

**DEPARTMENT OF TAXATION'S ANNUAL REPORT REGARDING THE
INTEGRATED TAX INFORMATION MANAGEMENT SYSTEM (ITIMS) REQUIRED
BY ACT 273, SESSION LAWS OF HAWAII 1996; AND ACT 155, SESSION LAWS OF
HAWAII 1999**

December 2002

BACKGROUND

Act 273, Session Laws of Hawaii 1996 (Act 273), authorized the Department of Taxation (Department) to enter into performance-based contracts for a Systems Replacement Project. Act 273 requires, among other things, a report from the Department which provides detailed information on the cost and benefits of implementing the Systems Replacement Project; the amount of increased tax, interest, and penalties collected; and the amount paid to the vendor.

Act 155, Session Laws of Hawaii 1999 (Act 155), established the integrated tax information management systems special fund and requires a report from the Department which provides an accounting of the receipts and expenditures from this fund.

At the inception of the Systems Replacement Project, the Department had two major (computer) processing systems, the Comprehensive Net Income Tax (CNIT) and the General Excise, Withholding and Transient Accommodations (GEW/TA) tax processing systems, which are not integrated and cannot "talk" to each other. These systems were antiquated and rigid, did little more than automate manual processes, and still require substantial additional manual processing. There also are additional seven tax types that are maintained manually. The State would not be able to maximize tax revenue collections even at the current level of staffing without an integrated system for all taxes that is flexible and responsive to rapidly changing departmental, legislative and taxpayer needs and requirements.

The state of Hawaii's economy, the projected cost of an integrated tax information management system, and the Department's past experiences with other computer projects led the Department to explore alternative methods of contracting and financing. The tax and revenue agencies in California and Kansas had entered into performance-based contracts. These contracts allowed for the contractor to be paid only from the increased revenue and/or cost saving realized after delivery and implementation of the product. The California Franchise Tax Board had already successfully completed two performance-based contracts and has embarked on a third in 1995. Those two states were used as models in asking for legislation to allow the Department to enter into performance-based contracts. Act 273 is the result.

Act 273 allows the Department to enter into performance-based contracts to acquire automated tax systems. A performance-based contract is one in which the State is liable to pay the vendor only if

the promised “performance” is achieved. In this case, the “performance” consists of the State collecting more tax revenue than it would have collected if the vendor’s services were not used. The nature of a performance-based contract is designed to shift the risks to the vendor who carries the cost of the work performed. If the expected benefits are not in fact produced, the vendor does not get paid.

The Department’s need for an integrated tax system and its components, which incorporate the newest technological advances, is even greater today. Tax collections account for over 70% of the State’s General Fund revenues. Current and future budget restrictions and taxpayers’ increasing awareness of technology and tax avoidance strategies affect the Department’s ability to collect tax revenues at optimal levels. The Department must maintain credibility as a tax agency to ensure taxpayer confidence, critical to a voluntary compliance self-assessment tax system.

DESCRIPTION OF THE SYSTEMS REPLACEMENT PROJECT

A Two-Step Request for Proposal was released on October 28, 1996, for an integrated tax information management system (ITIMS). A competitive screening process was used to select a contractor with the expertise to assist in developing the new system on September 12, 1997. The financing and payment arrangements were approved by the Comptroller, in consultation with the Director of Finance, in accordance with the provisions of Act 273, SLH 1996. The contract with American Management Systems, Inc. (AMS) was signed on August 12, 1999.

AMS has demonstrated success in areas including design of large tax and accounting systems, development in a data base management systems environment, and awareness of new technology products and trends. This private sector business partner will supply the expertise and will fund development costs until the State realizes increased revenue from the project from which the partner-contractor can be paid. Act 155, SLH 1999, provides for a Special Fund from which the contract cost can be paid, contingent upon realization of increased revenue from the initiatives below.

During this five-year project, longer term systems infrastructure development will be implemented concurrently with other initiatives. The short-term or immediate initiatives will generate the revenue to fund the project, and are termed the “Early Wins” program. The longer-term focus and pace of the ITIMS implementation are structured such that the Department can better absorb the impact of change over a more manageable time frame and exploit the benefits of a progressive development program. Project initiatives include:

- ***Immediate Customer Service and Collection/Benefit Initiatives:*** A new collection sub-system will be implemented first to improve delinquent detection and collection efforts, reduce the accounts receivable balance, and increase revenue. The implementation of a proven audit modeling and selection module will provide automated selection to allow audit staff to focus on accounts that would yield maximum return.

- ***Integrated Tax Information Management Systems (ITIMS) Development and Implementation Track:*** The ITIMS implementation track has the goal of creating an environment at the Department that is reengineered and technically enhanced to facilitate customer service and support key business objectives. It is anticipated that numerous improvements will be identified, with some of the following priority items:
 - ***Taxpayer Services*** will be significantly enhanced, and consolidated taxpayer profile information will be more available, as a result of implementing a new registration and taxpayer accounting system. Electronic filing, automated telephone information, and other services can be accommodated and business registration streamlined.
 - ***Returns Processing*** will enhance the capture of taxpayer return, remittance and demographic information. The returns processing module will improve the accuracy and timeliness of processing all types of tax returns. This will be accomplished by increasing productivity through improved processes and more efficient access to information.
 - ***Revenue Accounting System*** will provide a control and reporting mechanism for the revenue collection and disbursement process. This will be greatly improved by a redesigned intake processing system. Integrated systems will provide consolidated processing which also facilitates specific tax requirements.
 - ***Collections and Audit*** will be enhanced by using case management systems for collection and audit. Automated workflow and processing will increase collector efficiency and effectiveness. Improved audit modeling tools will allow the Department to better utilize our limited auditing resources.

