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Legislative Fiscal Bureau

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April 22, 1999 | Joint Committee on Finance | Paper #831

Integrated Tax System (DOR -- Tax Administration)

[LFB 1999-01 Budget Summary: Page 530, #2]

CURRENT LAW

The Department of Revenue (DOR) has base level funding of $3,420,500 GPR to develop and implement an integrated tax system (ITS).

The integrated tax system involves the use of technology to develop and implement a comprehensive modernization, upgrade and reorganization of the Department's tax administration personnel, activities, processes and systems into functional components.

GOVERNOR

Provide $2,315,500 GPR and $915,000 PR in 1999-00 and $2,280,500 GPR and $950,000 PR in 2000-01 in additional funding to continue implementation of an integrated tax system in DOR. The bill includes an additional $4.78 million in sales and use and corporate income and franchise tax revenues in 2000-01 that would be generated by audits related to implementation of the ITS.

DISCUSSION POINTS

1. The 1997-99 biennial budget (1997 Wisconsin act 27) provided the Department with $1,257,100 GPR in 1997-98 and $203,500 GPR in 1998-99 to contract with a private vendor to develop and implement an integrated tax system. The funding was placed in the Joint Committee on Finance's supplemental appropriation and DOR was required to submit a plan for developing the system before the funding could be released. The Department submitted the plan at the Committee's June, 1998, meeting under s.13.10 and the Committee approved release of $45,000 GPR in 1997-98 and $1,415,600 GPR in 1998-99. In addition, the 1997-99 budget adjustment bill (1997 Wisconsin

Act 237) provided the Department with another $2,000,000 GPR in 1998-99 to implement the ITS.

2. DOR contracted with IBM to develop the ITS master plan and to work with the Department in designing and developing the ITS. However, the contract gives DOR flexibility to contract with other vendors to develop components of the system. The ITS master plan was completed in September 1998.

3. DOR has divided the ITS into the following functional components:

Data Capture. Capturing all submissions received by the Department in a standard electronic form that can be used in tax processing and customer service activities. Submissions include correspondence, returns, payments (paper and electronic) and registration forms. Data collection would include electronic filing, telefiling, scanning, imaging and Internet filing.

Registration. Single centralized registration by all taxpayers regardless of tax type. Capture and maintenance of information such as name, address, related account information and demographic data about each customer across all tax types in one central source.

Taxpayer Accounting. A centralized process that creates and maintains a single integrated account for each taxpayer and generates bills and assessments.

Delinquent Tax. Upgrading and incorporating the delinquent tax collection system into an integrated billing and collection system.

Returns and Payment Processing. Integration and simplification of the workflow of processing tax returns, forms and payments. The process would include receiving returns and form data, verifying their integrity and posting transactions in accounts.

Refunds. A centralized financial system (included with processing and accounting) that would calculate, post and issue refunds.

Financial Accounting. A single automated system that provides disbursements and statistics to internal and external customers for all documents, collections and refunds issued.

Case Management. Administrative support and information needed to manage a tax case throughout the tax process. Case management would provide information on correspondence, status, outcomes of actions, and other information about tax cases.

Audit/Decision Support. Information and processing support for the audit process. Includes data warehousing, high-powered query and analytical tools.

Customer Service. Technology support for the services provided by the Department. The component would the use of technology to improve responses to customer inquiries, redesign and distribute tax forms and to communicate with taxpayers.

There would be several initiatives and pilot projects that would not be specific components of the core computer system but would be related to front-end tax processing and the testing of new technology that, when successfully completed, would be incorporated into the permanent system. These projects would include upgrading and expanding scanning and imaging, a sales tax Internet filing pilot project, a data warehouse pilot project, and tax forms redesign to improve compliance and enhance scanning activities.

The accounting components and refund billing and collections would be developed together because implementation would involve common processes. In addition, all components have been reconfigured in a process model used to structure its implementation.

4. Each component will be developed through the following general activities:

Business Process Reengineering. A project team identifies potential processes that should be included in the component. Includes review of organizational structure and technology.

Requirements Definition. Business rules for the processes are written that eventually become the computer code supporting the automated system.

Design. Computer models of component processes are developed. System performance and integration will be analyzed.

Development. Computer code is written to instruct each system how to function. Also, code is written to support integration.

Test/Implement. Each system or application is tested to determine if it functions properly both separately and as an element of an integrated system. Following successful testing, the system or application will be put into production.

5. DOR intends to implement the ITS in six phases that coincide with state fiscal years. The implementation phases begin with fiscal year 1998-99 and end with fiscal year 2003-04. Each phase includes a number of components, parts of components, special projects and related activities that would be completed within the fiscal year. All of the activities required for each of the phases must be completed to fully implement the ITS within the timeframe specified for the project. DOR can contract for each phase separately based on the performance of the vendor during the previous phase. The Appendix shows the components, projects and related activities by phase.

6. Each component will be developed to include all of the Department's tax systems. However, each tax will be separately incorporated into the ITS components. The first tax merged into the ITS components will be the sales tax, which should be able to operate though the ITS on January 1, 2001. The individual income tax system will be the second tax incorporated and should begin operating as part of the ITS on July 1, 2001.

7. The ITS master plan indicates that the precise scheduling of the implementation of each ITS component can only be determined when the detailed work plan for the next phase is developed during the latter part of the current phase. According to the master plan, the proposed

sequenced implementation of each component during different phases "will require appropriate support and participation by DOR staff and careful management by the selected vendor. Since each component can only be delivered after it has been tested and subsequently accepted by DOR users, DOR and the partnering vendor must constantly review the implementation schedule to be certain that each component is implemented successfully."

8. Project management of the ITS is based on review of several similar large projects conducted by other agencies and is designed to ensure that DOR meets all business requirements on time and within budget. Several project management strategies will be used including: (a) phased implementation to increase control; (b) clear organization of roles and responsibilities; (c) a partnership relationship with vendors; (d) use of management plans; (e) hiring an independent technical lead to prepare for and monitor technical requirements; (f) use of performance-based contracting; (g) establishment of hardware and software standards; and (h) reliance on business standards.

9. DOR has appointed a project manager who is responsible for the progress of the project. An executive steering committee will monitor progress. Frequent oversight meetings are required and the Secretary's Office will be involved in project oversight. Documentation and work breakdown structures are also required. Project teams will be used to develop and implement the ITS. All project planning and control documents are available from DOR.

10. Table 1 shows the estimated costs incurred for implementation of the integrated tax system. The costs are divided between estimated expenditures for contracted services and DOR costs. DOR expenses are expected to be primarily for a technical consultant and InfoTech and related costs. Funding would also be provided for special projects such as the sales tax Internet filing project. Note that no costs are projected to be incurred after 2002-03. However, master lease payments will be made through 2009-10.

TABLE 1

Projected Costs of the Integrated Tax System

	1998-99	1999-00	2000-01	2001-02	2002-03	TOTAL
Contract Costs						
Master Plan	$1,017,500	$0	$0	$0	$0	$1,017,500
Registration	1,065,400	2,776,400	0	0	0	3,841,800
Data Capture	320,000	913,200	0	0	0	1,233,200
Returns	450,000	5,609,100	5,609,100	0	0	11,668,200
Taxpayer Accounting	0	262,500	2,059,600	1,009,600	0	3,331,700
Financial Accounting	108,000	262,500	869,100	0	0	1,239,600
Refunds	0	350,000	2,948,800	2,179,500	0	5,478,300
Audit & Decision Support	0	0	262,500	700,000	0	962,500
Case Management	0	0	1,410,500	3,290,400	0	4,700,900
Delinquent Tax	172,000	0	0	350,000	4,117,400	4,639,400
Customer Service	0	0	350,000	0	1,418,900	1,768,900
Other - IBM	674,600	2,872,500	1,872,500	1,872,500	1,872,500	9,164,600
Internet Sales Tax Pilot	300,000	0	0	0	0	300,000
Data Warehouse Pilot	0	689,500	0	0	0	689,500
Forms Redesign	300,000	0	0	0	0	300,000
Scanning upgrade	1,000,000	0	0	0	0	1,000,000
Subtotal	$5,407,500	$13,735,700	$15,382,100	$9,402,000	$7,408,800	$51,336,100
DOR Costs						
LTE Salaries & Fringe	$0	$87,000	$87,000	$0	$0	$174,000
Supplies & Services	29,600	39,500	42,500	42,500	42,500	196,600
Permanent Property	125,000	125,000	0	0	0	250,000
Consulting	290,000	290,000	290,000	290,000	290,000	1,450,000
Dev. Computing costs	250,000	750,000	1,250,000	1,250,000	1,250,000	4,750,000
Subtotal	$694,600	$1,291,500	$1,669,500	$1,582,500	$1,582,500	$6,820,600
Total Costs	$6,102,100	$15,027,200	$17,051,600	$10,984,500	$8,991,300	$58,156,700

11. The contract costs are based on IBM's costing methodology and the company's tax industry experience. The IBM methodology estimates total hours of work for the basic project activities, such as programming, that would be required to implement each component. The industry average hourly rate of pay was applied to the total hours for each activity. The estimated cost of hardware and software and funding for special projects is also included.

12. Adjustments were made to reflect the contribution of Department assets, such as the existing delinquent tax system. In addition, the estimates assume that the Department of Revenue will provide approximately 25% of the work to implement the ITS project. The costs associated with this work will be funded by internally reallocating resources and are not shown in Table1. During development of the ITS, the Department will incur additional costs for programming and

testing, supporting interfaces among old and new systems, purchasing new software tools, creating client/sever development and test environments, and for developing and testing hardware. DOR has also indicated that it will reallocate existing resources, including any savings resulting from implementation of the ITS, for additional operating, maintenance and technical support costs related to the ITS. The new system is expected to increase computer usage and related InfoTech costs, change the types of maintenance required and require additional technical support staff during development.

13. As noted, the bill would provide $2,315,500 GPR and $915,000 PR in 1999-00 and $2,280,500 GPR and $950,000 PR in additional funding for implementation of the ITS. Table 2 shows base level and total funding, by appropriation, that would provided for ITS for the biennium. The $269,500 PR in base funding for business tax registration is expenditure authority for contract programming to complete the system that would be used to incorporate the business tax registration system into the ITS.

TABLE 2

Funding for Integrated Tax System by Appropriation

Appropriation	Base Funding	AB 133 1999-00	Total 1999-00	AB 133 2000-01	Total 2000-01
GPR					
Integrated Tax System	$3,420,500	$2,315,500	$5,736,000	$2,280,500	$5,701,000
PR					
Administration of Special District Taxes	0	45,000	45,000	30,000	30,000
Business Tax Registration*	269,500	0	269,500	0	269,500
Administration of Local Taxes	0	75,000	75,000	75,000	75,000
Administration of County Sales And Use Tax	0	750,000	750,000	800,000	800,000
Administration of Liquor Tax	0	45,000	45,000	45,000	45,000
Total PR	$269,500	$915,000	$1,184,500	$950,000	$1,219,500
Total Funding	$3,690,000	$3,230,500	$6,920,500	$3,230,500	$6,920,500

*Base level funding for contract programming to complete the business tax registration computer system.

14. Table 3 shows projected expenses and expenditures for the ITS. DOR intends to master lease contractor and hardware/software costs separately for each project phase. Each master lease would extend over a seven-year period. DOR indicates that it would manage the timing of lease commitments, prepayments and other factors to keep current and future cash flow within base funding levels. Based on the Department's projections, the final master lease payment would be made in 2009-10.

