

2013

Oregon Department of Revenue

**Presentation to the
Joint Ways and Means
General Government Subcommittee**

Responses to Questions from Committee Members

April 18, 2013



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During testimony, Eric Smith testified that financing costs for the core system replacement project were estimated at \$24.8 million. This was an error. He mistakenly referred to a line on his spreadsheet that reflected estimated principal and interest payments during the first five years of the project. The actual estimated debt financing costs for the project are \$11.2 million. The projections are based on issuing four separate seven-year bonds.

Below is a breakdown of estimated project costs, amount financed, debt cost, and total project cost including debt.

Total estimated project costs	\$76,007,711
Less costs incurred through 6/30/13 (est.)	<u>\$7,728,023</u>
Total estimated remaining project costs	\$68,279,688
Total estimated project costs subject to debt financing	\$55,744,180
Total estimated debt financing interest expense	\$11,173,133
Total estimated project costs including interest expense	\$87,180,844

What has been spent to date on the core systems replacement project? What impact have these expenditures had on agency operations?

Through June 30, 2013, we expect to have spent \$7.7 million on the core systems replacement project. This includes \$2.3 million spent in the 2009–2011 biennium, and expected expenditures of \$5.4 million in the current biennium. The expenditures this biennium included two large components: meeting the Budget Note requirements from the 2011 Legislature, and the procurement process we went through in the current biennium.

We’ve used existing resources to fund the preparation work for the core system replacement project. Legislative reductions of 3.5 percent across the board (\$5.3 million GF), the 6.5 percent reduction to Services and Supplies (\$2.1 million GF), and the project’s initial costs (\$4.9 million) have all been managed by holding positions vacant. We’ve held approximately 120 positions vacant (including about 45–50 for the project) to meet these funding challenges. The project costs represent approximately 40 percent of the total funding gap created by these challenges.

The opportunity costs from the vacancies are outlined below:

- IT vacancies have required focusing on production problem resolution and increased response times for service requests. We've reduced enhancements in security infrastructure, new technologies, and application delivery.
- The Processing Center has an 8-week backlog in business electronic funds transfer (EFT) registrations, which delays businesses from filing payroll taxes electronically instead of by paper. Vacancies in processing personnel cause delays in processing times for tax returns.
- Property Tax Division vacancies have resulted in a lower level of training and assistance to counties, fewer appraisals, and a reduced ability to provide fully developed values on both industrial property and centrally assessed properties.
- The Personal Tax and Compliance (PTAC) Division streamlined many of its workflow processes and implemented new technologies to help meet current revenue goals. Vacancies have forced the agency to narrow the scope of work in both collections and audit.
- Business Division vacancies resulted in delays of suspended cases being resolved and calls being returned in the account resolution area. In the Business Compliance Investigation Unit, we've identified fewer underreported wages and conducted fewer offsite investigations. Vacancies have resulted in fewer accounts worked and less money collected.

What's the return on investment over 10 years?

To supplement the most recent version of our *Core System Replacement Business Case Analysis* updated August 15, 2012, we added an *Addendum to Core System Replacement Business Case Analysis* published January 31, 2013. Included in the addendum is a total cost of ownership (TCO)/net benefit 10-year comparative analysis.

The TCO/net benefit chart on page 8 of the Addendum (also on page 5 of this document) compares five alternatives:

- Continuing operations with Revenue's legacy systems:
 - Current operations (maintains our legacy systems as they are, with incremental improvements occurring over time).
 - Remodel (remodels our legacy systems to seek the functionality found in modern tax administration systems).
- Replacing core systems with FAST's GenTax COTS solution comparing three funding methods:
 - Direct appropriation (funds the project through a direct appropriation from the legislature).
 - Debt financing funding (funds the project through a commonly recognized financing vehicle).
 - Specified receipts, or "benefits based" funding (funds the project from a special fund established and managed by the legislature that receives quarterly deposits based upon performance of certain late payments and enforcement receipts).

If you have questions about material contained within the Business Case or the Addendum, please contact Eric H. Smith, DOR program management office administrator, at eric.h.smith@dor.state.or.us.

