




Using Technology to Transform the Business of Achieving Compliance

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Transforming Collections: The Accounts Receivable Collection System (ARCS)

Transformation in Collections

ARCS System Functionality

Performance-Based Procurement and ARCS
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Information Technology Planning and Governance: Gaining an Enterprise Perspective

Rethinking IT Governance
Focus on Enterprise View
Eyes on the Prize—IT Governance is a
Means to Accomplish our Vision



Questions?

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Introduction

In the best tax administration scenario, taxpayers would file timely and accurately and would fully pay, at the time of filing, any outstanding liability. For the most part, I've just described what most taxpayers actually, in fact, do.

Most TP's self-correct

Compliance programs focus on that relatively small percentage of taxpayers who don't file timely or accurately or pay their liability when due. Of this relatively small percentage of taxpayers most are, what I term self-correcting—that is, they want to fulfill their tax obligations if given the right information, assistance and tools.

Focus on self-correcting

At the Franchise Tax Board, we have decided to focus primarily on these self-correcting taxpayers. We are not ignoring that very small group of taxpayers who are trying to game the system, but we are not designing our compliance programs around them.

42 investigators

Just to emphasize that we are not ignoring them, we have 42 investigators on the staff and at any given point we have approximately 350 cases under felony investigation. But let me return to the primary focus of our compliance efforts.

Partnership w/TP's

We have characterized our relationship with taxpayers as a partnership. Our job is to decrease taxpayer burden and improve service.

IT improves compliance

Taking this view, technology offers opportunities to improve compliance at every step in the tax filing and payment process—from upfront education efforts, to simplified filing, to fair and effective audit processes, to appropriate collection activities, and timely resolution of protests.

Today's Focus

Today, I'm going to focus on the traditional compliance activities—audit, collections, and nonfiler enforcement.

Specifically, I'll be addressing our:

- Accounts Receivable Collection System (ARCS)
- E-government efforts, including e-installment agreement
- Integrated Nonfiler Compliance (INC) System
- Integrated Audit System (IAS)
- Secure Electronic Communications Project

TGC- new perspective

In addition to these new systems and services, we have also taken a step back to reevaluate how we plan for IT, allocate IT resources, and oversee implementation of IT on an enterprise basis.

The result is a new structure that promises a more enterprise view of IT at FTB, a view that aligns with our overall vision of transforming our relationships with our stakeholders, building a strong organization, and fairly and effectively administering California's income taxes.

I. The Accounts Receivable Collection System (ARCS)

1. Transformation in Collections/ARCS

Cultural evolution

The culture and approach of FTB Collections has evolved over several years, triggered by feedback from customers and a dawning recognition that it made better business sense to establish a more collaborative relationship with taxpayers.

Meetings with TP Reps

For example, we regularly meet with the California Society of Enrolled Agents to gain their feedback. This has allowed us to find out what practitioners need from us, what works well, and what needs work. We kept practitioners' feedback in mind as we designed the Accounts Receivable Collection System or ARCS.

ARCS-Tailored to TP's

ARCS allows FTB to tailor collection action to the individual taxpayer. Since most taxpayers are self-correcting, we do not want to be overly heavy-handed or intrusive in our collection strategies. However, we want to collect the debt in a quick and efficient manner.

STRATA

2. Functionality (STRATA)

ARCS is built on technology (STRATA) that allows us to respond on a case-by-case basis, customized to individual taxpayer needs. Strata is decision analytics software that models taxpayers based on their past behavior.

STRATA differentiates between taxpayers

Using STRATA, ARCS can differentiate between different types of taxpayers and automatically take the best actions based on the business rules that we have established. Otherwise compliant taxpayers are given more notices and time to correct a debt. Taxpayers with a history of noncompliance receive quicker and firmer collection activity.

STRATA-assesses risk

ARCS uses risk and yield to make intelligent business decisions to continually improve the performance of collections strategies. The STRATA software models taxpayer behavior and arrives at a risk score, which uses debtor and account characteristics to predict the likelihood of payment. This allows FTB to use the right resource to work the right account and take the right action at the right time.

3. Performance Based Procurement and ARCS Benefits

Perf. Based Procurement benefits

We developed ARCS and several other large systems at the FTB by pioneering an alternative funding method, called performance-based procurement. Performance based procurement has many benefits.

