and software.

- **Reform funding for ITS.** Currently, ITS charges agencies for the use of its services according to a rate schedule set annually. This practice should be changed to fund ITS through the continuation budget and therefore simplify ITS finances and administration.
- **Enforce accountability.** The Commission recommends that the State Auditor or State Controller evaluate major initiatives by focusing on accountability and cost overruns. Currently, vendors and agency program managers are the ones responsible for dealing with cost overruns and subpar performance. This practice is not working well.
- **Increase the use of electronic forms.** Several efficiency commissions have recommended the increased use of electronic forms for time and attendance, certified email (rather than express or overnight regular mail) and other routine tasks. Off-the-shelf programs with a minimum of specialized changes in the software should be explored for appropriateness. The State Personnel Office has designed an electronic time and attendance program that is used currently by some state agencies.
- **Reform the state's business infrastructure.** Last year, the General Assembly supported a study of the state's business infrastructure in order to examine the feasibility and need to integrate the state's human resources, personnel and budget systems. The Office of the State Controller was designated as lead on this project. However, the budget crisis led to a freeze in funding for this project. The Commission recommends that the state provide the investment as soon as possible to move this process forward. The Commission notes that the state currently has over 40 separate payroll systems, none of which can "talk" to each other. Redundancy therefore exists, with no value added to crucial services.

- **Reengineer business processes.** Technology provides the potential to dramatically change processes and service delivery. IT investments are focused more on automating existing processes, rather than questioning the efficiency and effectiveness of these practices. The Commission recommends the creation of an enterprise technology strategic business planning process that includes all of state government.

The Commission notes that the private sector is rapidly moving processes online and the public sector should do the same through moving services such as permitting and licensing online. This approach needs to be a significant part of the strategic business planning.

- **Improve contracting practices.** The State Budget office has made several recommendations to improve IT contracting based on an in-depth study completed earlier this year. The Commission supports these recommendations and would recommend that service contracts be treated like commodity contracts in the state procurement process.

Moreover, the Commission recommends that the state initiate innovative, incentive-based contracts with outside suppliers that encourage cost reduction and service improvements. The Commission has already recommended renegotiation of existing contracts for better pricing and added value services.

- **Implement Host to Post mail technology.** The Department of Health and Human Services has saved several million dollars annually by implementing host-to-post technology. This technology should be expanded to other departments and consolidated when appropriate.
- **Establish a universal list of primary and secondary statewide funding priorities.**
- **Explore the use of seat management approaches.** Seat management offers crucial flexibility, uniformity and support and should be used where shown to be cost-effective.
- **Modernize legacy applications and systems.** Many legacy systems (essentially obsolete systems that are no longer robustly supported by vendors)

are used by the state for critical state functions. This presents significant risk and expense. The Commission recommends the identification and upgrade of these applications.

- **Create a universal asset/inventory management system.** All state entities, including the educational systems, should have one repository of the entire IT inventories. The Commission recommends that such a system be housed in the State Controller's Office or ITS.
- **Establish an enterprise approach to public school connectivity.** The State Department of Public Instruction should manage an enterprise approach to IT using service level agreements (SLAs). Currently, all LEAs do implementation independently, leading to inequitable and inefficient provision of service.
- **Invest in training and staff development.** These areas are the first sacrificed to budget cuts, but the Commission recognizes that investing in the development and implementation of systems without training leads to inefficient and ineffective use of technology.
- **Achieve IT efficiencies throughout the UNC system.** UNC needs to engage in university-wide and campus-wide IT budget planning to aggregate central computing and other unit computing budgets in order to identify duplication and inefficiencies. This can also be used to leverage infrastructure investments and economies of scale, while recognizing the differences in mission and purposes of campuses through collaborative management models. The lack of ability to enter into long-term contractual commitments for IT was identified as an issue for the university system.