Core System Replacement TCO/Net Benefit 10-Year Comparative Analysis

	Net Benefit									
	LEGACY				GENTAX					
	CURRENT OPERATIONS		REMODEL		DIRECT APPROPRIATION ¹		COP FUNDING ¹		SPECIFIED RECEIPTS FUNDING	
Low Estimate Scenario	Increased IT Cost ²	\$ -	Increased IT Cost ²	\$ (6.0)	Increased IT Cost ²	\$ (36.2)	Increased IT Cost ²	\$ (36.2)	Increased IT Cost ²	\$ (36.2)
	Project Cost	(7.7)	Project Cost	(98.0)	Project Cost	\$ (69.9)	Project Cost	(80.6)	Project Cost	(69.2)
	TCO	(7.7)	TCO	(103.9)	TCO	\$ (106.1)	TCO	(116.9)	TCO	(105.4)
	(Opportunity Cost)³	(42.6)	Benefit³	33.9	Benefit³	\$ 60.9	Benefit³	60.9	Benefit³	60.9
	Net Benefit	\$ (50.3)	Net Benefit	\$ (70.1)	Net Benefit	\$ (45.3)	Net Benefit	\$ (56.0)	Net Benefit	\$ (44.6)
Medium Estimate Scenario	Increased IT Cost ²	\$ -	Increased IT Cost ²	\$ (6.0)	Increased IT Cost ²	\$ (36.2)	Increased IT Cost ²	\$ (36.2)	Increased IT Cost ²	\$ (36.2)
	Project Cost	(7.7)	Project Cost	(98.0)	Project Cost	\$ (69.9)	Project Cost	(79.8)	Project Cost	(69.2)
	TCO	(7.7)	TCO	(103.9)	TCO	\$ (106.1)	TCO	(116.0)	TCO	(105.4)
	(Opportunity Cost)³	(59.6)	Benefit³	46.5	Benefit³	\$ 85.2	Benefit³	85.2	Benefit³	85.2
	Net Benefit	\$ (67.3)	Net Benefit	\$ (57.4)	Net Benefit	\$ (21.0)	Net Benefit	\$ (30.9)	Net Benefit	(20.3)
High Estimate Scenario	Increased IT Cost ²	\$ -	Increased IT Cost ²	\$ (6.0)	Increased IT Cost ²	\$ (36.2)	Increased IT Cost ²	\$ (36.2)	Increased IT Cost ²	\$ (36.2)
	Project Cost	(7.7)	Project Cost	(98.0)	Project Cost	\$ (69.9)	Project Cost	(75.2)	Project Cost	(69.2)
	TCO	(7.7)	TCO	(103.9)	TCO	\$ (106.1)	TCO	(111.4)	TCO	(105.4)
	(Opportunity Cost)³	(94.3)	Benefit³	68.1	Benefit³	\$ 134.7	Benefit³	134.7	Benefit³	134.7
	Net Benefit	\$ (102.0)	Net Benefit	\$ (35.8)	Net Benefit	\$ 28.6	Net Benefit	\$ 23.3	Net Benefit	\$ 29.3

¹ Opportunity Cost of 1-Year Delay for New Procurement For COP and Direct Appropriation Alternatives			
Low	\$	(1.2)	Low
Medium	\$	(1.8)	Medium
High	\$	(2.8)	High

²Estimated 10-year IT base costs of \$98.3M. Base IT costs are not included in the figures above. Increased IT costs above are in addition to base IT costs.

³These benefit/(opportunity) estimates are developed by DOR and are independent of the estimated \$51.5 million estimate by FAST which is for a 4-year period.

How do we protect against future price gouging on the cost of maintenance and support for a new core system?

Maintenance and support pricing is driven by what the market is willing to bear. The proposed vendor is currently in 16 U.S. states and actively working to increase their market share in state and local jurisdictions. A sharp increase in maintenance and support would have a chilling effect on future sales. Additionally, the current community of customers could react negatively to a significant increase in maintenance and support costs by seeking other solutions to meet their needs.

In order to mitigate maintenance and support costs following the final rollout, the agency has included the first three years of maintenance and support in the contract (contingent upon legislative approval). There are different levels of maintenance and support. The level of support we believe we will need will cost \$2.4 million per year for the three years (starting in 2018 if approved in 2013). Some of the items covered include defect repair, service packs, version upgrades, and the cost of on-site vendor staff to install service packs, install version upgrades, and perform defect evaluation and repair. This price is comparable to what other states pay for the same level of service.

The proposed contract includes the option of including additional vendor personnel to work on enhancements to current operations.

These prices are based on 2012 prices. Parties have agreed that upon execution of the long-term maintenance and support agreement, the prices would be increased based on a specified CPI index.