First, the vendor assumes the up-front cost of development and is paid only after the system begins to produce benefits. This approach reduces the risk to the state in building a large system and increases the vendor's interest in building a system that works well. Importantly in these tough budget times, it also allows us to proceed with the systems we need for the future with less up front investment.

**ARCS-
\$338
million**

ARCS has proven extremely successful. It has resulted in \$338 million in additional revenue from July 1998 to April 2002.

**Systems
are a first
step**

4. Culture Change

Bringing up new automated systems was an important first step in giving us the tools to change how we interact with our customers. Equally important has been new policies and attitudes to complement our system capabilities.

**More \$\$\$,
happier
TP's**

Our change in philosophy has paid great dividends, which extend far beyond revenue. We now collect more revenue with less intrusion and headache for our employees and taxpayers. Additionally, we now get a lot of compliments from our customers.

**Example-
Practitioner
Liaison
Group**

Probably the best example of the great customer service treatment we give is one from our practitioner liaison group. Practitioners asked for better service and we gave it to them. We gave them a dedicated fax line available only to practitioners. Practitioners are promised turnaround in under 24 hours, and most cases are resolved within a few hours.

**Fast
Response**

In one case, we called the practitioner with the answer before he got back from his fax machine! That is a record response, but it is a good example of our philosophy. When we answer the questions of taxpayers and their representatives quickly and efficiently, and treat them as partners, it helps people to resolve their tax problems, which makes good business sense.

**OIC, IA
available**

If the amount taxpayers owe is much greater than the likelihood that they will ever be able to fully repay, they can request an Offer In Compromise. If taxpayers can't pay their entire balance due at one time, they can set up an Installment Agreement.

**IA more
user
friendly**

Using stakeholder feedback, FTB has worked to make the terms of its installment agreement program more user friendly for taxpayers. It is now much easier for taxpayers who want to pay their outstanding tax debt to enter installment agreements.

**A revenue
up, defaults
down**

In exchange for this simpler process, we require that taxpayers pay their installments using electronic funds transfer (EFT). As a result of these changes, revenues from installment agreements are up and defaults are down significantly. Prior to these changes, the program had a default rate of over 40%. In 2001, the overall default rate was under 5% with the default rate for EFT installment agreements under 2.5%.

**Compliments
in our
attitude**

As a result of the changes we made to our installment agreement program and our attitude toward delinquent taxpayers, people often remark how shocked they are at the customer service they receive in our installment agreement program, and we frequently get compliments on our employees' attitudes.

II. e-Installment Agreements

**e-gov-
power to
the people!**

E-government is both the driver and the enabler of some of the transformation that is occurring at the FTB, because it gives us the opportunity to take some of our information and processes and put them directly into the hands of taxpayers.

**IA to go on
line**

In the case of installment agreements, we will soon be putting an application online that will enable taxpayers to set the terms of their own installment agreements—including the amount and duration of payments—subject to guidelines established by the FTB.

**e-IA helps
FTB-TP
partnership**

This type of empowerment increases taxpayers' stake in the arrangement and reduces the amount of human intervention required by FTB. Our e-installment program will be another step forward in becoming partners with taxpayers to resolve their tax issues.

III. The INC Project

1. INC Overview:

**Won FTA
award last
year**

As you may remember, our Integrated Nonfiler Compliance (INC) Project was the subject of a presentation last year as the winner of FTA's Compliance Award. The INC Project is the major rewrite of the FTB's nonfiler identification, case management, and decision support systems.

**Rectal R.
Colon**

Here's an example of why we needed the new system: The old system had to determine whether income was from a business or an individual. We made a mistake and a business name was entered into the individual tax system, and a notice was sent to Rectal R. Colon. The taxpayer replied very sarcastically telling us to get our records straight!

**NC
functionality**

Let me just provide you with a brief summary of INC's functionality and an update on some of the improvements we are making to the system.

**NC
innovative
use of data**

Unlike the more typical approach of simply identifying "stop filers," the INC program aggressively uses income or activity data to identify nonfilers who have a potential filing requirement. The innovative use of data is one of the strengths of the project. More than 220 million income information records from a variety of sources are gathered and processed to achieve compliance from nonfilers.

