



# Benefits-Based Contracting: Funding new IT initiatives with little to no budget

Presented by:

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**“No funds? How to have your project and Revenue too!”** *Terry Garber*

# Introductions

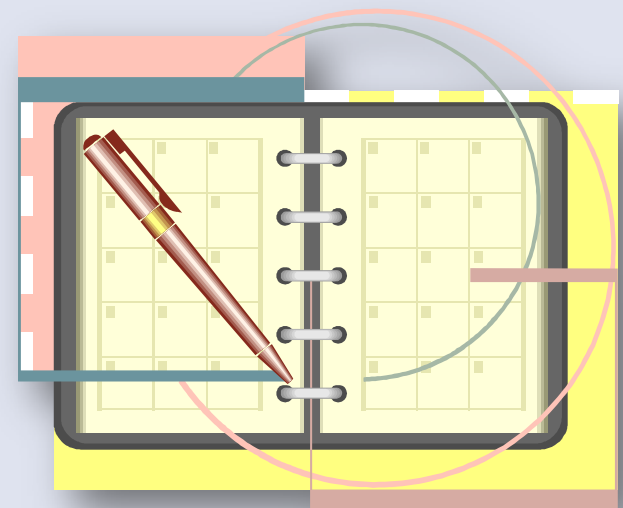


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  - Manager, New Application Development, South Carolina DOR
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- **Brian Ridderbush**
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# Agenda



- The Problem
- The Solution
- Key Issues to Consider
- South Carolina Experience
- Lessons Learned
- SC Legislation
- Final Thoughts
- Additional State Experiences



# The Problem Statement



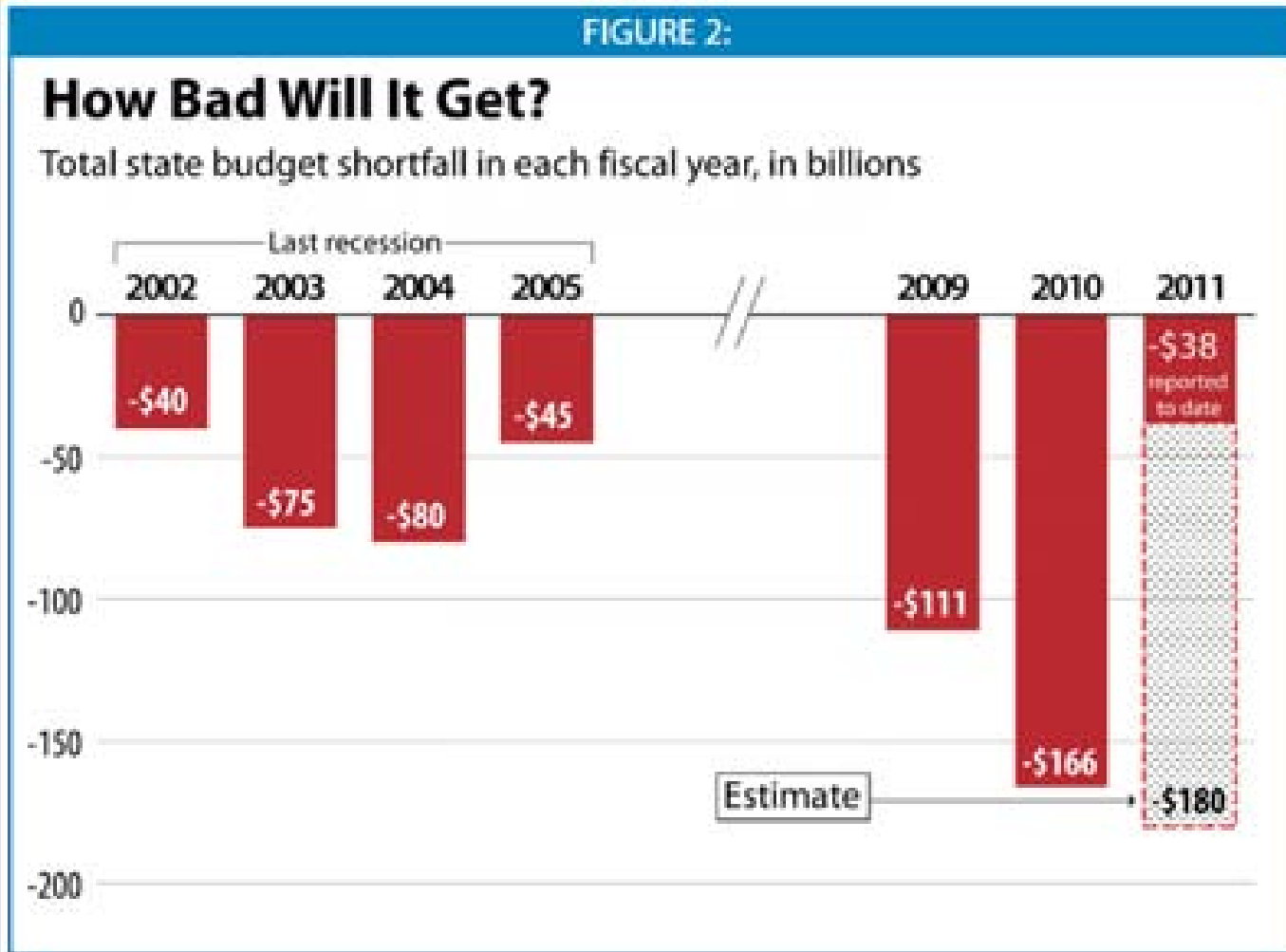
- It takes funding to make funding – IT initiatives can significantly improve compliance and collections for state revenue agencies
- Funding IT initiatives with large capital budgets is difficult to sell – even in a good economy
- A time of financial stress; 48 of 50 states are experiencing budget shortfalls, cuts to current service levels, mandatory furloughs, and performance targets (oh my!). Projections are awful!