3. Revenue Collection

The ways in which the state collects its revenue are as important as the processes and procedures by which it spends the revenue. Special care must be taken to ensure compliance with revenue laws in order for taxpayers to have confidence that the state performs this function in the fairest and most efficient manner possible.

The Commission recommends the following:

- **Centralize the collection of revenues in a single agency.** The Commission, by previous action, recommended that the state improve accounts receivable collections through the addition of a collection fee and by centralizing the efforts. In 2001, total accounts receivable were \$567 million (not including delinquent taxes). The Office of the State Controller notes, however, that only a fraction of this amount can be collected. Legislation was proposed, but did not pass in the 2002 legislative session. Moreover, the Commission recommends that the Office of State Controller and Department of Revenue devise a plan for the Department to collect more of the agency fees in order to streamline the process and take advantage of the Department's capacity and expertise in this manner. The Department already performs this function for some fees payable to the Secretary of State.
- **Assess the use of fees to recover costs.** The Commission supports the draft recommendation by the Commission to Modernize State Finances to require the State Budget Office to analyze the use of fees, especially the cost of collection and the fee payment related to the cost of service provision. Departments and agencies should study their own operations for opportunities to use appropriate fees and eliminate taxpayer subsidy where appropriate.
- **Invest in Department of Revenue efforts to improve taxpayer compliance.** The Department's Project Collect Tax, an effort to collect delinquent taxes, has met with great success. However, the Department needs additional resources to recover uncollected taxes in the underground economy and from non-filers and those who file fraudulent returns. Efforts to simplify the tax code will help avoid some compliance problems, but there are substantial issues with the current complicated tax code that the Department should explore for retroactive recovery.
- **Change the method of providing the sales tax preference for state and local governments from refunds to exemptions.** Currently each agency has to complete paperwork to recover its upfront payment of sales taxes, thereby complicating the process substantially. Eliminating the tax payment at the time of the sale would reduce administrative errors and burden at both the state and local government level.

Structure of Government

The Structure of Government subcommittee recommendations focus on the key questions of what services should government provide and who and how should these services be provided.

The Commission recommends the following:

1. Explore privatization and managed competition.

The state should provide services in a manner that ensures the quality of service and the cost-effectiveness of the service. A number of services are already privatized in state government, including: custodial, maintenance, health services, information technology, vehicle repair, food services and so forth. The Processes Subcommittee found that outsourcing can be used to supplement state employees in information technology. State employees should retain core competencies, while using outsourced personnel for value added to projects and programs. There can also be instances where the public provision of services can be most efficient and these opportunities should be explored as well. The Commission recommends that a panel serve to review state government to identify key areas for consideration. This panel, and state government, should review privatization efforts in other states to determine best practices, and give appropriate consideration to these ideas. The Commission recommends the following areas as likely candidates for privatization/managed competition.

- **Creating public defender offices, rather than use of the private bar.** The Administrative Office of the Courts has conducted a cost-benefit analysis that shows that public defender offices may result in savings over payments to private lawyers to defend indigent clients.
- **Use private contractors for secondary road construction (GPAC).** Private contractors already are instrumental in building the state's highway system and fuller use of their capacity should be made.
- **Privatize the Raleigh and Charlotte DMV offices (GPAC).** DMV offices are private operations in most areas of the state, including the Raleigh and Charlotte areas. These two offices are the exception to this practice. In recent years, however, the transaction fee to contractors has been increased to cover their costs when more citizens began to register online. Any change must be

scrutinized to make sure the cost savings envisioned at the time of GPAC would be realized.

- **Improve child support collections.** Private sector efforts in other states to collect child support have increased state revenue and support for the child. This success demands that the state explore this effort here, although some preliminary efforts have not fared well.
- **Sell state assets.** The Commission believes that the state's assets should be inventoried and considered for privatization, where appropriate.