**Data
Sources**

Sources used in the program include: IRS; wage information; sales tax information; Form 1099 information returns; Form K-1 partnership returns; real property sales; Form 1098 mortgage interest and occupation licensing information.

Identifying nonfilers

The income records are cleansed using a sophisticated data-cleansing tool, thus helping us avoid erroneous contacts to taxpayers. Once the data is associated to an entity and matched against filed returns, the nonfilers are identified. A sophisticated case management system creates cases, calculates the potential tax liability, chooses the best cases to pursue, places questionable cases in a review status, as well as interfacing with other systems to determine when a tax return is received.

Notices, timeframes

The case management system also monitors the nonfiler cases and first sends a request to file the required return. Failure to respond to the request results in the issuance of a Notice of Proposed Assessment. The nonfiler is given sixty days to file a return; protest the assessment; or provide proof that a return is not required. The assessment becomes due and payable on the sixty-first day.

Notice redesign, tailored to TP

FTB nonfiler notices have undergone a complete redesign as part of the INC Project. With input from the state of New York's redesign effort, an INC focus group and a nonfiler survey were used to make sure the needs of nonfilers were met. The notices have been redesigned from a "one size fits all" approach to one tailored to what the customers need to be able to file based on their past filing history. For example:

- The notice a first-time nonfiler receives acknowledges the taxpayer's prior filings and contains text with a "softer" tone.
- If the taxpayer sold real property, the notice includes information on how to compute the gain/loss from the sale of the property.

Better, faster TP response to notices

Part of the notice redesign effort has shown that taxpayers respond more quickly and more often to the use of color and graphics that are now part of the new FTB nonfiler notices.

FTB studies show that taxpayers reply to the new notices three days quicker and 7% more often than the prior versions of the letters. Due to concerns about taxpayers' rights, the notices clearly indicate the date a reply is due. A calendar graphic with a highlighted due date is now part of all notices to nonfilers.

Remailing notices

In addition, INC maintains multiple addresses for the taxpayer and notices are automatically re-mailed to the taxpayer if the prior notice is returned to FTB by the post office.

2. INC's Data Warehouse

INC has a tremendous store of data that can be used throughout FTB. INC serves as a warehouse for:

- 160 million pieces of income data
- Income data on 35 million individuals
- Income data on 4 million businesses
- 1 million nonfiler cases

Huge data store

**Decision
Support
tools**

The INC database includes data on filers as well as nonfilers. It stores information in various relational tables, with logical relationships that allow decision support tools to search across multiple tables. In addition to identifying new types of nonfiling entities to be pursued, information in the INC database assists other FTB programs. For example:

- Multiple addresses stored in the INC database assist in determining whether an individual /entity has presence in California, to determine if a residency case should be pursued.
- When reviewing taxpayer income/deductions, information from Licensing Boards provides a good indication of the taxpayer's line of business.
- Collections uses for new levy sources

**Foundation
for new
applications**

In addition, the INC data warehouse and organization of data helps lay the foundation for future new business applications, such as improving audit case selection further, or for return-free filing in the future. I'll be sharing more information about one of these future new business applications in a moment.

3. Self-service Internet Transactions

Again with nonfilers, e-government offers us an opportunity to put taxpayers in the driver's seat in resolving their compliance problems. Once we've contacted a nonfiler, they have the option of logging on to a website to resolve their account or get additional information.

**INC on line:
TPs, resolve
own issues**

For example, taxpayers can:

- Get tax forms and information
- Give themselves an additional 30 days to reply to a notice or file a return
- Tell us they've already filed and our notice had an incorrect SSN on it. In these cases, they will get confirmation no further action is necessary
- Communicate in a secure environment with us regarding why they don't think they have a filing requirement
- Link to information on our installment agreement or credit card payment options if they want to file, but cannot afford to pay
- Request to be reminded via e-mail in the future when a return is due

**TP Resolve
own issues-
continued**

Our vision is for nonfiler cases to be resolved by the taxpayer going to the web and answering a series of questions. Today nonfiler cases are resolved by evaluating data on the INC case plus obtaining answers to a series of questions via a telephone conversation or correspondence from the taxpayer. If the questions can be asked and answered on the web, code can be written to use the answers provided and the data on the INC case to resolve the case.