# Funding State Programs .. A New Challenge!



Source: Center on Budget and Policy Priorities, June 29, 2009

# Projected State Budget Deficits



Source: Center on Budget and Policy Priorities, June 29, 2009

# Shortfall Shock



- “This year was a tough test for state budget writers. Next year will be a harder one.”  
- Alan Greenblatt, *Governing Magazine*, July 2009.
- “The budget process focused on just the next two years, operating on the assumption that stimulus money is going to continue to be there, when the inconvenient truth is that it’s going to be gone.” –  
*Christian McNeil, Grow Smart Maine*, July 2009
- “All the stimulus did was delay the decision-making for one year on the hope and prayer that the economy is going to turn around...and I don’t think that it’s going to happen.” – *Jay Emler, Chair, Kansas Senate Ways and Means*, July 2009



# The Solution



- State Revenue agencies are in a unique position to generate revenue
- Departments of Revenue can leverage their revenue generating capabilities to fund IT initiatives that can enhance revenue production
- *A performance-based procurement, also known as benefits-based funding, enables a state Department of Revenue to pay for IT projects out of the additional funds collected and directly attributable to the project*



# The Solution



- A performance-based procurement is considered a “win/win” for both the state and the vendor
  - The state only pays for projects that are implemented successfully and show a proven return on investment
  - The vendor is able to win business that would not have been available without the special funding mechanism
    - The vendor only wins if they deliver the promised results
  - Puts “skin in the game” for both parties and creates a true partnership approach



# The Solution



- **Types of performance-based procurements**
  - No Cap: vendor takes a share of all benefits during a specified contract period. Vendor is incented to help drive high results.
  - Capped: vendor has a fixed fee that is paid from benefits.
  - Cost savings: vendor is paid out of the project's cost savings (people, office space, equipment).



# The Solution



- States that have used performance-based procurement successfully for IT projects
  - California
    - EDD, FTB and BOE
  - Hawaii
  - Missouri
  - Kansas
  - South Carolina
  - Virginia
  - Texas
  - New Jersey
  - New York
  
- One of the first performance-based projects was done by FTB nearly 20 years ago



# Issues to Consider



- What type of project best lends itself to performance-based procurement?
  - Projects that provide direct, measurable revenue, such as in Audit and Collections compliance programs
  - Projects that provide “indirect” revenue, such as Integrated Tax Systems
    - Compliance components can “carry” the rest of the program
  - Projects that generate a cost savings (labor, equipment, floor space, maintenance)
    - Examples: EDD Tax re-Engineering and Modernization (TEAM), California DMV