TABLE 3

Integrated Tax System Expenses, Expenditures and Budget

	1998-99	1999-00	2000-01	2001-02	2002-03
Expenses					
Contractor Costs	$5,407,500	$13,735,600	$15,382,000	$9,401,900	$7,408,800
DOR Costs	694,600	1,291,500	1,669,500	1,582,500	1,582,500
Total Costs	**$6,102,100**	**$15,027,100**	**$17,051,500**	**$10,984,400**	**$8,991,300**
Amount Master Leased	$2,707,500	$8,718,300	$12,246,900	$8,251,300	$7,408,800
Expenditures					
Master Lease Payments	$21,000	$611,700	$2,115,900	$4,187,400	$5,801,100
Direct Payments	3,394,600	6,308,800	4,804,600	2,733,100	1,582,500
Total Outlays	**$3,415,600**	**$6,920,500**	**$6,920,500**	**$6,920,500**	**$7,383,600**
Budget					
Base Budget	$3,415,600	$3,690,000	$3,690,000	$3,690,000	$3,690,000
Request	0	3,230,500	3,230,500	3,230,500	3,230,500
Total Available	**$3,415,600**	**$6,920,500**	**$6,920,500**	**$6,920,500**	**$6,920,500**

15. The Department was provided $3,420,500 GPR to fund ITS implementation activities in 1998-99. As shown in the Appendix, fiscal year 1998-99 is phase 1.2 of the ITS project. All activities specified for the phase have been contracted and are underway. Phase 1.2 should be completed by August, 1999. Specifically, a project master plan, tax type sequencing plan, delinquent tax system analysis and high level system model have all been completed. In addition, business process reengineering for the Data Capture, Registration and Returns Processing components is being performed, the sales tax Internet filing project is being implemented, and the tax forms and scanning upgrades are in progress. DOR is in the process of developing a plan for Phase 2 and negotiating a contract with IBM.

16. Under the master plan, the Data Capture, Registration and Returns Processing components will be completed in Phase 2. In addition, The Accounting and Case Management components will undergo business process reengineering. Requirements will also be developed for the Accounting component and a data warehouse project will be implemented.

17. Based on the current cost estimates, approval of the Governor's recommendation would provide the Department with funding that would be sufficient implement the ITS by 2004-05. While it appears that project activities are conforming to the master plan, most of the implementation activities will be performed in future years and most project costs have not yet been incurred. In addition, specific plans and contracts for future phases have not been developed. Since the project appears to be progressing in conformance with the master plan and within budget, the Committee could approve the funding provided in the bill for implementing the ITS. However, as

an alternative, the Committee may wish to place the entire amount of funding that would be provided in 2000-01 ($5,701,000 GPR and $1,219,500 PR) in its GPR and PR supplemental appropriations. DOR could be required to submit a report to the Committee, detailing ITS past and proposed expenditures and activities, for approval under s. 13.10 before the funding could be released. This alternative would recognize the inherent uncertainty of cost estimates and implementation schedules in projects of this nature.

18. The bill includes an additional $4.78 million in sales and use and corporate income and franchise taxes that would be generated by audits related to implementation of the ITS. The projection of the amount of additional revenues that could be generated was developed by IBM based on analysis of specific cases where the tax gap caused by taxpayer underreporting could be reduced through the ITS. DOR has estimated that the gap is between $270 and $370 million. The additional revenue in 2000-01 would be primarily generated by using external data in conjunction with ITS records to identify use tax audit candidates and businesses that are not filing or underreporting sales and income and franchise taxes.

19. Assuming that implementation of the ITS would generate additional revenue through related audit activities raises a significant budget issue. The 1997-99 budget provided DOR with 12 additional auditors to conduct corporate income and sales tax audits, and included an additional $700,000 in annual revenues for the activities of each auditor. The Department is required to provide a report on these activities by January 1, 2000. The Act also included additional revenue of $1,000,000 per year for individual income tax audits identified through the use of new computer software. In addition to the anticipated revenues from the ITS, AB 133 includes $448,500 in 1999-00 and $1,894,000 in 2000-01 in corporate income and franchise and sales and use taxes that would be generated by the activities of additional positions in the Department's Nexus Unit and temporary events operator/vendor program (see Issue Paper #832).

The size of the estimated tax gap indicates that there is potential for these positions and activities to generate significant revenues, particularly in the short term. However, over time there is a concern that each of these pursuits will not continue to be as productive as originally estimated. As a result, the Committee may wish to require the Department to prepare a report that estimates the incremental additional revenues that are generated by each of these activities. The report could be due on January 1, 2002.

ALTERNATIVES

1. Approve the Governor's recommendation to provide $2,315,500 GPR and $915,000 PR in 1999-00 and $2,280,500 GPR and $950,000 PR in 2000-01 to continue implementation of an integrated tax system in DOR.

2. Adopt the Governor's recommended funding amounts with a modification to place $5,701,000 GPR and $1,219,500 PR in 2000-01 in the Committee's appropriations. These funds, which represent the total recommended budget for the system in 2000-01 (including base funding),

could be released, under s. 13.10, after the Committee approves a report submitted by DOR that details past and future expenditures for the ITS.

3. Require the Department to prepare a report which identifies the additional revenue generated by enhanced revenue collection measures included in the 1997-99 biennial budget and AB 133 and submit the report to the Joint Committee on finance by January 1, 2002.

4. Maintain current law.

Alternative 4	GPR	PR	TOTAL
1999-01 REVENUE (Change to Bill)	- $4,780,000	$0	- $4,780,000
1999-01 FUNDING (Change to Bill)	- $4,596,000	- $1,865,000	- $6,461,000

Prepared by: Ron Shanovich

MO# Alts. 2+3

2 BURKE	Y	N	A
DECKER	Y	N	A
JAUCH	Y	N	A
MOORE	Y	N	A
SHIBILSKI	Y	N	A
PLACHE	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A
1 GARD	Y	N	A
PORTER	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUBER	Y	N	A
RILEY	Y	N	A

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APPENDIX

Integrated Tax System Component Sequencing

PHASE 1.2 1998-99	PHASE 2 1999-2000	PHASE 3 2000-01
Components Data Capture Registration Returns Processing Accounting **Projects** Internet Filing Scanning Upgrade Work Plan for Phase 2	**Components** Data Capture Registration Returns Processing Accounting Case Management **Projects** Data Warehouse Pilot Forms Redesign Work Plan for Phase 3 **Specific Tax System Focus** Sales and Use Individual Income	**Components** Accounting Case Management Audit Customer Service **Projects** Correspondence Pilot Work Plan for Phase 4 **Specific Tax System Focus** Sales and Use Withholding Individual Income Estate
PHASE 4 2001-02	**PHASE 5 2002-03**	**PHASE 6 2003-04**
Components Delinquent Accounts Case Management Audit/Decision Support **Projects** Work Plan for Phase 5 **Specific Tax System Focus** Sales and Use Individual Income Estate Withholding	**Components** Delinquent Accounts Customer Service **Projects** Work Plan for Phase 6 **Specific Tax System Focus** Sales and Use Individual Income Corporate Income Withholding Estate	**Projects** Merge Miscellaneous Tax Types **Specific Tax System Focus** Sales and Use Corporate Income Utility Property Withholding Individual Income Estate Excise

(Gov) Agency: DOR -- Nexus and Temporary Events Tax Collections

Recommendations:

Gard 3
1
1

Paper # 832: Nexus: Alternative 2 7 Sauch motion /
Temp. Events: Alternative 1
Report: Alternative 1

Comments: The department estimates it can collect an additional $1.3 million in the biennium by beefing up staffing of its Nexus Unit, which hunts down businesses that should, but don't, pay Wisconsin tax.

Fiscal Bureau points to several vacancies that could be filled an shifted to reduce the cost of this initiative. Alts 2 and 3 accomplish this, with 2 appearing to be the simpler path.

Temporary Events: The department suddenly has discovered it hasn't been enforcing temporary events very well, and believes doing so would bring in an extra $1 million over the biennium.

While Fiscal Bureau presents a way to do this by filling unfilled positions, it may be wise to give Revenue new slots to fill here, because the unfilled slots also need to be filled. In the last budget, you will recall, the committee gave them additional auditors. What they need is a fire lit under them to fill all these positions.

Report: This requirement might help light the fire.

Prepared by: Bob

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April 22, 1999 Joint Committee on Finance Paper #832

Nexus and Temporary Events Tax Collections (DOR -- Tax Administration)

[LFB 1999-01 Budget Summary: Page 531, #3]

CURRENT LAW

The Department of Revenue's Nexus Unit consists of 3.0 revenue tax specialist (nexus specialist) positions and 1.0 administrative support position. The primary function of the unit is to discover and investigate individuals, partnerships and corporations that are not registered or filing tax returns in Wisconsin but have business activities in the state that are sufficient to meet a tax filing requirement. The unit attempts to get these entities to register and file tax returns. Funding of $155,800 GPR is provided for the nexus specialist and administrative support positions.

Operators of temporary events are required to report certain information, including the name and seller's permit number, concerning vendors selling at their events. Operators that fail to comply with this requirement within 10 days following the close of the event are subject to a penalty of $200 for the first failure and $500 for each subsequent failure to notify the Department. The information submitted by operators is used to identify and notify vendors that should obtain sellers' permits and to collect state sales taxes. Currently, a 0.25 GPR position is used for this activity.

GOVERNOR

Provide $109,700 GPR in 1999-00 and $113,000 GPR in 2000-01 and 2.5 GPR positions beginning in 1999-00 to: (a) identify and contact nonresident businesses that have activities that establish nexus with the state; and (b) coordinate and conduct projects to identify, register and collect the appropriate state and local taxes from vendors at temporary events. The activities of the additional positions would generate estimated general fund revenues of $448,500 in 1999-00 and $1,894,000 in 2000-01.

DISCUSSION POINTS

Nexus Unit

1. The Nexus Unit was created in 1976 to discover and collect taxes due from out-of-state merchants who were not charging sales or use taxes to their customers and out-of-state corporations that were subject to the state corporate income and franchise tax. Since it was formed, the Nexus Unit has assessed or collected about $64.5 million in sales and use and corporate income and franchise taxes. Registrations or tax returns have been filed by 4,400 out-of-state taxpayers.

2. The bill would provide the Nexus Unit with an additional $66,200 GPR in 1999-00, $66,100 GPR in 2000-01 and 1.5 GPR positions in each year. A revenue agent position would work on unit projects while a 0.50 program assistant position would provide clerical and administrative support.

3. The Nexus Unit conducts the following major projects:

Prospect Reports. Department field auditors and revenue agents provide prospect reports to the unit when they discover possible taxable activities by out-of-state companies during their normal duties.

Reciprocal Information Exchange. Wisconsin has agreements with Iowa, Minnesota, North Dakota and Illinois to share information about companies that file corporate tax returns with each state's nexus program.

Corporate/Withholding Match. The unit matches corporations on the withholding tax roll with the corporate income tax roll to generate a list of non-matching corporations. The unit then determines if listed corporations are required to file Wisconsin returns.

Multistate Tax Commission National Nexus Program Reports. The Multistate Tax Commission provides the unit with reports about prospects that are found through voluntary disclosure agreements and audit reports from other states and through the Commission's own investigations.

Voluntary Proposals. Attorneys and accountants contact the Nexus Unit on behalf of clients who wish to disclose past tax liability, register and file returns and be subject to minimal penalties.

Self-Initiated Prospects. Unit staff review national publications to find specific types of companies that are subjected to test investigations to determine if more thorough investigations should be conducted.

4. The table below shows leads, new filings or registrations, and assessments and collections for the Nexus Unit from fiscal year 1993-94 through fiscal year 1997-98.

TABLE 1

Nexus Unit Activities

	1993-94	1994-95	1995-96	1996-97	1997-98
Solid Leads	618	651	282	719	574
New Filings/Registrations	114	116	175	185	149
Assessments	$3,086,800	$1,810,800	$4,010,300	$3,239,100	$2,943,900

5. The Department indicates that the additional nexus specialist would permit the Nexus Unit to conduct additional project activities to address a substantial workload. The unit has the following backlog: (a) 341 prospect reports have not been reviewed; (b) reciprocal information for 130 companies has not been acted upon; (c) 530 pages of a 1993 corporate/withholding match printout remain to be reviewed; and (d) no new test investigations have been conducted since April 1997.