2. *Shift Authority in Service Provision*

The question of service provision is not only one of public or private. It also demands changes in which state agencies provide the service and what level of government is most appropriate for service provision. As such, the Commission recommends the following:

- **Reduce the workload for DHHS education agencies by shifting provision to local education agencies.** Officials in Morganton noted to Commission members that the distance from Raleigh exacerbates the difficulty of service provision. They recommended, and the Commission agrees, that coordination with local education agencies for schooling may be appropriate.
- **Shift responsibility of alcohol and drug treatment from the state to area mental health authorities (GPAC).** In recent years, there has been a shift from the use of institutionalized care to community-based care. Institutionalization is more expensive and many believe that it is not the most appropriate means of treatment.
- **Shift responsibility for museum operation and oversight to one agency.** Currently, the Department of Environment and Natural Resources, the Department of Transportation and the Department of Cultural Resources all operate museums across the state. The Department of Cultural Resources operates the majority of these, and should be given the responsibility to oversee the others in order to ensure administrative efficiencies.

- **Move the duties of alcohol law enforcement to local officials and the SBI (GPAC).**
- **Reduce the use of sworn law enforcement provisions (GPAC).** The state's law enforcement agencies should review their personnel practices to eliminate the use of sworn officers for jobs that do not require such a credential and avoid more costly personnel.
- **Require local counties to pay for Butner public safety functions (GPAC).** Currently the state provides for all public safety in the Town of Butner, which houses numerous state facilities. This subsidy of local residents should not continue.
- **Examine the role of the Department of Juvenile Justice and Delinquency Prevention.** This department operates youth development centers and delinquency prevention programs. The State Auditor is currently conducting a performance audit of this Department, which may contain relevant recommendations to eliminate duplication of functions.
- **Consolidate workforce development programs (GPAC).** Perhaps no other area of state government is cited more often as an example of inefficiency as workforce development. The diffuse authority over these programs developed largely as a result of different eligibility criteria by the federal government. Within the past few years, the federal government has consolidated a number of funding streams and the state should take full advantage of that change to find efficiencies in this important policy area. State funding for workforce development programs totaled \$929 million in 2000-01 – a huge enterprise for state government. The Commission strongly recommends that the Governor designate an agency to lead these efforts.
- **Integrate early childhood programs.** The General Assembly required various public and private organizations to improve the efficiency and effectiveness of services to at-risk preschoolers. These programs include Smart Start, More at Four, Head Start among others. The Commission supports this recommendation.

- **Allow municipalities to perform more transportation functions through municipal agreements (GPAC).**
- **Combine worker safety programs found in the Industrial Commission and in the Department of Labor.** Testimony to the Commission revealed that worker safety had been the province of the Industrial Commission until the federal Occupational Safety and Health Act (OSHA) resulted in the creation of similar programs in the Department of Labor. These programs should be examined for consolidation.

3. Provide Services More Efficiently

- **Consolidate administrative and support functions in areas of high concentration of state facilities.** Commissioner Morse spent substantial time pointing out the efficiencies possible in these consolidations. Similar approaches should be taken throughout the state, and the Morganton action was enacted by the General Assembly. The legislative change may result in a model that can be replicated elsewhere.
- **Reduce frequency of services such as trash pickup and lawn service.** Several corporations pointed out that reduction of some nonessential services could help save costs.
- **Improve contracting practices.** The State Budget office has made several recommendations to improve personal services contracting based on an in-depth study completed earlier this year. The Commission supports these recommendations. Routine quarterly reporting on these contracts has begun, with routine analysis to be provided to the General Assembly.
- **Reform motor vehicle management.** A recent State Budget analysis of the motor fleet management made several recommendations regarding the reduction in fleet size, reduction in billing, streamline fleet maintenance and periodic surveys of repair costs to ensure competitiveness. The Commission endorses these recommendations.