# Issues to Consider



- Most states require special legislation authorizing the Department of Revenue to use performance-based procurement
- Remember to include the ability for the revenue agency to reimburse its own costs outside of vendor payments, such as additional staffing
- Legislation, if needed, should extend beyond the vendor contract period, to provide funding for the program on an ongoing, long term basis



# Issues to Consider



- The vendor has needs that must be considered
  - Vendors will make up-front investments in the project and may not get paid for months after the project start
  - The vendor needs the revenue stream to get started as soon as possible in order to recoup those up-front investments and reduce working capital costs (i.e. internal interest charges)
  - Vendors will structure a project such that there are “early wins” that can start generating revenue as soon as possible after start up



# Issues to Consider



- The development and implementation of the methodology to measure the increased revenue is a project in and of itself (but there are many examples to “borrow” from)
- Identifying initial revenue baselines can be more difficult than one might expect
- The Department of Revenue should be prepared to invest business and IT resources in order to implement the measurement methodology
- Agency Senior Management and Internal Audit must buy into the methodology and certify the benefits each measurement period



# Issues to Consider



- Contracts need to be structured such that there are clear client responsibilities and expectations they will deliver on resource and schedule requirements
- Additional agency-supplied resources such as contact center staff, Collections staff, phone lines, paper and printing likely will be needed
- Project success depends on agency commitment to maximize revenue/benefits
- Competing projects, changes in administration, and budget cut backs can jeopardize success



# Issues to Consider



- Client/Vendor relationship in a performance-based procurement
  - Both parties in this arrangement are dependent on the other in order to meet their objectives:
    - The DOR needs to increase revenue for the State
    - The DOR wants to procure new technology that will enable them to be more efficient and replace outdated technology and processes
    - The vendor needs to recoup the up front investment and make an overall profit on the engagement
  - Due to these dependencies, successful performance-based procurements work best when the parties treat the relationship as a true partnership
    - Neither can succeed in their objectives without the commitment of the other
    - Both parties have to “open the books”



# South Carolina Experience



- In 2003, SC DOR needed revenue to fund initiatives
- In 2004, a revenue projection study was completed and a Request for Proposals issued
- In 2005, the SC DOR implemented a five-year performance-based technology initiative: the Data Warehouse Project to Identify Uncollected Revenues
  - Data Warehouse solution generated the additional revenue to pay the vendor for hardware, software and services
  - The 9 compliance programs implemented focused on individual and business tax discovery (non-filers & under-reporters), audit scoring and collection risk scoring
  - 5 programs were measured

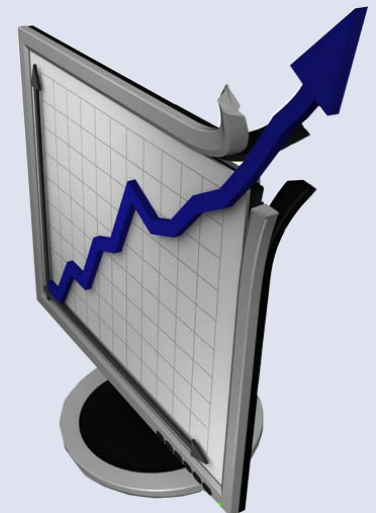


# South Carolina Experience



## ■ Project Results

- Original revenue target: \$98 million over five years
- Actual revenue: \$113 million with three months to go
- Vendor costs: \$20 million
- Direct agency costs: \$10 million
- Net revenue to state: \$83 million
- Increase in voluntary compliance
  - Current project underway to measure
  - It is real!