6. The current administrative position provides support to the Nexus Unit, the Fraud Unit in the Special Investigations Section, and the Alcohol and Tobacco Enforcement Section of the Division of Income, Sale and Excise Tax Administration. The position's administrative responsibilities include maintaining Fraud Unit criminal files, monitoring drug tax assessments and collections, providing assistance to local liquor licensing authorities, ordering forms, acting as designee for payroll and purchasing and performing administrative support activities for the section chiefs. The administrative support provided to the Nexus Unit includes cross checking tax rolls and corporate tax liabilities, entering new case information into a database used for tracking, and maintaining files.

7. Because of the varied responsibilities of the current administrative support position, the nexus specialists also must perform some administrative activities. These activities include: (a) preparing letters for projects; (b) preparing follow-up letters for nonrespondents; (c) closing out cases after returns are filed and taxes are paid; (d) maintaining tax roll microfiche, telephone books and other reference materials; and (e) generating statistical reports. The new 0.5 position would perform these activities and permit the nexus specialist positions to focus on projects.

8. The Nexus Unit is located in the Division of Income, Sales, and Excise Tax (IS&E), which is the largest division in DOR. The Division is comprised of three bureaus and an administrative staff. Organizationally, the Nexus Unit is attached to IS&E administration. IS&E administration is comprised of 94.3 positions of which 48.5 are applications development positions. There are 3.0 program assistant positions which provide administrative support and a program assistant supervisor who conducts certain projects assigned by the division administrator. The program assistant positions include the person who provides support to the Nexus Unit. The two

other positions provide administrative support to the division administrator's office, the technical services section and for applications development.

9. According to the state agency FTE position status report for the pay period ending March 13, 1999, a program assistant position attached to IS&E administration has been vacant for five months. Presumably, some of the administrative responsibilities of this position have been reallocated to other positions. As an alternative to receiving a new position, the vacant one could be filled and a portion of its activities could be allocated to support the Nexus Unit. Consequently, the 0.5 GPR program assistant position and $10,500 GPR in 1999-00 and $13,600 GPR in 2000-01 could be deleted from the bill. However, this could prevent existing positions from completely performing all of their responsibilities.

10. A portion of the funding for the positions provided to the Nexus Unit would be supplies and services funding from the general program operations appropriation of the Division of Administrative Services. The state agency position status report also indicates that a 0.50 GPR program assistant position funded through that appropriation has been vacant for 23 months. As another alternative, the Committee could authorize DOR to transfer that position and related funding to IS&E and use it to provide administrative support to the Nexus Unit. This option would also permit the 0.5 GPR program assistant position and $10,500 GPR in 1999-00 and $13,600 GPR in 2000-01 to be deleted from the bill.

11. Because of the workload faced by the Nexus Unit, the Department is confident the new staff would generate additional revenues. The bill includes $448,500 in 1999-00 and $897,000 in 2000-01 in general fund tax revenue to reflect revenue that would be generated by the new positions.

Temporary Events

1. Since the 1970s, field revenue agents have been attending temporary events, such as craft fairs, that are held in their areas to register vendors for mobile seller's permits and to collect delinquent taxes owed by vendors. In general, this activity has declined over time. In recent years, revenue agent visits have been limited to Summerfest and the State Fair.

2. Under a law change enacted in 1988, operators of temporary events were required to identify and report vendors that were selling at their events to DOR within 10 days following the closing of the event. Penalties for nonreporting were enacted in 1989. However, no penalties have been assessed under these provisions.

3. To administer this requirement, the Department mails informational flyers and vendor response forms to operators of temporary events. Unregistered vendors are supposed to use the response forms to report information about their operations to DOR. The Department checks lists of vendors obtained from operators against other records to identify and pursue vendors that owe state sales taxes.

4. Since 1994, flyers and vendor response forms have only been sent to temporary

event operators that request the forms. Moreover, any information received from operators since 1997 has not been reviewed. The Department indicates that there is significant evidence of noncompliance. For example, a 1997 pilot study of vendor compliance at Irish Fest in Milwaukee found that 30 out of 78 vendors scheduled to appear at the event were not registered to pay sales taxes.

5. The bill would provide 1.0 GPR tax specialist and $43,500 GPR in 1999-00 and $46,900 GPR in 2000-01. The tax specialist would coordinate activities designed to contact unregistered temporary events vendors, review vendor response forms and information, and direct on-site contacts by field agents. The revenue agent would also coordinate publication of information for operators and vendors and provide technical support.

6. The temporary events operator/vendor program is located in the Compliance Bureau. The Bureau is responsible for: collecting all delinquent taxes; registering taxpayers; issuing permits for and administering the sales and use, withholding, motor vehicle fuel and excise taxes; and providing taxpayer assistance. The Compliance and Audit Bureaus are responsible for most of the Division's taxpayer information and assistance activities. The Compliance Bureau has 264.1 positions, including 142.25 revenue agents and 24.9 tax representatives.

7. Initially, two positions were devoted to the operator/vendor program. However, these positions have been reallocated to other activities in the Compliance Bureau. A revenue agent position originally provided for the program is currently in the Inquiry and Technical Assistance Unit. This position provides taxpayer assistance related to business tax registration fees and other new taxes and fees, such as dry cleaning and rental vehicle fees. The person responds to taxpayer inquiries by telephone or through correspondence. The position also administers taxpayer accounts and maintains files.

A revenue tax representative position from the program is located in the Registration Unit. The position is involved in implementing the business tax registration system (BTR) by reconciling information from different tax systems and preparing it for entry into the BTR. The position also responds to taxpayer inquiries, performs file maintenance activities to correct errors in posting fees, and collects payments billed for unpaid fees.

8. The reallocation of the two positions from administering the temporary events operator/vendor program could be viewed as an indication that the Department placed a low priority on the program. If DOR now considers the program important, it could return one of the positions to administer it. The Department has indicated that the workload associated with the business tax registration system performed by the positions is expected to decrease. Consequently, 1.0 GPR tax specialist position and $43,500 GPR in 1999-00 and $46,900 GPR in 2000-01 could be deleted from the bill. However, this would prevent the Department from using the position for an increased workload due to shared registration activities with the Department of Workforce Development (DWD). The position would also contribute to the Department's share of workload related to the implementation of the integrated tax system (ITS).

9. GPR funding for both the Audit and Compliance Bureaus of the IS&E Division is provided through the Division's GPR general program operations appropriation. According to the state agency position status report for the pay period ending on March 13, 1999, 1.0 GPR revenue agent position in the Audit Bureau has been vacant for 14 months. As another alternative, the Committee could authorize the Department to transfer this position and related funding to the Compliance Bureau to administer the temporary events operator/vendor program. Consequently, 1.0 GPR tax revenue agent position and $43,500 GPR in 1999-00 and $46,900 GPR in 2000-01 could be deleted from the bill.

10. The Department believes that, because of significant noncompliance, the activities coordinated and conducted by the new tax specialist position would generate $997,000 in additional sales tax revenue in 2000-01.

Additional Revenue

1. As noted, the bill includes $448,500 in 1999-00 and $1,894,000 in 2000-01 in additional general fund tax revenues that would be generated by the new positions for the Nexus Unit and operator/vendor program. The additional Nexus Unit revenue is the estimated average annual collections for each nexus specialist between 1991 and 1998 (total assessments divided by number of nexus specialists adjusted to reflect the proportion collected). Additional operator/vendor revenue assumes 10,000 new unregistered vendors with one-third filing returns having an average liability of $300. It is anticipated that the nexus specialist could collect a lower level of revenues in 1999-00.

2. Assuming that an additional position in a tax collection activity would generate additional revenue raises a significant budget issue. In the bill, each position is assumed to generate an average amount of revenue. However, at some level of staffing, the average amount of revenue that could be generated by an additional position would begin to decline until, eventually, the cost of each position would exceed the revenue the position could discover. Thus, at a certain level of staffing, each additional position would raise less revenue than the cost of the position. As a result, it could be argued that providing the additional positions would not necessarily generate additional revenues.

3. In reviewing the estimated additional revenue attributed to the Nexus Unit and temporary events operator/vendor program, the level of potential workload is significant. As noted, four of the Nexus Unit's projects have a substantial backlog in possible cases. Similarly, the operator/vendor program has not actively attempted to locate noncomplying vendors since the early 1990s. Therefore, the estimated additional revenue attributed to the new positions appears reasonable for the 1999-01 biennium. However, as the new positions and activities reduce the existing workload, the additional revenue generated in future biennia is likely to decrease.

4. In order to assess the effectiveness of the new staff, the Committee could require DOR to prepare a report for the Committee on the activities of the Nexus Unit and temporary events operator/vendor program and to identify the amount of revenue generated by the new and existing

staff. The report could be due on January 1, 2002.

ALTERNATIVES

Nexus Unit

1. Approve the Governor's recommendation to provide $66,200 GPR in 1999-00 and $66,100 GPR in 2000-01 and 1.50 GPR positions each year for the Department of Revenue's Nexus Unit.

2. Modify the Governor's recommendation to delete $10,500 GPR in 1999-00, $13,600 in 2000-01 and a 0.50 GPR program assistant position each year. Direct the Department to reallocate existing positions to this activity.

Alternative 2	GPR
1999-01 FUNDING (Change to Bill)	- $24,100
2000-01 POSITIONS (Change to Bill)	- 0.50

3. Modify the Governor's recommendation to delete $10,500 GPR in 1999-00, $13,600 GPR in 2000-01 and a 0.5 GPR program assistant position in each year. Authorize the Department to transfer a 0.5 program assistant position and related funding from the appropriation under 20.566 (3) (a) to the appropriation under 20.566 (1) (a).

Alternative 3	GPR
1999-01 FUNDING (Change to Bill)	- $24,100
2000-01 POSITIONS (Change to Bill)	- 0.50

4. Maintain current law.

Alternative 4	GPR
1999-01 REVENUE (Change to Bill)	- $1,345,500
1999-01 FUNDING (Change to Bill)	- $132,300
2000-01 POSITIONS (Change to Bill)	- 1.50

Temporary Events

1. Approve the Governor's recommendation to provide $43,500 GPR in 1999-00, $46,900 GPR in 2000-01 and 1.0 tax specialist position in each year for the temporary events operator/vendor program.

2. Delete the funding and position recommended by the Governor and direct the Department to reallocate an existing position to the temporary events operator/vendor program.

Alternative 2	**GPR**
1999-01 FUNDING (Change to Bill)	- $90,400
2000-01 POSITIONS (Change to Bill)	- 1.00

3. Delete the recommended funding and positions. Instead, authorize the Department to transfer 1.0 GPR tax revenue agent position and related funding from the Audit Bureau to the Compliance Bureau.

Alternative 3	**GPR**
1999-01 FUNDING (Change to Bill)	- $90,400
2000-01 POSITIONS (Change to Bill)	- 1.00

4. Maintain current law.

Alternative 4	**GPR**
1999-01 REVENUE (Change to Bill)	- $997,000
1999-01 FUNDING (Change to Bill)	- $90,400
2000-01 POSITIONS (Change to Bill)	- 1.00

Report on Additional Revenue

1. Require the Department to prepare a report on the activities of the Nexus Unit and the temporary events operator/vendor program and an estimate of the revenues generated by new and existing staff. Require DOR to present the report to the Committee by January 1, 2002.

Prepared by: Ron Shanovich

Senator Jauch

REVENUE -- TAX ADMINISTRATION

Nexus Tax Collections

Motion:

Move to delete the Governor's recommendation to provide the Department of Revenue's Nexus Unit with an additional $66,200 GPR in 1999-00 and $66,100 GPR in 2000-01 and 1.5 GPR positions in each year. Instead, direct the Department to reallocate existing positions to the Unit.

Note:

AB 133 would provide $66,200 GPR in 1999-00 and $66,200 GPR in 2000-01 and 1.5 GPR position for DOR's Nexus Unit. This motion would delete the positions and funding and direct DOR to reallocate existing positions to the Nexus Unit.

