

SOUTH CAROLINA DEPARTMENT OF REVENUE
OUTSOURCE OR CONTINUE IN – HOUSE PROCESSING

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For Certified Public Management Program

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STATE DOCUMENTS

Introduction

The mission of the South Carolina Department of Revenue is to “administer the revenue and regulatory laws of this state in a manner deserving the highest degree of public confidence in our integrity, effectiveness and fairness. To accomplish its mission, South Carolina Department of Revenue will continuously evaluate and implement innovative technology to improve the quality and speed of service delivery while minimizing cost. Since 1994, South Carolina Department of Revenue has seen a dramatic increase in its technological initiatives by allowing returns to be electronically filed. Currently, 55% of the returns filed are electronic returns. However, paper returns continue to require large numbers of temporary staff and demand significant full time resources for several months, (January through June) of the filing season.

Because state funds are limited, South Carolina continues to explore alternatives to processing paper documents. There is a critical need to review our current paper return requirements, processes, and cost to process a batch of individual income tax refund returns. I will compare the total cost for the current process to the cost of outsourcing the process. The “Process” is defined as all activities and resources required to process the income refunds from picking up the mail from the post office until it is stored in the file room. The process also includes the cost to process applications for temporary employees. These temporary personnel added during the processing season impacts the entire agency. The process will be examined to determine it’s costs and compare that cost to outsourcing the processes.

Collection of Activity and Financial Information

To determine the cost of the tax process and outsource options, financial and activity information were gathered from the Mail Center, Revenue Processing, Income Tax, Processing, Data Entry, Data Control and Central Records. For individual Income tax year 2007, we processed a total of 2.6 million individual income tax returns. Of the 2.6 million returns, we processed approximately 1 million through our heads down data entry processing and approximately 1.4 million was filed electronically. In 2008 we were in the top 10 in the country in Electronic Filing per Federal Taxation Administration. Of the paper returns, we processed approximately 384,000 short forms (SC1040A) and 689,000 long forms (SC1040) refund returns. Our processing times through the first of June were as follows:

Return Type Tax Year 2007 As of 06-06

Short Refunds	17.5 days
Long Refunds	16.57 days

These times are from receipt of return to refund check issued. The times are from a sample of returns pulled each day. We gather this data from the end of January through the first of June. The April processing time is higher due to the sheer volume of returns received.

Operational Definitions

Application Processing- The activity of collecting employment application, conducting interviews, checking for income tax filing and doing criminal background checks.

Mail Center- The activity of picking up the mail, opening, sorting and extracting the mail, and delivering the mail to the various sections.

Revenue Processing- The activity of verifying the returns and payments for all required data pieces, assigning document locator number(s) to returns and payments and batching documents for Data Entry.

Income Tax Processing- The activity of reviewing the income tax return, verifying credits and payments and assigning a document locator number.

Data Entry- The activity of keying and verifying tax data, and transmitting information to the mainframe computer system.

Data Control- The activity of separating checks and documents, endorsing checks and depositing funds into the bank.

Central Records- The activity of picking up the tax records from Data Control and filing the paper documents for storage.

Develop a General Flow Chart- During the fiscal year 2007-2008, a study of DOR's tax processing systems was conducted. A product of that study was a detail process analysis that outlines the flow of work. The analysis was compared to the interviews I conducted.

Adjustments were made to reflect changes in DOR processes. A general Tax Process flow chart was developed. Exhibit #1 is the general flow chart developed.

Interview Section Supervisors- Interviews of supervisors were conducted to determine current staffing, work flow, and documentation of processes. Exhibit #2 is a copy of the interview questions.

Collection of an Outsource Vendor Cost Information- Outsourcing is defined as contracting with a private-sector firm to take responsibility for a function or process for which the

government remains accountable. All the DOR positions associated with Tax Process were identified along with hourly pay rate for each job. The hourly pay rate includes the state benefits package. These DOR positions were compared to similar positions with the vendors (Again the financial information is dated and being used, due to no current data was available.). Exhibit #3 has the comparison of DOR employee cost compared to similar position with an outsource vendor. The outsource vendor rate has a 40% markup.

Collection of the Agency's Financial Data for Fiscal Year 2002-2003 – The financial data is outdated, but is being used for this report solely, because no updated data was available at the time of this report. DOR conducted a budget review. Under the direction of the agency's Administrator for financial management, John Taylor, CPA, a Zero Base Budgeting (ZBB) process had started. All expenditures were identified by divisions. Detail financial information within each division, by sections, was available. I utilized the Excel database spreadsheet to collect all the financial information for the Mail Center, Income Tax Processing, Revenue Processing, Data Entry, Data Control and Central Record sections. Exhibit #4.