STATUS OF THE SYSTEMS REPLACEMENT PROJECT

The proposed project plan is based on a five-year schedule (see attached). The short-term Early Wins initiatives were planned for and implemented in years one and two, 2000 and 2001. The ITIMS blueprint planning effort was also initiated in year one, with replacement of the CNIT system targeted in year three, 2002, followed by the replacement of the GEW/TA system in year five, 2004.

During the second year, 2001, the major efforts focused on four areas: ITIMS Early Wins Program, Electronic Filing, commencement of the CNIT system replacement, and the commencement of the organizational development component.

- The ITIMS Early Wins Program generated benefits by producing more effective collection notices and encouraging timely tax filing. During 2001, a full function collection system using a pre-existing AMS software product was implemented. The amount of benefits generated from inception through October 31, 2002 was \$100 million. The benefits generated from the project now exceed the cost (\$52 million) of the entire project, including general excise tax and interest.
- The Department's electronic filing initiatives provided comprehensive self-service capabilities for Hawaii's citizens and businesses through the Internal Revenue Service's Joint Electronic Filing (JELF) and the State of Hawaii's Internet portal (eHawaiiGov). By the end of October 2001, the Department received 23,000 electronically filed returns through the JELF program. Also by the end of the same period, the Department had a variety of tax forms on the Internet portal including the periodic returns for general excise, transient accommodations, and withholding taxes.
- The CNIT system replacement portion of the project commenced.
- The organizational development portion, which addresses the organizational changes and the steps to implement them, began.

In the third year, 2002, the CNIT system replacement portion of the project was implemented on schedule. Additionally, the focus was on enhancing the electronic filing delivery channels, commencing a project to implement a remittance processing system (including the modification of forms) and completing the first phase of the organizational change. In addition, the design and development phases of GEW/TA system replacement will begin.

- The CNIT system replacement went through many steps during 2002, including completion of system development, system testing, training of employees, and user acceptance testing. The three years of effort culminated with the implementation of the CNIT replacement system on November 6, 2002. After implementation the system will be in a "controlled production" phase in which production activities are monitored to ensure that system operations meet expectations. It is also a period in which the Department is able to adapt to the new application. This phase will last approximately five months ending in April 2003.
- The electronic filing systems were enhanced in three ways. First, more forms were added to the JELF processing channel and there was additional publicity regarding JELF. 81,000 returns were processed through JELF. Secondly, the third set of forms, including the individual short form return (N-13) and the annual returns for the general excise tax and transient accommodations tax were placed on the state's internet portal. Lastly, work commenced on a high volume Internet filing channel to address service provider needs

(accounting services, payroll services, property management companies and trust companies) with a high volume delivery channel at minimal cost. This project is expected to be completed by year-end.

- The remittance processing system (RPS) was undertaken to reduce the time delay between receipt and processing of payments and the recordation of the payment into the legacy applications (CNIT system replacement and GEW system). This project utilizes automated equipment that captures information from a payment voucher and uploads this information nightly to the legacy applications. Forms modifications have also been completed to match the new process and implementation is scheduled for the end of January 2003.
- The first phase of the organizational development portion of the project was completed in September 2002 with the approval of the reorganization plan by the Department of Budget and Finance. The main thrust of this reorganization is to establish the support areas of the department for the new automated systems and affects primarily staff offices. The reorganization utilizes vacant positions to achieve the required changes. This reorganization affects approximately 18 positions.

Business process re-engineering, organizational development, change management, and transition management activities are crucial in reshaping the Department's processes and will be undertaken as a partnership.

The Department's organizational development effort will entail the movement of positions and responsibilities between divisions, branches, and staff offices. In certain instances, position descriptions will be refined and in others, re-written. The organizational development portion will be implemented in three phases starting in October 2002 and ending in July 2004 to ensure the Department is able to execute its operations while continuing to meet performance objectives. To facilitate the phased in organizational development implementation, select vacant positions will be left open until utilized in the appropriate phase. This approach will reduce the level of stress associated with staff movements within the Department as a result of the organizational development implementation.