[Change to Bill: -$122,300 GPR and -1.5 GPR positions]

MO#__________

2	BURKE	Y	N	A
	DECKER	Y	N	A
1	JAUCH	Y	N	A
	MOORE	Y	N	A
	SHIBILSKI	Y	N	A
	PLACHE	Y	N	A
	COWLES	Y	N	A
	PANZER	Y	N	A
	GARD	Y	N	A
	PORTER	Y	N	A
	KAUFERT	Y	N	A
	ALBERS	Y	N	A
	DUFF	Y	N	A
	WARD	Y	N	A
	HUBER	Y	N	A
	RILEY	Y	N	A

AYE 10 NO 6 ABS 0

Motion #517

MO# Temp Events Alt 3

2 BURKE	Y	N	A
DECKER	Y	N	A
1 JAUCH	Y	N	A
MOORE	Y	N	A
SHIBILSKI	Y	N	A
PLACHE	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A
GARD	Y	N	A
PORTER	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUBER	Y	N	A
RILEY	Y	N	A

AYE 9 NO 7 ABS ____

MO# Depot Alt 1

2 BURKE	Y	N	A
1 DECKER	Y	N	A
JAUCH	Y	N	A
MOORE	Y	N	A
SHIBILSKI	Y	N	A
PLACHE	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A
GARD	Y	N	A
PORTER	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUBER	Y	N	A
RILEY	Y	N	A

AYE 8 NO 8 ABS 0

(Gov) Agency: DOR - Tax Administration
Occasional Vehicle Sales Funding Conversion

Recommendations:

Paper No. 833: Alternative 2

Comments: Alternative 2 ends up costing $542,600 GPR more than the gov's proposal, but it's more honest and appropriate budgeting (see paragraph 8 in FB memo and/or ask FB to explain).

These auditors are doing a good job, but they just can't generate enough extra sales tax collections to pay for themselves - hence the need for GPR. As an alternative, maybe you could just fund 2 auditors for the next two years. That would cost less GPR and maybe they could generate enough $$ to pay for themselves. Ask Lang & Gard what they think.

But, overall, this is not a big deal. Alternative 1 would be fine as well, and wouldn't cost as much GPR in the near term.

prepared by: Barry

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April 22, 1999 Joint Committee on Finance Paper #833

Occasional Vehicle Sales Funding Conversion (DOR -- Tax Administration)

[LFB 1999-01 Budget Summary: Page 532, #4]

CURRENT LAW

Under current law, purchasers of motor vehicles through occasional sales are required to report and pay the state and county (if applicable) sales and use tax to the Department of Transportation (DOT) at the time the vehicle is registered or titled. Occasional sales of motor vehicles are sales of automobiles, trucks, motorcycles and motor homes between private parties or fleet sales and auctions that are not conducted by licensed dealers.

DOR is provided $595,000 PR and 6.0 PR positions annually to administer the audit program for occasional sales of motor vehicles. A separate PR appropriation is used to fund the activities associated with auditing these sales of motor vehicles. The source of program revenues for the appropriation is 25% of sales taxes collected through the audit program.

GOVERNOR

Delete $595,000 PR and 6.0 PR positions annually and provide $397,200 GPR in 1999-00 and $399,200 GPR in 2000-01 and 4.0 GPR positions in each year to convert the primary funding source for the audit program for occasional sales of motor vehicles from program revenue to GPR. As a result of the funding shift, there would be no program revenue expenditure authority for administration of the audit program.

DISCUSSION POINTS

1. The current structure of the audit program for occasional sales of motor vehicles was established by the 1995-97 biennial budget (1997 Wisconsin Act 27). The Act provided additional positions and created the program revenue funding source to improve DOR's verification activities

related to occasional vehicle sales. The conversion to PR funding and increased expenditure authority were used to upgrade DOR's audit activities and to contract with a private vendor for services to improve the motor vehicle valuation system.

2. Under the current program, a private vendor performs monthly valuation determinations of DOT transaction data using a proprietary vehicle database and sends letters to sellers identified as having made questionable transactions. DOR sends follow-up letters to buyers and performs other related activities.

3. Since the program was fully implemented, there have been significant increases in the number of sales reviewed, the number of assessments of additional sales and use taxes, and in the amount of additional tax collections. Between 1995-96 and 1997-98, the number of transactions reviewed increased from 1,800 to 15,500, the amount of assessments increased from $454,900 to $2.1 million, and the amount of additional sales and use taxes collected increased from $452,400 to $1 million. However, the amount of program revenue generated has not been sufficient fund the administrative costs of the occasional vehicle sales audit program.

4. Table 1 shows the estimated biennial appropriation balance for the occasional vehicle sales audit program under current law provisions. Under current law, the appropriation would have an estimated deficit of $1.7 million in 2000-01. Moreover, even with growth, revenues would not be sufficient to fund total budgeted expenditures in future years.

TABLE 1

Occasional Motor Vehicle Sales Audit Program Appropriation
(Current Law)

	1999-00	2000-01
Opening Balance	-$950,500	-$1,342,300
Program Revenues	203,200	204,200
Total Revenue	-$747,300	-$1,138,100
Expenditures & Reserves	$595,000	$595,000
Closing Balance	-$1,342,300	-$1,733,100

5. The bill would convert funding for the occasional vehicle sales audit program to GPR to address the ongoing deficit in the audit program's program revenue appropriation by eliminating all position and expenditure authority. However, 25% of audit collections would continue to be placed in the appropriation as program revenue. This is intended to provide annual funding that would eliminate the deficit in the 2001-03 biennium. Table 2 shows the biennial appropriation balance under the Governor's proposal.

TABLE 2

Occasional Motor Vehicle Sales Audit Program Appropriation (Assembly Bill 133)

	1999-00	2000-01
Opening Balance	-$950,500	-$747,300
Program Revenues	203,200	204,200
Total Revenue	-$747,300	-$543,100
Expenditures & Reserves	$0	$0
Expenditures Freeze		
Closing Balance	-$747,300	-$543,100

6. Deficits in program revenue appropriations are funded through transfers from the general fund. This transfer is reflected in the year-end balance in the general fund. The general fund is repaid by future surplus program revenues that are generated for the PR appropriation.

7. As noted, the source of funding for the occasional vehicle sales audit program is 25% of sales and use tax audit collections.

8. The Department of Administration's 1999-01 budget instruction manual defines general purpose revenue as general taxes and other moneys which are collected by state agencies and deposited into the general fund, and are available for appropriation by the Legislature. Program revenue is defined as moneys that are collected from the general public by state agencies for specific purposes, deposited in the general fund and credited directly to an appropriation to finance those purposes.

Since the source of revenue for the occasional motor vehicle sales audit program is a general fund tax and not revenue collected for a specific purpose, it could be argued that designating a portion of sales taxes as a program revenue is inappropriate. Also, general purpose revenues fund administration of most general fund taxes such as the individual and corporate income and franchise taxes. From this view, sales taxes collected through the audit program should not be treated as program revenues.

Under the bill, some of the sales and use taxes collected through the audit program would be used to eliminate the deficit in the program's PR appropriation. Consequently, the Committee may wish to delete the occasional motor vehicle sales audit program appropriation and funding and provide $950,500 GPR in 1999-00 to offset the current deficit in the appropriation. Under this option, general fund revenues would be increased by $203,200 in 1999-00 and $204,200 in 2000-01 to reflect the sales taxes that would no longer be placed in the occasional vehicle sales appropriation. General fund revenue would also increase in the 2001-03 biennium because the appropriation deficit would be addressed immediately rather than over several years.

ALTERNATIVES

1. Approve the Governor's recommendation to delete $595,000 PR and 6.0 PR positions in each year of the biennium and provide $397,200 GPR in 1999-00 and $399,200 GPR in 2000-01 and 4.0 GPR positions in each year to convert the funding source for the audit program for occasional vehicle sales of motor vehicles from program revenue to GPR.

2. Approve the Governor's recommendation and, in addition, delete the program revenue appropriation used to fund the occasional motor vehicle sales audit program and provide $950,000 GPR in 1999-00 to offset the deficit in the appropriation.

Alternative 2	GPR
1999-01 REVENUE (Change to Bill)	$407,400
1999-91 FUNDING (Change to Bill)	$950,000

3. Maintain current law.

Alternative 3	GPR	PR	TOTAL
1999-01 FUNDING (Change to Bill)	- $796,400	$1,190,000	$393,600
2000-01 POSITIONS (Change to Bill)	- 4.00	6.00	2.00

MO# 4H.2

2 BURKE	Y	N	A
DECKER	Y	N	A
JAUCH	Y	N	A
MOORE	Y	N	A
SHIBILSKI	Y	N	A
PLACHE	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A
GARD	Y	N	A
PORTER	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUBER	Y	N	A
RILEY	Y	N	A

Shanovich

AYE 14 NO 2 ABS 0

(Gov) Agency: DOR -- Financial Systems Internal Auditor

Recommendations:

Paper #834: Alternative 2

Comments: The department claims it needs to spend $100,000 to bring in an outside computer consultant. DOR says an outsider would have greater objectivity. Fiscal Bureau points out that the Department has not identified specific activities or project for the consultant.

Why don't they just hire objective, qualified people in the first place?

Prepared by: Bob

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April 22, 1999 Joint Committee on Finance Paper #834

Financial Systems Internal Auditor (DOR -- Tax Administration)

[LFB 1999-01 Budget Summary: Page 532, #7]

CURRENT LAW

DOR conducts financial transactions through a variety of computer systems, including mainframe and local area networks.

GOVERNOR

Provide $50,000 GPR annually to contract with a consultant to review and ensure the integrity and accuracy of the Department's financial computer systems.

DISCUSSION POINTS

1. DOR has over 130 application systems dedicated to tax administration and revenue collection. Generally, the systems have been developed to support a specific program. Although each of the systems is generally reliable, they have been implemented at various times over the last 30 years using different methods of organizing data and programming languages. The Department relies on system development technology and integrity to ensure that the system itself and the financial transactions performed are accurate and appropriate. Periodically, the Legislative Audit Bureau (LAB) performs financial audits. However, the financial computer systems of DOR are not systematically audited to determine if proper internal controls are in place to ensure that data, records, transactions, processes and documentation are accurate, correct and comply with statutory provisions and financial accounting principles.

2. The Department has established a team to develop an internal control plan for all of DOR's financial systems based on guidelines established by the State Controller's Office. The team will review existing internal controls and modify them or implement new ones if it determines it

necessary.

3. Under the guidelines, the Department's internal control structure would include the following components:

Control Environment. A general overall organizational philosophy, activities and structure that supports internal controls. Control environment factors would include: integrity and ethical values; commitment to competence; management philosophy and operating style; organizational structure; designation of authority and responsibility; and human resource policies and practices.

Risk Assessment. Identification and analysis of the risks to achieving the objectives controls are designed to ensure. The risk assessment would be used as a basis for determining the way in which risks are managed.

Control Activities. Policies and procedures to ensure the necessary actions are taken to address risks to system operations.

Information and Communication. Methods and records established to identify, assemble, analyze, classify, record and report transactions. Also, maintaining accountability for related assets and liabilities.

Monitoring. Assessment of the quality of the internal control structure over time.

4. The Department indicates that it will designate existing staff to develop the appropriate internal controls for its financial systems. Formal procedures for manual activities and operation and testing of automated systems will be implemented.

5. The Department would use the funding provided in the bill to contract with a business process consultant to periodically review Department procedures and processes to identify and eliminate the underlying causes of errors and inconsistencies with DOR's existing financial systems. DOR believes that this would provide greater objectivity and flexibility for reviewing the Department's financial processes and internal controls than developing an independent internal review capability. Hiring consultants would also be the fastest way to implement the review capability.

6. Although the types of services provided by financial audit consultants are varied, audits of agency computerized data processing can be grouped under two categories--management and environmental reviews and system reviews.

Management and Environmental Control Reviews. The objectives of this type of review include obtaining sufficient knowledge about: agency policies and procedures regarding separation of duties within the information systems area; development and maintenance of application systems; physical security; disaster recovery; general security and access controls; system back-up; maintenance of system software; and data control and computer operations to assess whether the controls are adequate to ensure accurate and timely processing of data for each platform on which critical files or applications reside.