## ■ Project Results

- DOR has ownership of a strategic asset in the form of an enterprise-wide data warehouse
- DOR is leveraging the data warehouse for compliance and other business intelligence initiatives
- Data in the warehouse is being used to support executive dashboard reporting, taxpayer education initiatives, operational performance measurement and more!
- The warehouse has enabled DOR to be a more data-driven organization than was ever possible before the project

# Lessons Learned



- Do not underestimate the investment of the agency in the project
  - Agency must invest resources in revenue recovery, taxpayer service, and benefits measurement components of the project
- With legislative support, SC DOR also received special funding to augment their compliance staff
  - It is not just technology that provides the return on investment, staff are needed as well
  - Auditors and Collectors have a direct impact on enforced collections



- **Communication of the project to agency staff**
  - There may be a perception at the staff level that the credit for their work is going to the vendor or project, rather than to compliance staff
  - Communication of the project arrangement to agency staff and the “win/win” nature of the project can help reduce some staff resentment
  
- **Communication of the project to senior management**
  - Keep senior management apprised of benefit levels and other “wins” to maintain support
  - Communicate potential issues promptly, such as taxpayer complaints or unexpected expenses



- External Communications are also critical
  - Proactive public communications with “spin” of catching tax cheats helps deflate concerns of “big brother” data gathering
  - Support from Governor and Legislature needed for upfront funding of agency supplied resources – or fund through the program
  - Increased noticing generates receivables! Impact of project on state Receivables to Collections ratio must be communicated to state Treasurer/Comptroller and managed throughout the life of the program



# Lessons Learned



- **Compliance programs cannot run on auto pilot!**
  - Selection criteria and liability calculations must be continuously refined to avoid erroneous notices which can lead to taxpayer complaints and bad press
  
  - Program run speeds and noticing volumes must be continuously managed
    - Maintain acceptable receivables levels
    - Work within agency capacity for processing, printing, postage budgets
    - Work within agency capacity to handle volumes of phone calls and letters from taxpayers



# Legislation Example



## South Carolina Proviso:

“The Department of Revenue is authorized to contract with private industry to establish data mining and data warehousing capabilities within the department, to enhance compliance and collections. Such arrangements may include payment from the increased revenue generated by such capabilities. The department shall be allowed reimbursement of costs associated with administration of this proviso from the data warehouse generated collections. This amount may be retained and expended for budgeted operations.”

# Final Thoughts



- A performance-based procurement is a very effective way to fund agency IT project(s)
- It's nothing to be afraid of. It works; and there are plenty of models out there to help from justification to measurement.
  - Now is the time to move forward; budget planning begins soon!
- Performance-based projects have been quite successful
  - Benefits have reached projected targets and been able to fund the project and provide additional revenue to the state after the project has concluded
- Performance-based procurements require a commitment at the executive management level of the agency
  - The vendor may include language in the proposal that will require certain commitments from management to provide support resources and to change processes and procedures in order to generate the additional revenue
- Vendor and agency must work together to construct a successful project considering strengths and weaknesses of the agency

# Revenue Solutions, Inc.



## Mission Statement

“Assist revenue agencies to maximize collections, increase compliance, improve customer service and streamline operations through the use of enabling technologies, in particular, integrated tax and tax data warehouse solutions”



[www.RevenueSolutionsInc.com](http://www.RevenueSolutionsInc.com)

- Incorporated in May 1996; 200+ projects completed successfully
- Headquartered in Pembroke, MA with Solution Centers in Roseville, CA and Charlotte, NC
- Dedicated exclusively to providing products & services to tax agencies
- Over 220 tax professionals with 800 combined years of revenue systems consulting;
- Deep tax administration domain expertise
- Software Solutions for Integrated Tax and Integrated Compliance Management (Data Warehousing, Audit, Collections, Fraud...)
- Committed to client partnerships in delivery of projects



# Questions and Contact Information



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# Benefits-Funded Projects Case Studies