The following are the major milestones achieved and projected in the next year for the Systems Replacement Project:

<u>Timeframe</u>	<u>Description of Major Milestones</u>
Prior and Current Year:	
Jan 1999	Bill introduced to establish a special fund for the integrated tax information management system.
Jun 1999	Act 155, SLH 1999, establishes the integrated tax information management systems special fund.
Aug 1999	Contract signed August 12, 1999.
Sep 1999	Contractor started work September 7, 1999.
Oct 1999	Invitation for Bid (IFB) for quality assurance consultant services released.
Nov 1999	Bid opening and award of contract for quality assurance contract services.
Jan 2000	Contract for quality assurance consultant services signed. Contractor starts work.
Feb 2000	Memorandum of Understanding (MOU) signed with the Internal Revenue Service to participate in the joint Federal/State Electronic Filing Program (JELF).
Mar 2000	First Early Wins implementation: Collections - GEW/TA (automated billing via legacy GEW/TA system).
Apr 2000	First automated printing of GEW/TA first and second billing Failure to Pay notices relieved Collection staff from manually adjusting over 5,000 accounts and manually producing over 6,000 bills.
May 2000	First realization of increased revenue due to ITIMS.
Jun 2000	First automated printing of GE Failure to File notices.
July 2000	First assignment to collectors of cases processed through GEW billing system of GE Failure to File notices.

<u>Timeframe</u>	<u>Description of Major Milestones</u>
Aug 2000	Second Early Wins implementation: ITIMS audit modeling and selection (IAMS).
Nov 2000	<p>Delivery of Blueprint planning report that identified core processes, breakthrough concepts and recommendations for business re-engineering.</p> <p>Delivery of ITIMS scoping document which identified the functional application requirements, and conversion and interface requirements.</p>
Dec 2000	Delivery of ITIMS implementation and alternatives strategy for CNIT replacement that included the scope and performance order of remaining ITIMS initiatives.
Jan 2001	<p>Implemented JELF.</p> <p>Start of ITIMS Tax Processing System (ITPS) for CNIT replacement: implementation analysis project plan, followed by general system design and development activities.</p> <p>Start of organizational development document (Organizational Impact Analysis).</p>
Mar 2001	<p>Early Wins Implementation: ITIMS Collection System (ICS) for GEW/TA legacy system.</p> <p>Implemented first set of forms and processing for eHawaiiGov portal.</p>
June 2001	Early Wins Implementation: ITIMS Collection System (ICS) for CNIT legacy system.

<u>Timeframe</u>	<u>Description of Major Milestones</u>
July 2001	<p>Delivery of General System design document for CNIT system replacement.</p> <p>Commencement of programming effort of modifications for CNIT system replacement.</p>
Aug 2001	<p>Finalization of list of required modifications for CNIT system replacement.</p> <p>Installed: Replacement data entry system hardware and software.</p>
Oct 2001	<p>Implemented second set of forms for eHawaiiGov portal.</p> <p>Commenced manual data cleansing effort for CNIT system replacement.</p>
Jan 2002	<p>Completion of development of programming modifications for the CNIT system replacement.</p>
Feb 2002	<p>Implementation of third set of forms for eHawaiiGov portal.</p>
June 2002	<p>Completion of system testing for CNIT system replacement.</p>
July 2002	<p>Commencement of staff training for CNIT system replacement.</p> <p>Start of user acceptance testing for CNIT system replacement.</p> <p>Start of bulk filing internet system project.</p> <p>Start of Remittance Processing System (RPS) project.</p>
Oct 2002	<p>Completion: User acceptance testing of CNIT system replacement.</p> <p>Completion: Staff training for CNIT system replacement.</p>
Nov 2002	<p>Implementation: CNIT system replacement.</p> <p>Implementation: Phase I of organizational development plan.</p> <p>Commencement of CNIT system controlled production activities.</p> <p>Commencement of GEW/TA system replacement modifications.</p>

<u>Timeframe</u>	<u>Description of Major Milestones</u>
<i>Planned/Projected</i>	
<i>March 2003</i>	<i>Completion of controlled production phase.</i>
<i>July 2003</i>	<i>Approval of Phase II of reorganization plan.</i>
	<i>Completion: GEW/TA system replacement modifications.</i>
<i>Oct 2003</i>	<i>Implementation: Phase II of organizational development plan.</i>
<i>March 2004</i>	<i>Approval of Phase III of reorganization plan.</i>
	<i>Commencement of user acceptance testing for GEW/TA system replacement.</i>
<i>July 2004</i>	<i>Completion of GEW/TA system replacement user acceptance testing.</i>
	<i>Implementation: GEW/TA system replacement.</i>
	<i>Implementation: Phase III of reorganization development plan.</i>

ACCOUNTING FOR THE RECEIPTS AND EXPENDITURES FROM THE ITIMS SPECIAL FUND, AS REQUIRED BY ACT 155, SLH 1999

The Contract for the ITIMS was signed on August 12, 1999. Work on the ITIMS project commenced on September 7, 1999. In accordance with the terms of Act 273, SLH 1996, and the contract, payments will be made only from increased revenue attributable to ITIMS.

For fiscal year 1999-2000, expenditures from the ITIMS special fund amounted to \$7,288,917.54.

For fiscal year 2000-2001, expenditures amounted to \$16,201,056.84.

For fiscal year 2001-2002, expenditures amounted to \$9,003,575.21.

For fiscal year 2002-2003, expenditures as of November 30, amounted to \$4,137,740.79.

Cumulative to date expenditures for the ITIMS project totaled \$36,631,290.38.

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ITIMS Project Timeline Future