System Reviews. The objective of this type of review is obtaining and documenting a sufficient understanding of the internal control policies and procedures within the agency over the operations of the computer system. This includes a review of the application that is used to determine whether there are adequate procedures and controls to ensure financial transactions are computed accurately and in compliance with state statutes, and that the financial transactions are recorded in accordance with generally accepted accounting principles. The review involves analysis of system inputs, processing and outputs.

Comprehensive management and environmental reviews and system reviews can each involve over 2,000 hours of audit activities. The activities of each type of audit are described in the Appendix.

7. The bill would provide DOR with $50,000 annually to purchase services from a business process consultant. As noted, the Department would use the consultant to review its financial processes to develop internal controls and for special studies of specific systems or areas where problems exist. However, the Department has not identified specific activities or projects for the consultant. Staff at various state agencies, including SWIB, ETF, DHFS and LAB indicated that consultant fees would range from $90 to $150 per hour. At $90 an hour, DOR could purchase services that were equivalent to a 0.27 position. The funding level provided limits the activities that could be conducted by a consultant

8. The Department has indicated that the position could review specific areas of a system. Alternatively, the consultant could identify work activities for DOR staff that would be necessary to review and implement internal controls. However, DOR staff would have primary responsibility for review, internal controls development and ensuring the integrity of financial systems.

9. DOR is in the process of implementing an integrated tax system (ITS) that involves the use of technology for a comprehensive upgrade and reorganization of the Department's tax administration personnel, activities, processes and systems functional components. The Department has developed a master plan under which the system is projected be completed by fiscal year 2004-05. Under the plan, existing systems will be incorporated into the integrated system. DOR will contract with consultants to implement the integrated system, including assisting in developing internal controls for components of it. The bill would provide DOR with total funding of $6,920,500 annually to implement the ITS system.

10. In reviewing this request the Committee may wish to consider a number of factors. First, the amount of funding provided limits the type of projects the consultant could conduct. In addition, an outside consultant would be unfamiliar with DOR systems and would require some time to acquire an understanding of the systems. As a result, existing staff will have primary responsibility for, and perform most activities related to, improving internal controls.

Second, the consultant would be hired to work on existing financial systems. However, the current systems will be modified, upgraded and incorporated into the integrated tax system or eliminated within five years.

Finally, the integrated tax system will be implemented with significant internal controls on system operations, maintenance and modifications. DOR staff could use these as a basis for reviewing controls on current systems. Moreover, a number of the current automated financial systems, such as the Business Tax Registration and Delinquent Tax systems, will be basic components of the integrated system and incorporated early in the implementation process. The internal controls of these existing systems will be reviewed and modified as they are incorporated into the integrated system.

Given these considerations, the Committee may wish to delete the consultant funding.

ALTERNATIVES

1. Approve the Governor's recommendation to provide $50,000 GPR annually for the Department to contract with a consultant to review and ensure the integrity and accuracy of financial computer systems.

2. Maintain current law.

Alternative 2	GPR
1999-01 FUNDING (Change to Bill)	- $100,000

MO# Alt. 2

2 BURKE	Y	N	A
DECKER	Y	N	A
JAUCH	Y	N	A
MOORE	Y	N	A
SHIBILSKI	Y	N	A
PLACHE	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A
1 GARD	Y	N	A
PORTER	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUBER	Y	N	A
RILEY	Y	N	A

ovich

AYE 16 NO 0 ABS 0

APPENDIX

Audits of Computerized Data Processing

The following information describes the types of activities that are typically conducted in auditing computerized data processing systems.

Management and Environmental Control Reviews

Initial audit procedures generally begin by determining if the agency has financial applications or critical files which reside on the computer or system or a centralized data processing unit or bureau which provides centralized controls or services to the other divisions. If the agency has a centralized information systems function that other divisions rely on to perform data processing for their financial systems or provide services and controls for division systems then controls are centrally reviewed.

Organizational Responsibilities. Staff duties are documented to ensure there is a distinction among computer access, authority, operation and recording functions. Tasks that must be separate include systems programmer, applications programmer, data control, data administrator, security officer, data entry, and data base administrator. Evaluations determine if employes have adequate back-ups with separation of duties.

Development and Maintenance of Applications Agency procedures for obtaining system changes are identified. Adequate controls must exist to ensure unauthorized program changes are not completed and transferred to production status. Controls that are reviewed include: adequate testing of changes; user sign-off; adequate procedures for moving programs from test to production; and quality assurance policies and procedures. Persons involved in system change activities are identified and the input of users during program change development and testing is determined. Procedures for program failures and quick fixes, agency and user program documentation and completeness are also reviewed. Finally, program documentation must be properly secured.

Physical Security. Critical equipment and reports are identified. Observations and evaluations are made to determine the adequacy of controls over access to the computer room, tape libraries and computer terminals, confidential reports and other items that are susceptible to theft. The review includes an evaluation of control activities as well as observing the effectiveness of such controls. Procedures and devices available for emergency situations are identified. Agency items susceptible to fire, water, electrical and temperature emergencies should have adequate protection.

General Data Security and Access Controls. The procedures for setting up access to the computer or system, personnel who can authorize access, and employe responsibilities related to access are reviewed. The review also includes procedures for: eliminating access when an employe terminates; removing consultants' access when their work is completed; and changing access when job duties change. Personnel responsible for reviewing access and violation logs and follow-up procedures are also identified. Access rules must be periodically reviewed to ensure individuals whose job duties have changed or who have left are identified. Security reports must be reviewed and documented.

System Back-Up. Review and evaluation is performed on: back-up procedures for operating systems; systems programs; personal libraries; and application production programs and data. Procedures for creating back-ups are evaluated and back-up controls are reviewed to ensure that controls are working as intended.

Maintenance of Systems. Procedures for changes to system software are reviewed. Adequate controls must exist to ensure unauthorized changes are not completed and transferred to a production status for system software. Controls include: adequate testing of changes; quality assurance policies and procedures; and notification of system software being refreshed. Persons who authorize system software changes and transfer the changed program back to production status are identified.

Data Control/Computer Operations. Procedures concerning the handling, releasing and destruction of confidential information are documented to ensure that only authorized data and programs are executed and that only programs and data in the production environment are processed. Controls must be evident to ensure that data processing jobs run to completion. Software used for this function by the agency is documented to determine how it and related controls operate.

Systems Reviews

State Compliance. Statutory requirements and procedures used to develop program requirements are reviewed. Appropriate procedures should be used to calculate revenues and expenditures. Fiscal year revenues or expenditures are analyzed to determine if revenues are within the statutory requirement.

Understanding and Documenting the Application. The application system is reviewed to determine controls which provide assurance that the system is accurate and functioning properly. System inputs, outputs and interfaces with other systems are documented.

Data Security and Access Controls. Security systems and security procedures are identified. Procedures for adding and deleting employes from the security system are evaluated to ensure that procedures only allow access to authorized employes and that terminated employes are promptly removed from the system. Reports are generated by the security system and procedures used for reviewing and acting upon information from such reports are evaluated. Agency procedures must ensure that passwords are frequently changed, not easily accessed and not written or shared.

Data Preparation and Input Controls. Sources of input are identified. Input documents are reviewed to determine necessary controls to ensure accurate and proper entry into the computer system. Controls may include: proper authorization; key verification; record count; marked after being keyed; keying edits; batches logged in/out; check digit; and batch totals. Personnel who access input data after it is entered and before it is processed through the application are identified. Procedures should be in place to correct errors for proper authorization, documentation, timely correction and assure that all errors are corrected, reviewed and documented. Input procedures are documented using flowcharts, procedure narratives and agency documentation. Internal control strengths and weaknesses are identified.

Data Processing and Update Controls. The system's flow is reviewed and documented by using techniques such as flowcharts, procedure narratives and agency documentation. Internal control strengths and weaknesses and programs containing critical edits and calculations are identified.

Data Output Controls. Outputs produced by the system, including files transferred to other systems, are identified. Output procedures used by data control and users to ensure complete processing are documented. Controls include: control totals; reconciliations; output log; and turnaround documents. Controls concerning the distribution of output and procedures for discarding confidential output are evaluated. During the review, the criticality and confidentiality of the data is identified.

Back-Up Controls. Agency back-up procedures are reviewed to determine what data and programs are backed-up, how often and where the copies are kept for safe keeping. These procedures are evaluated to ensure adequate information is maintained to aid the agency in restoring information in a timely manner. Data set retention periods are also evaluated. Back-up tapes kept for the application should exist at an off-site facility. A referencing workpaper documenting an overview of the system and containing the details for critical portions of the system is produced. A summary and evaluation of risks and documented controls within the system is developed.

Test of System Controls Procedures and Assessment of Control Risk. A sample of financial transactions is used to evaluate system controls. Access controls over critical transactions and data sets are also tested.

Gov Agency: Revenue—Tax Administration—Tax Forms and Instruction Printing Costs

Recommendations: Russ: 2 ✓

Paper No. 835: Alternative 1

Comments: This money just allows DOR to fund the costs associated with incorporating tax law changes into the new forms and publications. It's a modest request, $35,900 GPR, and probably should be approved.

Prepared by: Julie

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April 22, 1999 | Joint Committee on Finance | Paper #835

Tax Forms and Instruction Printing Costs (DOR -- Tax Administration)

[LFB 1999-01 Budget Summary: Page 533, #8]

CURRENT LAW

The Department of Revenue (DOR) annually modifies tax returns and booklets to reflect tax law changes, including updating references to the federal Internal Revenue Code (IRC). The Department also makes periodic changes to simplify and improve the quality of the documents. Copies of forms, booklets and other information are sent to taxpayers. Base level funding for printing tax forms and related documents is $471,500 GPR annually.

GOVERNOR

Provide $35,900 GPR annually to fund the costs of incorporating recent tax law changes into the appropriate tax forms, booklets and instructions.

DISCUSSION POINTS

1. The additional funding would be provided to modify individual income tax forms, booklets and related schedules to reflect tax law changes included in 1997 Wisconsin Acts 27, 63 and 237. Tax changes enacted in Act 27 include the working families tax credit, manufacturer's sales tax credit, a deduction for certain long-term care insurance and an exclusion for certain gains on the disposition of business and farming assets. Act 237 created a deduction for certain tuition expenses. Act 63 established an income tax reciprocity agreement with Illinois that requires compensation payments when the net forgone tax revenues of one state exceed those of the other state.

2. The working families and manufacturer's sales tax credits require additional lines on tax forms, instructions and separate worksheets or forms. The long-term care insurance and tuition

expense deductions and exclusion for the disposition of certain assets require separate subtractions from income, new instructions and worksheets.

Under the income tax reciprocity agreement with Illinois, DOR is required to conduct a study that will establish a basis of reciprocity payments. The study will use income tax returns to estimate the number of individuals who live in one state and work in another and the amount of compensation. The data will be used to calculate the amount of taxes forgone by each state and the resulting payment. Act 63 provided the Department with additional funding to conduct the study. DOR indicates it will need additional funding to modify tax forms to provide a check box and additional income lines on tax forms and to provide additional instructions.

3. These modifications require four new pages for Form 1, 1A and 1NPR booklets at an annual cost of $14,500, $4,400 and $1,000 respectively. Annual funding of $5,100 is required to print eight pages of separate instructions for Form 1A. The new manufacturing sales tax credit schedule costs $700. The Department is expanding the separate sheet Form 1 from the current two-page, one-sheet format to a three-page, two-sheet format. Funding of $10,200 is required to cover the cost of expanding the return.

4. DOR indicates that printing and blank spaces on forms were getting quite small and difficult to read. Adding lines would make completing returns much more difficult for taxpayers. As a result, the forms were expanded to make them more readable.

5. The Department estimates that the additional costs of modifying the tax forms and booklets cannot be absorbed with existing base level funding for printing tax documents ($471,500). In this regard, it should be noted that only $12,450 out of a $33.5 million budgeted amount lapsed from the collection of state taxes, general program operations appropriation in 1997-98.