Data Analysis and Interpretation

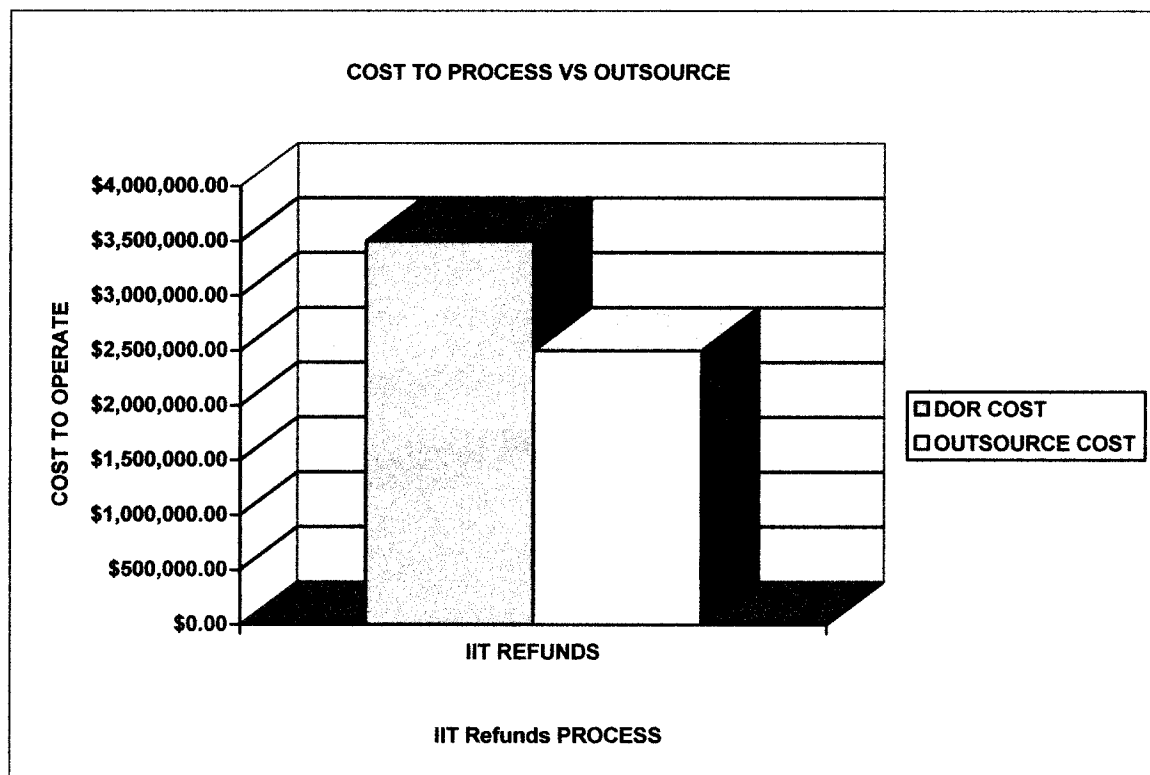
The process to compile the data in Exhibits 3 and 4 required several assumptions. The following assumptions were made:

- The process to be considered for outsourcing is the paper process. The electronic process is not a part of the analysis;
- A work day is composed of 7.50 hours;
- The PC, software, computer mainframe and space costs provided in the DOR's ZBB excel spread sheet represent yearly costs;
- The vendor will hire own employees, and conduct it's own income and criminal background checks of employees; and
- Training will be done by the outsource vendor staff.

Exhibit # 4 has been summarized in Exhibit 3. Clearly, the cost to outsource is less than the current cost DOR is incurring to process the income refunds. To outsource the tax process for ITT refunds would save our agency approximately: \$ 1,080,387 (based on the '03 data).

There would be great savings in the IIT refund process if we were using this data today. However, a closer review of the notes from the supervisor's interviews identifies one area that is difficult to determine and that is the total cost of knowledge. One reason for the gap in DOR and the outsource vendor costs can be attributable to training cost. The DOR man hours required to train, the training manuals, supplies and the knowledge level of the outsource vendor's staff are factors that would consume a significant portion of the savings. Before any decision is made to move forward, considerable cost analysis would need to be made.

Chart 1



Implementation and Evaluation

To implement an outsource operation, the following “best practices” have been followed:

- Transition/ Implementation Teams³;
- Stakeholder buy – in;
- Balanced score card;
- Partnership charter. Focus on teamwork or partnership approach.¹;
- Innovation; and
- Develop a performance based pricing structure.²

DOR should develop a transition team to include the following: Contract manager, Human Resources, Key Department Management, Information Systems, Legal, Finance.