**More
functions
Fall 2002**

Many cases will be able to be resolved in this manner beginning in late Fall of this year when taxpayers receiving a nonfiler notice will be able to go to our website

and indicate if they do not think they have a filing requirement or are not sure if they need to file.

More self-resolution

The taxpayer will then view one of three sets of questions. Which set will depend on the type of information that resulted in the notice. Based on the answers supplied, the taxpayer will be told that their case has been resolved (no additional action is needed), they do have a filing requirement, or the case needs to be reviewed by FTB staff and a determination will be sent to the taxpayer once the review is completed.

4. Results from INC

Perf-Based Procurement, NC \$\$\$

We also used performance based procurement to implement INC and expect it pay for itself in short order. Prior to INC, we were able to identify 650,000 potential nonfilers. INC enables us to identify an additional 100,000 nonfilers annually. Over the next three years, FTB expects to collect \$346 million annually from filing enforcement, of which \$80 million is due to INC.

Reducing intrusion

What is just as critical, is that the improved targeting of our compliance efforts resulting from INC also helps us to reduce erroneous contacts by 50%--which translates into less intrusion and less burden for law abiding taxpayers.

IV. Integrated Audit System (IAS)

PASS

PASS: modeling, case mgmt, auditor's desktop

Several years ago, we used performance based procurement to implement our Professional Audit Support System (PASS), which brought new information, modeling capabilities, case management tools, and automated functionality to our business entity audits. Among other things PASS provides us with:

- Automated mapping of income relationships among pass-through entities
- Sophisticated audit modeling capabilities at the network, server and desktop levels
- Case management and tracking tools
- Automated correspondence
- Workpaper Standardization: Auditors now have folders and templates to document their work, which provides a common point of reference and direction
- A movable desktop: Auditors now have anytime, anyplace access to their cases and tools in an integrated suite of office tools that includes case assignment and management, correspondence management, tax library, computational programs, spreadsheet and forms preparation, case history, taxpayer information access, and time and production reporting.

PASS-\$122.8 million

PASS has proven to be a very successful system, helping us to bring in an additional \$122.8 million during the four year development and implementation of the project.

The Integrated Audit System (IAS)

Reece's example

Do you remember the old commercial where the kid with the jar of peanut butter runs into the kid with the bar of chocolate and Reece's Peanut Butter Cups are born? Well, when we looked at the functionality that we were able to apply to our business entity audits through PASS and the data warehouse built as part of INC, we had a similar epiphany.

Leveraging NC and modeling

As a result, FTB is moving forward with a concept for a new system that will expand upon the capabilities of the PASS system and leverage INC's huge database to improve the selection of cases, and assist in identifying issues such as abusive tax shelters.

IAS and abusive tax shelters

We expect that IAS will help us combat abusive tax shelters since it will provide flexible "pinpoint" modeling, so that we can look for the particular return characteristics that indicate abusive tax shelters. Modeling efforts can focus on partnerships, LLC's and S-Corporations (PTEs) that:

- Were formed and terminated in the same year
- Had large short-term capital losses
- Designated Investment Activities as their Principal Business Activities (BPAs)
- Had large "total assets" but nominal tangible assets
- Had M-1 and M-2 activity indicating significant differences between tax and book inventory

We will also be able to look for large short-term capital losses or large ordinary losses and we can look for returns where individuals have large gains from sale of businesses but small adjusted gross income (AGI) as result of netting shelter losses against gains.

AS replaces 31 applications

As conceived, IAS would replace 31 separate audit applications. Some of the applications it would replace include: PASS, ASTRA - the current PIT audit modeling system, STARS, the selection system for statutory and single issue audits, CP 2000, which is used for matching IRS and FTB information, the PIT RAR Inventory System, which tracks and manages IRS Revenue Agent Report workloads, and HOH, a selection system for head of household filing status.

Integrated system functions

IAS would replace all of these systems with a single integrated system for modeling, auditing, case management, decision support, and final case resolution. This new system would place all audit activities on the same system whether they concern bank, corporation, pass-through entities or personal income tax audits.