6. Although DOR indicates that the additional costs of modifying tax documents cannot be absorbed, frequently, additional funding is not provided to administer tax law changes. For example, additional funding is typically not provided to adjust tax documents to reflect tax law changes that are adopted for state tax purposes through the annual IRC update. Similarly, the Department did not receive additional funding to modify tax forms and instructions for the changes to the development zones tax credits that were enacted in both the 1995-97 and 1997-99 biennial budgets. However, expanding tax documents to make them more readable could be viewed as more significant than reflecting incremental tax law changes.

7. The Department has base level funding of $70,000 GPR in 1999-00 and 2000-01 that was provided in Act 237 to administer the education tuition deduction. In addition, the Department is provided $74,300 GPR in 1998-99, $105,000 GPR in 1999-00 and $50,700 GPR in 2000-01 to conduct the Illinois-Wisconsin reciprocity study. DOR did not request additional funding for tax document printing during legislative deliberations on either Act 27 or Act 237. Subsequently, in September, 1998, DOR submitted a request to the Joint Committee on Finance under s. 13.10 for $35,900 GPR to fund tax document printing costs related to provisions of Acts 27, 237 and 63. However, the Department withdrew the request indicating it would absorb these additional costs in fiscal year 1998-99.

8. The Department has allocated $300,000 in integrated tax system (ITS) funding for the redesign of individual income tax forms. The funds are intended to cover the costs of contracting to develop designs for the tax forms so that they improve taxpayer compliance and become more compatible with the scanning process. DOR was going to contract to redesign Form 1 for tax year 1999. However, the Department intends to begin funding the redesign activities internally. It could be argued that some of the funding allocated for redesign costs could be used to fund printing costs related to redesigned forms.

ALTERNATIVES

1. Approve the Governor's recommendation to provide $35,900 GPR annually to fund the costs of incorporating recent tax law changes into the appropriate tax forms, booklets and instructions.

2. Maintain current law.

Alternative 2	GPR
1999-01 FUNDING (Change to Bill)	- $71,800

Prepared by: Ron Shanovich

MO# Alt. 2

2	BURKE	Y	N	A
1	DECKER	Y	N	A
	JAUCH	Y	N	A
	MOORE	Y	N	A
	SHIBILSKI	Y	N	A
	PLACHE	Y	N	A
	COWLES	Y	N	A
	PANZER	Y	N	A
	GARD	Y	N	A
	PORTER	Y	N	A
	KAUFERT	Y	N	A
	ALBERS	Y	N	A
	DUFF	Y	N	A
	WARD	Y	N	A
	HUBER	Y	N	A
	RILEY	Y	N	A

AYE 8 NO 8 ABS 0

(Gov) Agency: DOR -- Business Tax Registration Administrative Funding

Recommendations:

Paper # 836: Alternative 2

Comments: The 1995 budget created a centralized business tax registration system that was supposed to be simpler, and paying for itself by now. Three project positions were created for start-up of this operation.

The system is running a deficit and now the administration wants to make the start-up positions permanent. Alternative 2 would eliminate these positions and spend $305,000 less than the bill.

Fiscal Bureau suggests that since this system is being merged into the department's ITS integrated system, the department could use ITS funding to accomplish its goals.

Meanwhile, the department argues increasing the initial business tax registration fee from $20 to $30 would help erase the program deficit (this is Alternative 3).

Prepared by: Bob

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April 22, 1999 Joint Committee on Finance Paper #836

Business Tax Registration Administrative Funding (DOR -- Tax Administration)

[LFB 1999-01 Budget Summary: Page 533, #12]

CURRENT LAW

Businesses are required to obtain a business tax registration certificate from the Department of Revenue (DOR) for certain licenses, permits and certificates related to sales and use, withholding, fuel and excise taxes. Applicants pay a fee based on the type of permit, license or certificate required; however, a single fee is paid for all such documents acquired.

Fees are placed in a program revenue appropriation used to fund administration of the business tax registration system. The appropriation has base level funding of $1,760,800 PR and 23.4 PR positions.

GOVERNOR

Provide $123,900 PR in 1999-00 and $181,100 PR in 2000-01 and 3.0 PR positions annually to convert project positions that provide support to the business tax registration system to permanent positions.

DISCUSSION POINTS

1. The business tax registration system was established by 1995 Wisconsin Act 27 (the 1995-97 biennial budget). Under Act 27, DOR was required to implement a centralized business tax registration system through which a taxpayer could apply for all required permits, licenses and certificates using one application and paying one registration fee. A two-year renewal cycle was established. The Department was directed to develop a registration fee schedule that reflected traditional differentials in fees and costs for businesses, with a minimum registration fee of $20 and

a minimum renewal fee of $10. DOR was also directed to submit the proposed fee schedule and an estimate of the point at which the fees would exceed the costs of administering the fee system to the Joint Committee on Finance at its first meeting under s. 13.10 in 1995-96.

A separate program revenue appropriation was created to fund administration of the business tax registration system with registration and renewal fees as the source of revenue for the appropriation. Annually, the unencumbered year-end balance in the appropriation in excess of 10% of fiscal year expenditures lapses to the general fund. Act 27 also converted the funding source for 16.8 GPR positions to PR and provided DOR with 3.0 PR project positions to administer the business tax registration system. The positions were funded from the program revenue appropriation.

2. The Department submitted two alternative fee schedules for approval at the Committee's October, 1995, meeting under s 13.10. The Committee approved the registration and renewal fee schedule that is currently in effect and the new fees were scheduled to begin on January 1, 1996. Consequently, registration renewal fees were due starting in 1998. The registration and renewal fee schedule was projected to generate fee revenues that would first exceed appropriation expenditures in 1997-98. The appropriation balance was expected to be positive beginning in 1998-99.

3. Under current law, every business that is required to obtain a permit, license or certificate from DOR must have a business tax registration certificate. This requirement applies to businesses that must obtain withholding certificates, seller's permits and fuel and excise tax permits. A supplemental fee must be paid for certain excise tax permits. The initial registration fee is $20 and covers a period of two years. The registration fee applies to the first permit or certificate obtained; there is no registration fee for additional permits or licenses. At the end of the two-year period, a $10 renewal fee must be paid for an additional two-year period. All persons holding business tax registration permits, licenses or certificates, including businesses that were not required to pay the initial registration fee because they held an active registration on December 31, 1995, must pay the renewal fee. Table 1 shows the current business tax registration and supplemental fee schedule.

TABLE 1

Business Tax Registration and Supplemental Fee Schedule

	Initial Registration	Biennial Renewal
Business Tax Registration Certificate	$20	$10
Expedited Services Fee	10	0
Supplemental Fees		
Wisconsin Liquor Wholesaler	1,000	1,000
Wisconsin Liquor Manufacturer	1,000	1,000
Wisconsin Liquor Rectifier	1,000	1,000
Out-of-State Liquor Shipper	500	500
Public Warehouse Liquor	200	200
Wisconsin Winery	200	200
Sports Club	600	600
Sports Club (Beer)	200	200
Airport Public Facility	600	600
Vessel (Liquor)	600	600
Vessel (Beer)	200	200

4. Under the provisions of AB 133, total expenditure authority from the business tax registration administration appropriation would be $1,637,400 PR in each year, to fund 23.4 PR positions. As noted, the funding sources for the appropriation are registration and renewal fees. Table 2 shows the revenues, expenditures (including compensation reserves and other adjustments) and appropriation balances under the bill.

TABLE 2

Business Tax Registration Administrative Appropriation

	1999-00	2000-01
Beginning Balance	-$1,382,600	-$1,170,400
Revenues	1,880,500	1,552,300
Expenditures	-1,668,300	-1,736,900
Appropriation Balance	-$1,170,400	-$1,355,000

5. The table shows that the projected appropriation balance will be a deficit of almost $1.4 million at the end of 2000-01. Moreover, since it submitted its budget request, DOR has developed estimates that indicate that, in the long term, the deficit in the appropriation balance will

increase to more than $2 million. DOR is required to obtain approval from the Committee to establish business tax registration fees. In order to address the long-term deficit in the appropriation, the Department now recommends increasing the initial registration fee from $20 to $30, beginning on January 1, 2000. The renewal fee would remain $10. The increased revenues generated by the higher registration fee are estimated to gradually reduce the deficit in the appropriation until it would be eliminated in seven years. In the 2000-01 biennium, this option would generate an estimated $132,600 in 1999-00 and $265,100 in 2000-01. DOR proposed a $30 registration fee in its 1995-97 budget request.

6. The fee supports an activity that provides a centralized automated registration system that simplifies the permit application process for businesses. In addition, the business tax registration system is in the process of being merged into the Department's integrated tax system (ITS). The current registration system will be a basic element in a centralized system for registering taxpayers for all taxes administered by the Department.

7. The proposed $30 registration fee would increase costs for most businesses, including a large number of small businesses. Moreover, businesses must obtain the permits, licenses and certificates for activities that are providing tax administration services to the Department. For example, businesses that obtain withholding certificates are retaining individual income taxes from their employes and sending the amounts retained to DOR. The higher fee would increase the cost of collecting and sending these tax revenues to the Department.

8. Given that the account for this activity is already in deficit by some $1 million, one can question the advisability of adding additional expenses which will magnify the problem. As an alternative, the Committee could delete the funding and the permanent positions provided in AB 133. Under this alternative, funding for the business tax registration administration appropriation would be reduced by $123,900 PR in 1999-00 and $181,100 PR in 2000-01 and 3.0 PR positions would be deleted each year. It is estimated that this would eliminate the deficit in the appropriation in nine years. If this action was taken in conjunction with the proposed fee increase, it is estimated that the deficit in the appropriation would be eliminated in three years.

9. The three positions were initially provided as project positions because their activities related to developing and implementing the business tax registration system. From this view, the positions were intended to address the additional workload associated with developing the registration system and making it operational. It was assumed that, once the registration system was operating effectively, workload would be reduced and the positions would not be needed. Since the system is being merged into the ITS, the Department could use ITS funding for additional support for the business tax registration system.

10. DOR indicates that full implementation of the business tax registration system does not eliminate workload. The system requires ongoing maintenance, technical enhancements and modifications to reflect law changes. The positions are also needed to assist in incorporating the business tax registration system into the ITS. Under the ITS master plan, DOR is required to perform 25% of the work on the ITS through the internal reallocation of resources. In addition, two of the positions are scheduled to expire in September, 1999, and one in December, 1999. The

Department also indicates that these employes are concerned about job security and are likely to leave if the positions are allowed to expire. Since these people are lead workers in the business tax registration system, their resignations would place completion of the registration system in jeopardy.

ALTERNATIVES

1. Approve the Governor's recommendation to provide $123,900 PR in 1999-00 and $181,100 PR in 2000-01 and 3.0 PR positions annually to convert project positions that provide support to the business tax registration system to permanent positions.

2. Eliminate the funding and positions recommended by the Governor from the bill.

Alternative 2	PR
1999-01 FUNDING (Change to Bill)	- $305,000
2000-01 POSITIONS (Change to Bill)	- 3.00

3. Increase the initial business tax registration fee from $20 to $30, beginning on January 1, 2000.

Alternative 3	PR
1999-01 REVENUE (Change to Bill)	$397,700

MO# Alt 2

2	BURKE	Y	N	A
1	DECKER	Y	N	A
	JAUCH	Y	N	A
	MOORE	Y	N	A
	SHIBILSKI	Y	N	A
	PLACHE	Y	N	A
	COWLES	Y	N	A
	PANZER	Y	N	A
	GARD	Y	N	A
	PORTER	Y	N	A
	KAUFERT	Y	N	A
	ALBERS	Y	N	A
	DUFF	Y	N	A
	WARD	Y	N	A
	HUBER	Y	N	A
	RILEY	Y	N	A

AYE 9 NO 7 ABS ____

Gov Agency: Revenue—Tax Administration

Recommendations:

Paper No. LFB Summary Items for Which No Issue Paper Has Been Prepared

Comments: Since this is a bill agency, no action is required to include them in the bill.