DOR will have to do many things to prepare for this change. DOR would need to know the responsibilities for the IT staff for the transition and after the transition and would have to give the vendor’s responsibilities for transition as well. It will be very important to know the role end users would have in the beginning and after transition, as well as the actions that need to take place to transfer knowledge, to the vendor. DOR will need to be very clear about the lines of communication between the vendor and the agency. For example, DOR needs to know when the error reporting will be scheduled for the agency viewing. What are the specific tasks that need to be done?

Tasks would needed to be set with priority established for each one and a time frame for the transition, and where the milestones in each time line should fall. DOR would have to determine what assets and licenses will need to be acquired. This information will be helpful with the change.

Recommendations

I think outsourcing is the best solution because it will let DOR process current year refunds within 10 days of receipt versus 14 days. It would also reduce or eliminate processing related errors (keying/transposition errors/data keyed on wrong). I think one of the biggest benefits would be the ability to tell the taxpayer that the return has been received, in today's world we cannot tell them the return has been received until it hits the IIT system. Outsourcing will allow immediate access to returns for working errors and eliminates the need to pull paper copies for errors. Savings in time and resources in Records staff is another reason why I think this would be the best solution.

Outsource the Process over a Three Year Period.

- | | |
|--------------|---|
| Year 1 | Partnership agreements developed with Outsource vendor to document the processes for all sections. Each section should work with vendor to outline a step-by-step operational manual. |
| Year 2 and 3 | Outsource the Mail Center, Scanner and the Income Tax processing activities for IIT refunds Part in processing the IIT refunds |

Develop and Conduct an Evaluation

An annual evaluation of vendor's performance should be made. Develop a scoring card, a list of expectations with success criteria, in year one that will objectively determine performance. Identify success criteria for each performance requirements. The success criteria categories will be: quality of reliability services, responsiveness and knowledgeable and accurate answers to questions asked of vendor staff.

Obstacles and Methods to Overcome

There are challenges that will need to be addressed with DOR and the outsource vendor that impacts performance and productivity. Issues include:

- Lack of motivation and commitment of vendor employees;
- Absenteeism of vendor employees;
- Income tax clearance and criminal background checks;
- Limited tax knowledge; and
- Hiring of vendor staff to meet DOR requirements and expectations.

Participation of Current DOR Staff

DOR should form teams to assist in the development of outsourcing forms or changes and provide timely information to employees so the objective of outsourcing is kept in focus. To minimize the fear of job loss, all of this should be done by continuing to communicate on a regular basis and having scheduled meetings with all parties from front line workers to upper management. To further reduce the fear of job loss, the entire plan should be shared step by step. A question and answer session would need to be scheduled for all employees involved in the process.

Conclusion

DOR has an opportunity to reduce processing cost through outsourcing. Careful planning and employee involvement are the keys to the success of outsourcing. Development of a knowledge management database from our experienced staff is essential. As state funding continues to decrease, outsourcing will become more of an investment rather than an option.