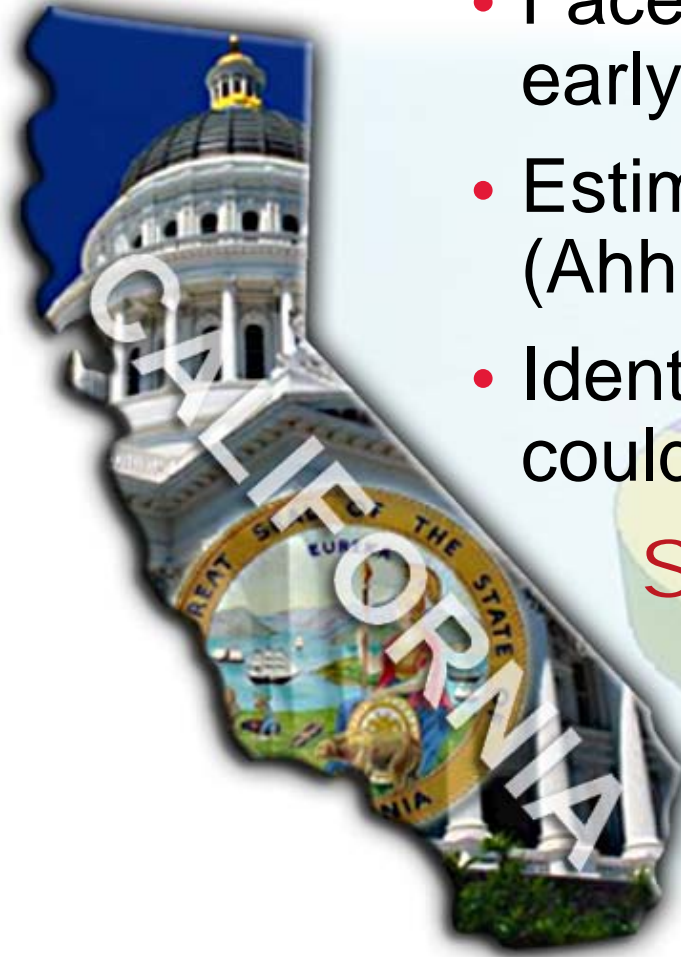
Ted London, Vice President, CGI

August 3, 2009

# Franchise Tax Board Case Study

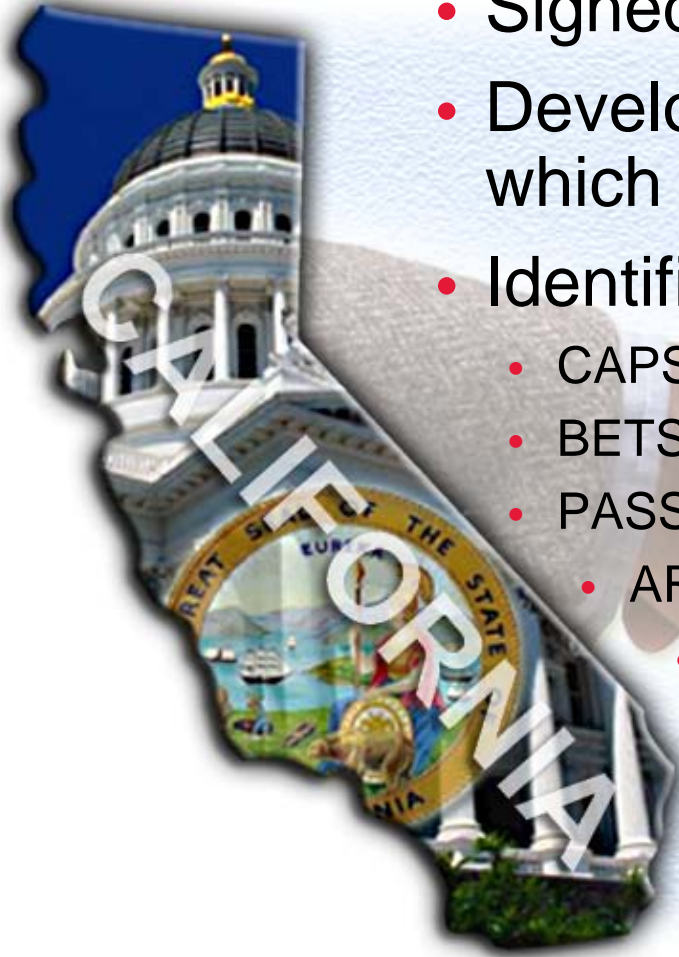
- Faced with significant budget gaps in the early 1990's
- Estimated tax gap of \$2.7 Billion (Ahh...the good old days)
- Identified significant opportunities, but could not get approval to proceed