Incorporate data

The new system would incorporate available data from filed tax returns, data services, the Enterprise Data Warehouse built through INC, as well as from state, federal, and other government entities.

Better case selection

This data would make audit case selection more effective and would also help during the audit itself to confirm accuracy of the returns and to identify audit issues. The system would provide pinpoint modeling, to help identify only those taxpayers that should be subject to an audit, thereby minimizing intrusion on compliant taxpayers.

Merge, cleanse data

IAS would provide Audit with the ability to merge its isolated data repositories that contain application specific data and would provide the capability to cleanse, store and model data from a comprehensive data source.

One source of data

INC's data warehouse provides an opportunity for the Integrated Audit System to improve the use of existing data by providing one complete data source from which all audit models can be pulled.

V. Secure Electronic Communication

SEC-fast, secure

Another improvement we are making in Audit is a Secure Electronic Communication Project that will provide a fast, secure communications channel between taxpayers and the FTB. It will help streamline a portion of the audit process both for our auditors and for taxpayers as documents and correspondence could be exchanged in a quick, safe manner, thereby improving audit completion times.

Easier for TP's to respond

The SEC project will make it easier for taxpayers to respond to audit requests and lessen the time it takes to provide information, and speed up refund claims during the audit process. In keeping with our philosophy, the system will be easy to set up and will not require intrusive information to sign up. We expect the service to begin around the beginning of the calendar year.

VI. Information Technology Planning and Governance: Gaining an Enterprise Perspective

Enterprise approach to IT

While we were quite successful in implementing technology projects within individual program areas during the 1990's, we realize the importance of creating and maintaining an enterprise approach to technology planning, resource allocation, and IT implementation as we move forward in the future. If we are to become truly customer-focused, leverage our IT systems and assets, deliver the most fair and effective tax administration, maximize efficiency, and realize the promise of e-government, we must look beyond our individual program areas and make IT investments with an enterprise view.

Streamlined, integrated approach

This realization prompted us to rethink how we plan for and govern IT within the FTB. As a result we have streamlined our IT governance processes, bringing our senior business and IT managers together to form an IT Governance Council to oversee more fully integrated approaches to budgeting, architecture and

standards development, addressing security needs, managing IT assets, and generally aligning our IT activities with our strategic vision.

**Enterprise
IT decisions**

While this IT Governance Council may sound like just another bureaucracy, it's not. Every member of this group has been given responsibility for our overall IT portfolio, so that every IT project or policy must be weighed against our other IT priorities and our overall vision. This group has the authority to pull IT resources out of one part of our organization to redirect them toward an IT project in another part of the organization—something that we have shied away from in the past.

**CIO-ITGC
Chair**

Our new CIO chairs this IT Governance Council and clearly has a primary role in driving out this new model and approach. In addition, he will drive the development of our next long-range technology plan—one that aligns with our overall strategic plan and is supported by our budget planning.

**3-5 years to
complete**

Industry best practices suggest that a change of this magnitude can take between 3 to 5 years to complete. While we are still early in the process of establishing the Council and its supporting structure, we are already seeing favorable results.

**Helps
achieve
our vision**

This is a group that is not afraid to ask the hard questions about how we can use IT to best move us forward as an organization. We realize this process won't be easy, but are hopeful that our new structure will better enable us to reach our vision of focusing on the customer, delivering the best possible business results, and building a strong organization—a vision that we will be able to achieve only if we tackle it at an enterprise level.

Conclusion

**Transform
relationships**

I believe we are entering an exciting new era of using technology to achieve compliance, which offers us an opportunity not just to automate our existing processes, but to transform them—and to transform our relationship with taxpayers.

**New models,
erase
boundaries**

We have opportunities to look at entirely new business models that cut across our organizations and consider the compliance implications of every interaction we have with taxpayers. We can use e-government to erase the boundaries between programs and engage taxpayers as partners in resolving their tax issues. We can bring our information and systems together, tailor compliance efforts, and become less intrusive while becoming more effective.

Win-win

This is the classic win-win—better for us and the state governments that depend upon the revenues we bring in and better for taxpayers. At the California Franchise Tax Board, we look forward to making this transformation a reality.