Prepared by: Julie

Pull out 17

REVENUE

Tax Administration

LFB Summary Items for Which No Issue Paper Has Been Prepared

Item #	Title
1	Standard Budget Adjustments
5	Network Line Costs
6	Postage Rate Increase
9	Investigator Funding
10	Expert Witness Funding
11	State Operations Base Level Funding Reduction
13	Funding for Increased Delinquent Tax System Infotech and Software Maintenance Costs
14	Debt Collection Applications Development
15	Funding Adjustment for Wisconsin/Illinois Benchmark Study
16	Mining Investment and Local Impact Fund Administrative Expenses
17	Recycling Surcharge Administration
18	Lottery Credit Administration
19	Transfers Between Appropriations
20	Administrative Services Appropriation
21	Tax Incremental Financing Report

MO# exclude items 9, 10, 17

1	BURKE	Y	N	A
	DECKER	Y	N	A
	JAUCH	Y	N	A
	MOORE	Y	N	A
	SHIBILSKI	Y	N	A
	PLACHE	Y	N	A
	COWLES	Y	N	A
	PANZER	Y	N	A
2	GARD	Y	N	A
	PORTER	Y	N	A
	KAUFERT	Y	N	A
	ALBERS	Y	N	A
	DUFF	Y	N	A
	WARD	Y	N	A
	HUBER	Y	N	A
	RILEY	Y	N	A

AYE 16 NO 0 ABS 0

Revenue

Lottery Administration

(LFB Budget Summary Document: Page 536)

LFB Summary Item for Which an Issue Paper Has Been Prepared

Item #	Title
3	Retailer Performance Program (Paper #840)

Gov Agency: DOR- Lottery Administration – Retailer Performance Program

Recommendations:

Paper No.: 840 Alternative: 1 and 3

Comments: See paragraphs 15 and 26 to support this alternative. Retailers are not enthusiastic about developing a retailer performance program. The say since the program is still a pipe dream of DOR, it's hard for them to support something when they don't know the details so they can't really tell how it will affect them. All they want is to raise their compensation rate to 7% (which would make it the highest rate in the Midwest). However, when their rates were raised in the past, sales did not go up, in fact, they have continued to decline.

Look for Kaufert to offer a motion to raise the level of compensation to retailers to 7% instead of these incentive programs. Grocers Association & Convenience Store folks are looking for support on this motion. They say they'll never come back to the legislature for another "raise" if they get this.

Also somewhere in this lottery discussion there is expected to be a Shibilski/Kaufert motion giving DOR the authority to "buy" a game from a vendor that changes the format for the live lottery drawing. It portrays the drawing as a virtual horse race rather than the little balls floating in the air. The vendor claims this will increase lottery sales by $30 million over the biennium. This is the motion Moira was talking to you about.

Prepared by: Cindy

Kaufert motion
Shibilski motion

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April 22, 1999 | Joint Committee on Finance | Paper #840

Retailer Performance Program (DOR -- Lottery Administration)

[LFB 1999-01 Budget Summary: Page 538, #3]

CURRENT LAW

Lottery retailers receive sales compensation of 5.5% of on-line ticket sales and 6.25% of instant ticket sales. This basic compensation is set in statute and paid from a sum sufficient appropriation with segregated lottery fund revenues.

GOVERNOR

Provide $2,113,000 in 1999-00 and $4,308,500 in 2000-01 for a retailer performance program funded from the lottery's sum sufficient retailer compensation appropriation. Authorize the Department of Revenue (DOR) to establish a program, under rules promulgated by DOR, for additional compensation to be paid to retailers who meet certain performance goals identified by DOR. Provide that compensation under the program could not exceed 1.0% of gross lottery sales revenue. The effective date of the provision would be January 1, 2000.

DISCUSSION POINTS

1. From the inception of the lottery in 1988 until 1995-96, basic retailer compensation was 5.0% of ticket sales. Under 1995 Act 27, compensation for all games types was increased to 5.5% in 1995-96. Effective January 1, 1998, retailer compensation for instant ticket sales was increased to 6.25% (with on-line compensation remaining at 5.5%). Wisconsin does not provide for additional compensation relating to sales performance or the sale of winning tickets.

2. Retailer compensation is estimated at $25.4 million in 1998-99, based on projected sales of $411.0 million. As of December, 1998, 3,731 retailers were licensed to sell one or more types of lottery games. Of this total, 3,069 retailers sell on-line lottery tickets. This represents a

decline in retailers over the last two years. In December, 1996, there were 4,167 retailers, 3,123 of whom sold on-line tickets.

3. The retailer performance program under the bill was requested by DOR in its 1999-01 budget request. According to lottery officials, additional tools are needed to motivate retailers to sell more lottery tickets. A performance-based incentive program is viewed by the Department as providing the basis for an improved partnership relationship with retailers and the motivational factor necessary to increase sales.

4. The Department also argues that the goal of the retailer performance program, which is to increase lottery sales, will help to maximize the amount of lottery proceeds available for property tax relief. If the performance program is approved, the Department projected, in its budget request, sales of $426.8 million in 1999-00 and $435.1 million in 2000-01. These sales totals would result in projected property tax relief credits totaling $110.4 million in 1999-00 and $111.8 million in 2000-01. The Department's sales and property tax projections were adopted by the Governor and these amounts are contained in the bill.

5. These sales projections represent increases of $8.3 million in 1999-00 and 16.6 million in 2000-01, 2% and 4% increases, respectively, compared to the DOR's projected 1998-99 sales of $418.5 million. (The increase is based on total sales, minus pull-tab lottery sales conducted by nonprofit organizations, which constitute about 1% of total sales.) The increased sales are entirely attributed to the retailer performance program and, if the program is not approved, the Department would project a continuation of lottery sales at current levels.

6. In October, 1998, the Department of Administration (DOA) and the Joint Committee on Finance reestimated lottery sales in 1998-99 at $411.0 million, for the purpose of certifying the lottery property tax credit in 1998-99. Lottery sales peaked in 1994-95, at $518.9 million and have declined each year since then, as shown in the following table:

Fiscal Year	Instant Games	On-Line Games	Totals
1994-95	$320,356,100	$198,558,900	$518,915,000
1995-96	310,401,700	171,722,300	482,124,000
1996-97	273,413,600	157,677,500	431,091,100
1997-98	252,787,600	165,725,800	418,513,400
1998-99*	241,000,000	170,000,000	411,000,000

* Estimated.

7. The projected sales increases of 2% and 4% associated with the retailer performance program appear reasonable. While some states have experienced more dramatic increases following the implementation of a retailer incentive program, the conservative estimate made under the bill is appropriate given sales trends in recent years and the declining number of retailers noted above. If the retailer performance program is not approved by the Committee, it also appears reasonable to project that sales will remain at the current level of $411.0 million.

8. Under the bill, the retailer performance program structure, policy and procedures

would not be statutorily defined; rather this program structure would be developed under administrative rules by the Department. In its budget request, DOR argued that this approach would provide the flexibility needed to adjust the program as business needs change.

9. The Department has developed materials that describe its intent for the program to some extent. These materials describe a program with two components:

a. A retail sales development component would utilize approximately 0.5% of ticket sales for distribution to retailers who meet pre-defined sales goals; and

b. A retailer winning ticket component would utilize approximately 0.5% of ticket sales for distribution to retailers selling winning tickets.

Under the DOR plan, if the awards under the retailer winning ticket component totaled less than 0.5% of the available funds in a given year, the remaining funds could be expended under the sales performance component.

10. The Department indicates that, under both components, administrative controls would be implemented to assure that expenditure totals would be controlled. Any retailer that successfully earns bonus compensation under either component would be limited to certain maximum amounts: (a) for the sales development component, up to the amount of sales increases generated by the retailer; and (b) for the winning ticket component, up to $100,000. Award payments would be made quarterly in order to sustain retailer interest in the program throughout the year. According to lottery officials, the program concept is based on successful incentive programs in other states (most lottery states have some form of bonus compensation) and on discussions with Wisconsin retailers.

11. The sales development component would allocate bonus compensation based on earned "shares," with each share reflecting a $500 increase in sales from the previous year. Shares would only be provided to retailers meeting a minimum percentage sales increase; for example, at least 3% more than the prior year. The total funding for the year would then be allocated to successful retailers in proportion to their shares.

12. Under the Department's approach, the total 0.5% funding (or more, if the winning ticket component does not fully expend its share) would be provided to those retailers achieving the minimum sales goal. If fewer retailers achieve the sales goals, each would receive a larger share of the funding (up to the maximum specified above), as compared to the situation where a greater number of retailers achieve their goals. That is, all the funds would be distributed, up to the maximum, regardless of the number of retailers achieving the sales goals. Thus, the program's success depends, to a great extent, on involving a large number of retailers in the program. In the event relatively few retailers participate and achieve sales goals, these retailers would be awarded relatively large bonus payments, up to the prescribed maximums. On the other hand, it is precisely this opportunity to achieve a share of the bonus compensation that may ensure significant retailer participation.

13. Under the proposed winning ticket component of the program, retailers would be provided with an award of 1% of the value of the winning tickets they sell, excluding winning tickets of $599 or less. This would provide the seller of a winning $8,000,000 Powerball ticket, for example, with bonus compensation of $80,000 (as compared to $0.055 under current law). Far more typically, however, prizes would fall in the $600-$2,000 range, providing bonuses of $6 to $20.

14. This proposed program structure continues to evolve. Lottery officials recently indicated that they now plan to exclude sales of on-line jackpot games (Powerball and Megabucks) in the prior year from the calculation to establish the percentage sales goal in the subsequent year. The reasoning for this is that sales for these games are unpredictable and fluctuate according to the jackpot; thus, basing a sales goal, in part, on these sales could hurt retailers if jackpots stayed low in the subsequent year. However, the sales in the subsequent year for jackpot games would count toward the sales performance totals for retailers. Lottery officials believe this is necessary to encourage retailers to sell these jackpot games. Questions could be raised about this procedure, which appears to benefit retailers on both the goal setting and the sales performance sides of the process. This practice could make it easier for retailers to achieve the sales goal each year.

15. The proposed performance program may have genuine potential to provide incentives for retailers and to enhance sales. It is also possible to raise some concerns about the impact of the program, particularly if fewer retailers participate. Further, some of the Department's plans for the program, at this point in time, are evolving as a result of further consideration and consultation with retailers. It could be argued that proposed administrative rules for the performance program should be drafted before funding is allocated. The proposed funding could be placed in unallotted reserve with a directive to DOA to not release the funds until the Committee, under a 14-day passive review process, reviews the Department's plan, based on proposed administrative rules. This would provide the Committee with the opportunity to approve the program's structure in a more developed form and to meet, if necessary, to discuss the program's structure.

16. Apart from the performance program's structure, some additional issues can be raised, including the potential effects on the lottery property tax credit, possible modifications to basic retailer compensation and the importance of field support of retailers by the state lottery.

17. As noted above, the retailer incentive program is intended to enhance the funds available for the lottery property tax relief credit. The Department takes the position that, without the program, sales would not increase from current levels. The sales increases projected under the bill are 2% and 4% of 1998-99 sales, which the Department estimated at $418.5 million (for total sales of $426.8 million in 1999-00 and $435.1 million in 2000-01). These 2% and 4% increases should be corrected to reflect updated 1998-99 sales estimates. Under the reestimated sales estimate of $411.0 million in 1998-99, the 2% and 4% increases associated with the performance program would result in sales of $419.1 million in 1999-00 and $427.3 million in 2000-01.

18. The following table shows the effect on the amount available for the lottery tax

credit, with sales estimates corrected to 1998-99 sales of $411.0 million, under current law and under the Governor's retailer performance provision.