**Solution:** Look for strategic partners to share the risks and rewards

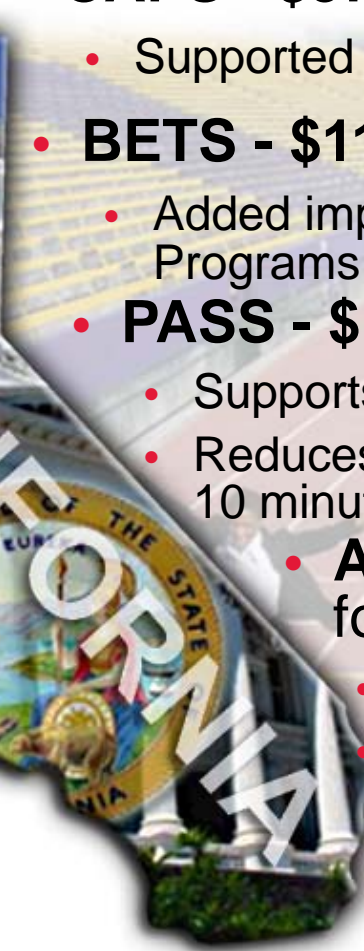


# Benefits-Funding Opportunities

- Signed long-term strategic partners
- Developed a set of partnership principles which vendors were required to sign
- Identified five projects:
  - CAPS: Business Collections and Decision Analytics
  - BETS: Business Tax Accounting System
  - PASS: Audit Data Warehouse
  - ARCS: Personal Collections and Decision Analytics
  - INC: Integrated Nonfiler Compliance Project
- Each procurement allowed for discovery of benefits



# Success Highlights

- 
- **CAPS - \$37 M** in first year, paid for itself in 45 days
    - Supported more than 300 staff
  - **BETS - \$11 M** in new revenue
    - Added important data sources for FTB's Compliance Programs
  - **PASS - \$176 M** in increased revenue for California
    - Supports more than 800 staff
    - Reduces pre-audit data collection from 6 months to 10 minutes
  - **ARCS - \$570 M** in increased revenue for California
    - Supports more than 1,700 staff
    - Utilizes risk models to maximize staff effectiveness
  - **INC - Generates annual revenue increases in excess of \$36 M per year**
    - Transformed FTB's Nonfiler Compliance Program

# Client Case Study

## Virginia Department of Taxation



### Client Situation

- Poor public image – critical state auditor report
- Aging infrastructure
- Lack of efficiency
- Inflexible, obsolete tax administration software tools
- Severe budget constraints

**Unable to support customer-centric vision for revenue and collections management**

### End State Vision and Strategy

- Seven-year program to re-engineer all business processes, applying technology where appropriate
- Integrated end-to-end program strategy:
  - Internet and channel management
  - Budget, financial, revenue mgmt systems
  - Org. design, change management, & training
- Benefits funded through improved collections:
  - Risk/behaviour modelling and development of decision analytics via Strata
  - CACS-G for collections case management

**New customer-centric practices reinforced with next generation technology**

### CGI's Progress For VA To Date

- Over \$231 million in recovered revenues and continue to accrue
- More than 50% of all new businesses register on-line
- \$4.5 billion in payments received on-line
- 96% of refunds issued in 12 days or less (99% of electronic returns)
- 11 national and state awards, incl. FTA, NASCIO, and Governor's Technology Award



# Client Case Study

## Hawaii Department of Taxation



State of Hawaii

Department of Taxation

Our mission is to administer the tax laws for the State of Hawaii in a consistent, uniform, and fair manner.

Hawaii is Open for Business

### Client Situation

- Aging technical infrastructure
- Need to re-engineer DOTAX to achieve the following goals
  - Be more taxpayer-centric
  - Allow taxpayers to more easily comply with tax laws
  - Improve return and payment processing time
  - Treat taxpayers fairly and consistently
- Budget constraints - system must fully pay for itself

### Outcomes

- **ITIMS exceeded all of its expectations** and has dramatically improve tax administration in Hawaii
- **Benefits achieved within 4 months** of project start
- New systems successfully implemented:
  - Tax processing system
  - Collections case management system
  - Audit selection system
  - Imaging of tax returns
- **Reorganised department** to better serve the public
- Original project benefits: **\$252 Million**.
- Subsequent project
  - Enabled by Private Collection Agency statute
  - Benefits: **\$44 Million** over the **first 18 months**

**ITIMS was the most successful large IT project in Hawaii State Government**

# Contact Information

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