- **Adopt Medicaid Reforms (GPAC).** GPAC made several recommendations to reform the certificate of need (CON), ICF/MR reimbursement and hospital reimbursement. Also, the state should permit over-the-counter drugs to be eligible for Medicaid reimbursement, which would avoid the current need to use expensive prescription drugs.
- **Change DMV registration practices.** Extension of vehicle registration to two years and drivers license renewal to eight years could reduce the caseload at DMV offices. GPAC recommended the closure of several DMV offices.
- **Streamline school aid formulae.** While the state has consolidated funding streams around at-risk formulas, the combination of formulas to accomplish specific goals could increase efficiency.
- **Improve economic development performance (GPAC).** The Commission recommends that regional partnerships, state regional offices and economic development nonprofits should work together in a more efficient manner. The General Assembly has authorized UNC-CH's Kenan-Flagler Business School to recommend a performance-based funding mechanism to support this purpose.
- **Avoid education program duplication.** The General Assembly required community colleges within close proximity of each other to avoid program duplication. The Commission endorses this recommendation and supports its use by the University as well.
- **Explore community college consolidation.** The Commission recognizes that there may be significant savings achieved through the consolidation of administrative functions at the 58 community colleges. A move to a multicampus structure with centralized oversight is appropriate.
- **Reduce education administrative costs.** The General Assembly required the State Board to study whether local education agencies can coordinate central office functions and operations across school districts. The Commission endorses this recommendation and supports its use by the community college system as well. The Commission also endorses the concept of funding a maximum of one administrative support structure per county regardless of the number of local education agencies. Further, the Commission recommends that

regional consolidation across county lines be incented through allowing local agencies to retain a share of the savings from such a move.

4. Focus on Core Mission

Over time, many programs that provide valuable services have been added to state government. Last year, Governor Easley required his Cabinet to provide recommendations to reduce their budgets by up to 11 percent by focusing on the core mission of the agency. The Commission supports this move and notes that it will require discipline to continue to do this task.

The Commission recommends the following:

- **Eliminate or transfer the advocacy functions located in the Department of Administration (GPAC).** The Department of Administration should function as the general services provider for state agencies and departments. Over time, a number of advocacy functions have located in the Department for various reasons. Some of these functions may be appropriate for government to provide and, if so, then they should be transferred. Others should be provided by the private or nonprofit advocacy sector.

Capital Management

The state has had virtually no capital budget in the past few years. The efficient management of assets will be imperative.

- **Sell the Blount Street properties.** These assets will meet with high demand from the private sector and will restore valuable real estate for local tax rolls.
- **Improve aircraft operations.** The Subcommittee has helped organize the state's pilots to make several recommendations that will result in substantial efficiencies and improve safety. Many of the state's 67 aircraft are for specialized purposes, such as law enforcement and firefighting. The Commission recommends that further study of aircraft for centralization and consolidation to reduce assets be done.

- **Implement performance contracting.** This crucial piece of the Utility Savings Initiative was approved by the General Assembly. The Department of Administration should take the leadership role of prioritizing projects to maximize General Fund savings.
- **Explore the use of tax-advantaged leasing.** Several cities have leased their properties to private interests that can take advantage of depreciation on their tax returns (public entities cannot). North Carolina may want to consider such a move.
- **Use more efficient facilities to save program costs.** The state has successfully used certificates of participation to finance three cost-effective prisons that will be less expensive to operate and were constructed in a timely manner. The state should use similar tools for facilities that will reduce overall operating costs, such as additional prisons and mental health institutions.
- **Monitor, manage and reduce energy costs.** The State Energy Office has identified nearly \$700,000 in savings from reviewing electricity rates. Monitoring, managing and reducing energy costs should be a core mission of the fiscal and facilities management sections of every agency.
- **Centralize office space.** The General Assembly has required the State Property Office to identify regional offices and develop a plan to consolidate them in each region. The Commission endorses this recommendation and recommends the involvement of the State Budget Office in the process.
- **Close regional offices.** The Department of Revenue should consolidate regional offices and provide services more effectively through a taxpayer assistance call center equipped with modern technology. The Commission supports this restructuring in the Department of Revenue.
- **Update transportation priorities.** The Department of Transportation has fashioned proposals to reprioritize and accelerate crucial transportation projects through the issuance of bonds already authorized by the voters. The Commission endorses this concept.