Lottery Credit Amounts

	1999-00	2000-01
Maintain Current Law		
No retailer program or increase in sales	$108,119,900	$108,501,200
Governor -- Reestimated		
Retailer program and sales increase 2% and 4%	$108,907,500	$110,149,600
Change to current law	$787,600	$1,648,400

19. This table illustrates that an increase in the lottery tax credit amount would be realized if sales actually increase by the projected 2% and 4%. However, if relatively marginal increases in sales result from the performance program, credit amounts would not appreciatively increase, or would decline, because the cost of the program itself ($2.1 million in 1999-00 and $4.2 million in 2000-01, under the bill as reestimated) needs to be paid from lottery sales. While precise estimates are difficult, it may require sales increases of approximately 1.5% in 1999-00 and 3.0% in 2000-01 (from the $411.0 million base) for the retailer performance program to pay for itself. However, if adequate sales increases can be realized and sustained as a result of the program, tax credits would be enhanced.

20. Some lottery retailer representatives have indicated that retailers support an increase in the basic compensation rate instead of a performance program, arguing that current compensation rates do not cover their actual costs of selling lottery tickets. However, lottery officials indicate that data regarding these costs have not been made available. In making the argument for a performance-based incentive bonus, lottery officials indicate that increases in the basic compensation rate have had little impact on increasing lottery sales. For example, in spite of increases to basic compensation made in 1995-96 and 1997-98, lottery sales have continued to decline each year since 1994-95. Based on current lottery sales trends, an increase in basic compensation is not likely to have a positive effect on sales and, in this event, would decrease the amount available for property tax credits. If sales remained constant at $411.0 million annually and retailer compensation was increased to 7%, the lottery credit amounts would decline to $105.9 million 1999-00 and $104.1 million in 2000-01.

21. If implemented, the success of the retailer performance program in increasing sales will depend largely on the lottery's ability to engage retailers in actively participating in the program. DOR indicates that its marketing and retailer relations staff will play a central role in the retailer performance program and will assist in the development of business plans for key retailers throughout the state. Lottery officials indicate that the success of incentive programs in other states have depended on a strong field presence among retailers.

22. Under the 1997-99 biennial budget act, the lottery was provided with 18.0 additional positions for retailer field support and customer telemarketing services. In addition, 12 existing

positions were converted to customer services specialist positions. With the position increase and reclassification provisions, the lottery's marketing and retailer relations unit is now allocated a total of 49.0 positions. This staffing should provide the basis for strong retailer support. It should be noted, however, that a recent personnel management report indicates that 15.5 of these 49.0 positions (32%) are currently vacant. However, lottery officials now indicate that one person has been hired and will start in June, offers have been extended for three other positions and recruitment is in progress on other vacancies.

23. Given the importance of strong retailer field support for the performance program under the bill, and the lottery's current vacancy levels in the area of marketing and retailer support, the increased sales projected under the bill may be questioned, at least initially. Positive sales results from the program may be delayed until operational staff are hired, trained and experienced.

24. Under the bill, the funding for the performance program would be provided from the sum sufficient appropriation for retailer compensation. Under current law, this appropriation funds the basic compensation provided to retailers, based on statutory rates for the sale of tickets, and compensation established under rules provided to nonprofit organizations selling pull-tab tickets. These payments are authorized under a sum sufficient appropriation because the payments to retailers are contractually required and cannot be precisely determined when the appropriation amounts are established in the biennial budget. Under the bill, the performance program would be funded from this appropriation and would be authorized to expend up to 1% of gross lottery sales revenue.

25. Setting the program limit at 1% of whatever sales total is achieved in the year is an important incentive feature of the lottery's plan in that retailers would receive greater compensation as sales increase. Alternatively, a sum certain amount could be provided and the retailer program could be viewed as a programmatic function funded from the lottery's general program operations appropriation, rather than the sum sufficient appropriation. Under this alternative, expenditure authority in the lottery's general program operations appropriation would be set at 1% of the estimated base year sales. Thus, the program could be funded at $2,035,000 in 1999-00 and $4,070,000 in 2000-01, based on 1% of 1998-99 estimated sales of $411.0 million. (Funding in 1999-00 is half the annual amount because the program would become effective on January 1, 2000.) The Legislature, then, could review the program every two years and appropriate funding during each biennial budget process.

26. Lottery officials argue that this would cap bonus compensation and thereby remove a major incentive for retailers to push sales as high as possible. Under the Department's plan, the actual amount available as bonus compensation would continue to increase as sales rise. Retailers, who would receive quarterly bonuses, would continue to experience this growth throughout the year and would be motivated to continue to promote sales.

27. The sum certain bonus approach would limit to some extent the incentive aspect of the program. However, if sales increase in each base year, the bonus amount could increase for the following biennium. It can also be argued that it should be possible to structure an effective

program based on an incentive package in excess of $4 million annually. This approach would require the lottery, however, to revise some of its program plans.

ALTERNATIVES

1. Approve the Governor's recommendation for a retailer performance program, with compensation not to exceed 1% of gross lottery sales revenues, funded from the lottery's sum sufficient retailer compensation appropriation. Delete $37,400 in 1999-00 and $76,200 in 2000-01 to reflect reestimated amounts for a retailer performance program of $2,075,600 in 1999-00 and $4,232,300 in 2000-01. [Under this alternative, sales would be estimated at $419.2 million in 1999-00 and $427.4 million in 2000-01. Lottery credit amounts would be projected at $108.9 million in 1999-00 and $110.1 million in 2000-01.]

Alternative 1	SEG
1999-01 FUNDING (Change to Bill)	- $113,600

2. Modify the Governor's recommendation by: (a) deleting $78,000 in 1999-00 and $238,500 in 2000-01 to provide that funding for the retailer performance program ($2,035,000 in 1999-00 and $4,070,000 in 2000-01) be based on 1% of estimated 1998-99 sales of $411.0 million; and (b) providing the funding to the general program operations appropriation of the lottery, rather than the sum sufficient retailer compensation appropriation. [Under this alternative, sales would be estimated at $419.2 million in 1999-00 and $427.4 million in 2000-01. Lottery credit amounts would be projected at $108.9 million in 1999-00 and $110.3 million in 2000-01.]

Alternative 2	SEG
1999-01 FUNDING (Change to Bill)	- $316,500

3. In addition to alternative 1 or 2, require the Department to provide the Committee with a performance program plan based on proposed administrative rules. Place the approved funding in unallotted reserve for release by DOA following approval of the proposed plan by the Committee under a 14-day passive review process.

4. Maintain current law. [Under this alternative, sales would be estimated at $411.0 million annually. Lottery credit amounts would be projected at $108.1 million in 1999-00 and $108.5 million in 2000-01.]

Alternative 4	SEG
1999-01 FUNDING (Change to Bill)	- $6,421,500

Prepared by: Art Zimmerman

MO# Alt. 4

2 BURKE	Y	N	A
1 DECKER	Y	N	A
JAUCH	Y	N	A
MOORE	Y	N	A
SHIBILSKI	Y	N	A
PLACHE	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A
GARD	Y	N	A
PORTER	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUBER	Y	N	A
RILEY	Y	N	A

AYE 8 NO 8 ABS 0

MO# Alts 1+3

2 BURKE	Y	N	A
1 DECKER	Y	N	A
JAUCH	Y	N	A
MOORE	Y	N	A
SHIBILSKI	Y	N	A
PLACHE	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A
GARD	Y	N	A
PORTER	Y	N	A
KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUBER	Y	N	A
RILEY	Y	N	A

AYE 14 NO 2 ABS 0

Representative Kaufert
Senator Shibilski

REVENUE -- LOTTERY ADMINISTRATION

Increase Basic Retailer Compensation to 7%

Motion:

Move to provide $50,800 SEG in 1999-00 and $19,000 SEG in 2000-01 to: (a) increase basic retailer compensation to 7% of both on-line and instant ticket sales, effective January 1, 2000; and (b) delete the Governor's provision for a retailer performance program.

* Sunset after two years – Kaufert [illegible] *

Note:

Under current law, lottery retailers receive sales compensation of 5.5% of on-line ticket sales and 6.25% of instant ticket sales. This basic compensation is set in statute and paid from a sum sufficient appropriation with segregated lottery fund revenues. Under the motion, with sales projected at $411.0 million annually, the 7% basic compensation rate would increase basic retailer compensation by $2,163,800 in 1999-00 and by $4,327,500 in 2000-01. Deletion of the retailer performance program would decrease retailer compensation by $2,113,000 in 1999-00 and $4,308,500 in 2000-01. Under the motion, property tax credit amounts would be estimated at $105.9 million in 1999-00 and $104.1 million in 2000-01.

[Change to Bill: $69,800 SEG]

Motion #505

MO# 505

BURKE	Y	N	A
DECKER	Y	N	A
JAUCH	Y	N	A
MOORE	Y	N	A
2 SHIBILSKI	Y	N	A
PLACHE	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A
GARD	Y	N	A
PORTER	Y	N	A
1 KAUFERT	Y	N	A
ALBERS	Y	N	A
DUFF	Y	N	A
WARD	Y	N	A
HUBER	Y	N	A
RILEY	Y	N	A

AYE 7 NO 9 ABS 0

Representative Kaufert
Senator Shibilski

REVENUE – LOTTERY ADMINISTRATION

Sum Sufficient Appropriation for a Daily On-line Lottery Game

Motion:

Move to provide $400,000 SEG in 1999-00 and $600,000 SEG in 2000-01 in a new sum sufficient appropriation to fund contract costs for a daily on-line lottery game with a horse-racing theme. Provide that the appropriation pay the contracted vendor up to 2% of total ticket sales of the daily on-line game. Provide, under a non-statutory provision, that the Department may, notwithstanding the currently approved average prize payout ratio for on-line games, provide up to 60% of ticket sales to game winners in 1999-00 for this on-line game.

Note:

The daily game under the motion is an on-line pick three game in which the winning numbers are randomly selected, but presented in the form of a one-minute televised animated horse race. The vendor that operates and markets the game would receive up to 2% of the total ticket sales of the game. Under the motion, a separate sum sufficient appropriation would be created to pay the 2% fee. Lottery officials project sales relating to the game at $20,000,000 in 1999-00 and $30,000,000 in 2000-01. At these sales levels, and assuming that the sale of other lottery games would not be affected by the new game, lottery property tax credit amounts would be projected to increase by $6.3 million in 1999-00 and $9.7 million in 2000-01.

Under the motion, estimates for related lottery sum sufficient appropriations under current law would increase to reflect costs associated with the new game, as follows: (a) $1,100,000 in 1999-00 and $1,650,000 in 2000-01 for retailer compensation; and (b) $160,000 in 1999-00 and $60,000 in 2000-01 for vendor fees. The non-statutory provision would allow the Department to pay up to 60% of sales to prize winners in 1999-00 only. The payout ratio for 2000-01 would be subject to the Committee's approval of the Department's annual prize payout report, required under current law to be submitted to the Committee under a 14-day passive review process on March 1 of each year.

[Change to Bill: $1,000,000 SEG]

Motion #514

MO# 514

BURKE Y N A
DECKER Y N A
JAUCH Y N A
MOORE Y N A
2 SHIBILSKI Y N A
PLACHE Y N A
COWLES Y N A
PANZER Y N A

GARD Y N A
PORTER Y N A
1 KAUFERT Y N A
ALBERS Y N A
DUFF Y N A
WARD Y N A
HUBER Y N A
RILEY Y N A

AYE 5 NO 11 ABS 0

Gov Agency: DOR – Lottery Administration

Recommendations:

Paper No.: LFB Summary Items for Which No Issue Paper Has Been Prepared

Comments: Since it's a Gov. agency, no action is necessary.

Prepared by: Cindy

REVENUE

Lottery Administration

LFB Summary Items for Which No Issue Paper Has Been Prepared

Item #	Title
1	Lottery Sales Projections and Fund Condition Statement
2	Basic Retailer Compensation
4	Vendor Fees

LFB Summary Item to be Addressed in a Subsequent Paper

Item #	Title
5	Lottery Funding for Compulsive Gambling Awareness Campaigns