EXHIBITS

EXHIBIT 1
TAX PROCESSING FLOW Chart

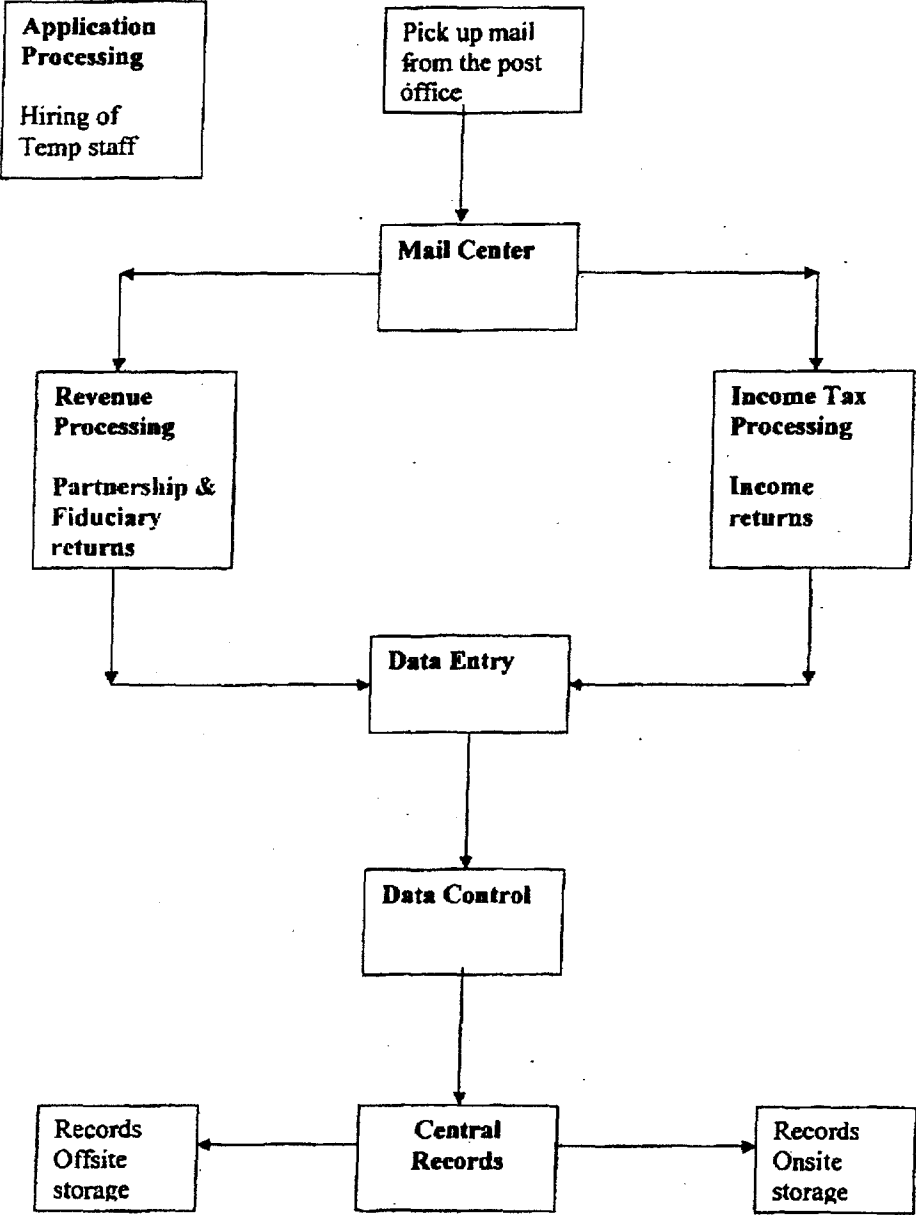


EXHIBIT 2

INTERVIEW QUESTIONS

Management Employee

Staff employee

NAME _____

DATE _____

Purpose of the interview

Define the process

Determine what information is available about the income, partnership and fiduciary processes.

Determine if any outsource work has been done.

Identify all costs associated with the current processes of income, partnership and fiduciary returns.

1. What are some possible causes for the processing delays with income, partnership and fiduciary tax returns?
Income Partnership Fiduciary
2. What are some possible solutions?
3. Are you aware of any work that has been done on the outsourcing issue?
Who? When? Where?
4. Are you aware of any state that has outsourced their process? Who?
5. To your knowledge, who works with the income, partnership or fiduciary tax returns? How much time is spent processing returns? How much time is spent on each return?
Income Partnership Fiduciary
6. As you know it, describe the process from the Mail Center to the Records Section.
For Income tax return
For Fiduciary tax return
For Partnership tax return
7. Are processes documented? Flow chart?

EXHIBIT 3

COST OF LABOR FOR DOR AND OUTSOURCE VENDOR

DOR rate per hour	DOR Positions	Outsource positions	Outsource rate per hour
\$31	Administrative Assistant	Staff Assistant	\$10.85
\$37	Data Control Supervisor	Senior Accounting Clerk	\$16.10
\$38	Data Coordinator B	Senior Accounting Clerk	\$16.10
\$40	Data Entry Supervisor B	Senior Accounting Clerk	\$16.10
\$23	Data Processing Supervisor	Senior Accounting Clerk	\$16.10
\$27	Data Technician A	Data Entry Operator I	\$10.50
\$36	Tax Examiner D	Data Entry Operator I	\$10.50
\$32	Mail Processing Supervisor	Senior Accounting Clerk	\$16.10
\$26	Postal Clerk A	Casual Labor- Heavy	\$10.15
\$28	Postal Clerk B	Casual Labor-Heavy	\$10.15
\$32	Records Coordinator	Senior Accounting Clerk	\$16.10
\$27	Records technician A	Records Management	\$10.85
\$32	Records technician B	Records Management	\$10.85
\$26	Revenue Processing Supervisor	Senior Accounting Clerk	\$16.10

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1. Outsourcing Journal, June 2003, "Outsourcing-Optimal Outsourcing-When Both Parties Are Reading from the Same Play Book" page 4.
2. Outsourcing Journal, June 2003, "Outsourcing-Optimal Outsourcing-When Both Parties Are Reading from the Same Play Book" page 4.
3. "Impact of Best Practices in Outsourcing Arrangement" by Kathleen Goosy, 2003.
4. "Outsourcing in Government: Pathways to Value", page 1, by Accentor, May 2003.
5. South Carolina Department of Revenue Strategic Plan