Systemic Change Recommendations

The Commission has noted that the work of previous commissions has tended to be ignored when the economy recovers and the immediate fiscal crisis passes. Several steps should be taken in addition to those listed above to avoid that process.

- **Analyze the current organization of state government.** The Commission believes that a comprehensive examination of the executive branch is in order to examine the core services and best structure to provide these services. The organization of other state governments should be studied for best practices.
- **Reduce the scope, size and numbers of boards and commissions.** The state has several dozen boards and commissions, some with significant budget, fee-raising authority and rulemaking authority. Often, these public entities are not part of the budget debate because most of them are supported by funding streams other than the General Fund. The Commission recommends that all boards and commissions:
 - Establish a sunset to ensure that the need for their function is examined periodically.
 - Reduce the number of members and meetings
 - Eliminate or reduce the regulatory burden that they place on state agencies. Regulatory commissions merit special consideration for elimination or consolidation.
 - Submit their budgets in a uniform manner to the State Budget Office and the Legislative Fiscal Research Division.

The State Budget Office is currently conducting an analysis of these issues.

- **Evaluate span of control.** While significant progress has been made in reducing span of control issues, the state can still improve efficiencies. The State Budget Office shall identify agencies with low span of control ratios in administrative functions and shall make recommendations for appropriate changes. The Commission notes that the span of control for most private sector entities is far greater than the span in most state agencies.

The Office of State Personnel has created a function within its primary personnel system (PMIS) to allow agency analysis of spans of control and management

layers. To be effective, all state employee records would have to be in PMIS, including university employees.

- **Use zero-based budgeting.** The state's budgetmaking, like those of most entities, is incremental in nature. A periodic review of the entire operation to ascertain the most important priorities in current times should be required. This undertaking is massive if performed all at once. Agencies should plan on ways to accomplish this task over a four-year period. The Commission recommends that this approach be instituted beginning with the 2003-05 biennium.

Zero-based budgeting should require agencies to identify their core activities and priorities, the cost of providing those activities and meeting those priorities, and describing the implications for eliminating other activities and the costs of those activities.

- **Renew budget flexibility.** The General Assembly authorized agencies and departments to transfer monies between personnel and nonpersonnel line items in order to maintain the level of services given reduced resources for the 2002-03 fiscal year. This provision should be made permanent.
- **Establish incentives to control costs.** Agencies and departments that manage their finances conservatively do not have any incentives to do so. The University system can currently retain its unused appropriations (called "reversions"). Agencies and departments should be allowed to use a portion of their reversions to fund important initiatives through reprogramming dollars. Many local governments have adopted such a system. The Processes of Government subcommittee recommended the possibility of dividing remaining information technology dollars between agency and enterprise information technology initiatives.
- **Mandate follow-up to these recommendations.** The Commission strongly recommends that the State Budget Office require agencies and departments affected by the Commission's recommendations to respond with an implementation plan within 120 days. If such compliance is not possible, then the agency shall describe why this is so. The State Budget Office should widely disseminate these results and shall report biannually on the implementation of these action steps.

- **Establish entities to follow up on the recommendations.** The Commission recommends that appropriate follow-up steps may include the creation of a permanent independent entity to recommend efficiency changes in a manner similar to the federal Base Closing Commission, creation of a panel to identify candidates for privatization through state government and use of management consultants to identify other savings recommendations.

CONCLUSION

After three years of budget shortfalls, quick and easy answers to the state's budget problems have long been exhausted. Given the forecast for ongoing budget problems, the Commission believes that the above recommendations will result in a better state government in North Carolina for years to come.