

OVERVIEW - INDIANA DEPARTMENT OF REVENUE:

The mission of the Indiana Department of Revenue (IDOR or Department) is to administer the tax laws and collect tax revenues in a fair, consistent and efficient manner for Indiana taxpayers and provide accurate, timely, and reliable funding and information to state and local constituents. During fiscal year 2012, the Department served over 4.2 million individual taxpayers and more than 185,000 business taxpayers collecting more than \$16.4 billion of revenue for the State of Indiana. These taxes included individual and corporate income taxes, sales taxes, state & county payroll withholding taxes, and over 40 additional specialized taxes. The Department's stakeholder group includes individual and business taxpayers, legislators, counties and municipalities, multiple state agencies, more than 2,000 tax practitioners, and more than 25 interest groups (chambers, associations, etc.). The Department is organized into several groups broken down among four primary functional accountabilities – Legal, Operations, Compliance, and Business Support. Please refer to the attached organizational chart for further detail.

A brief description of each of the functional areas is as follows:

LEGAL DIVISION

- **Tax Policy** - Manages policy research, legislation and tax rulings
- **Legal** – Conducts tax hearings, manages tax protests, advises on tax rulings and general business matters; also supports the Attorney General's office in matters before the Indiana Tax Court
- **Inheritance** – Handles Indiana inheritance tax issues
- **Administrative Law Judge** – Addresses commercial motor carrier violations and certificate of convenience and necessity licensing

OPERATIONS

- **Special Tax and Support Administration** – Manages all special taxes (e.g., fuel tax and cigarette tax), Motor Carrier Services, and operates the returns processing center
- **Tax Administration** – Manages all aspects of individual and business taxes including taxpayer customer service
- **Taxpayer Advocate** – Manages complex tax issues needing specialized attention when other departmental channels have been unable to resolve a tax matter and fulfills the legislatively mandated taxpayer advocate responsibilities; the Taxpayer Advocate's office also acts as the agency's liaison with the Internal Revenue Service regarding federal data security

COMPLIANCE

- **Enforcement** – Performs and manages taxpayer audits and special investigations
- **Collections** – Manages all aspects of inbound and outbound collection efforts including outside collection agencies, sheriffs, etc.; oversees expirations and renewals of Registered Retail Merchant Certificates (RRMC); manages taxpayers subject to bankruptcy protection

BUSINESS SUPPORT

- **Finance** – Manages budgeting and accounting, cashiering and electronic funds transfer, procurement, internal audit, and financial planning and analysis
- **Information Technology** – Manages divisional information technology platforms and applications including programming, hardware and software; oversees disaster recovery planning
- **Public Relations** – Manages all internal and external communications, community outreach and education, market research and all form and tax booklet development.
- **Human Resources** – Manages all employment issues, recruitment, training and succession planning

RECENT FOCUS & SUCCESS:

Over the last several years, IDOR has focused its attention and invested significantly in delivering exceptional service in an efficient manner to the individuals and businesses of the State of Indiana as they report and pay their taxes. Implementation of enhanced imaging technology, advanced electronic filing mechanisms, an integrated telephone system, and comprehensive staff training in a customer focused service approach, have resulted in IDOR being recognized as a national leader in service and efficiency among state departments of revenue. The agency has been able to achieve exceptional operational results at the same time reducing headcount and direct expenses. Processing of 2011 tax returns in the current year witnessed nearly a five week improvement over the prior year. To date, approximately 73% of 2011 individual tax returns were filed electronically and over 150,000 businesses are registered to file their sales tax and payroll withholding taxes online.

CHALLENGES:

While this operational focus was yielding best-in-class operational results, it was difficult to simultaneously provide the same focus on infrastructure and back office support systems. In fact, this overarching emphasis on speed and efficiency in processing taxes, ultimately translated into reduced emphasis on controls and information analysis in the IT, financial, accounting and reporting areas.

Further, the increasing complexity of changes within tax types, the advent of new payment methods, annual legislative changes, implementation of a new statewide general ledger system, and increased

compliance initiatives put a tremendous strain on aging, cumbersome, disparate, and non-integrated processing platforms and IT applications that were developed years ago.

As publicly disclosed, these issues contributed to two specific significant errors in reporting the aggregate allocation and distribution of taxes collected. Though subsequently corrected, these errors highlight the impact of these challenges and our need to address systemically the root cause of these errors. Accordingly, IDOR has worked collaboratively with Deloitte & Touche LLP (Deloitte), a highly regarded international accounting and consulting firm with expertise in revenue departments across the country, to conduct a comprehensive Operational Risk Assessment with their initial report being issued in September, 2012. This report identifies multiple risks, inherent and Department specific, which are being audited at present. IDOR is utilizing this report as a guidepost as we examine our processes and procedures closely and implement controls and procedures to mitigate these risks. Many new controls and procedures have already been implemented with additional measures to be addressed over the next months and even years. Our objective is to implement and achieve best practices in all areas of responsibility over time.

STRATEGIC PROGRAMS & INITIATIVES:

New leadership of the Department has clearly identified its top strategic priorities and has begun implementing programs and initiatives consistent with these priorities. **The top priority is to restore the credibility of the Department by ensuring accurate and reliable processing and reporting of all Indiana taxes.** This process began immediately with the arrival of the new Commissioner and CFO in May, 2012 and continues today with the on-going implementation of new controls and procedures, recruitment of appropriately skilled professionals, thorough documentation and understanding of systems, and comprehensive review and communication of priorities and strategies. **You will note that our funding request will clearly reflect investments, many of which have already been made in the current year, to support this top priority.**

Other immediate priorities are to:

1. Complete relocation, consolidation, and downsizing of our returns processing center, motor carrier services, and special taxes facilities
2. Implement the eFile mandate for corporate sales tax and payroll withholding taxes
3. Successfully implement and test legislative changes impacting the 2012 tax filers

Longer term strategic and cultural priorities for IDOR are to:

1. Continue to deliver exceptional customer service to all stakeholders
2. Process all filings accurately, efficiently and in a timely manner
3. Ensure consistent, fair taxpayer compliance
4. Provide reliable, relevant and timely information to stakeholders

We believe increased investment in taxpayer compliance initiatives, both in the area of audit and collections, will yield significant additional tax revenues to the State of Indiana without the adoption of any new taxes. Accordingly, you will note that our funding request includes increases in these areas as well.

ACCOMPLISHMENTS & OBJECTIVES:

As described above, many significant improvements were achieved in the areas of tax processing and customer service in 2011 and 2012.

FY 2012 Performance Statistics

- Collected over \$16.4 billion representing 44 active tax types
- Trust tax collections using INtax online platform grew to \$4.6 billion compared to \$2.7 billion in 2010, an increase of 70%
- INtax now has over 150,000 registered businesses and growing rapidly
- \$149 million in delinquent trust taxes collected
- Over 3 million individuals returns processed by May 11, nearly five weeks sooner than ever before
- 95% recommend rate for INfreefile users
- Customer Service:
 - Telephone calls: 534,680, with 86% immediate response rate
 - E-mails: 20,831
 - Walk-ins: 18,748
 - Correspondence: 28,560
 - Electronic filing of individual tax returns: 73%

Progress on Strategic Priorities

The Department has implemented numerous significant changes that provide the groundwork for the transformation of the Department over the next several years. Some of the key changes which have already been initiated include the following.

1. Re-defined Mission, Vision and short and long term strategic priorities emphasizing quality and accuracy in addition to efficiency and communicating them to stakeholders, particularly staff members;
2. Recruited new senior leadership including Chief Financial Officer and Chief Information Officer with strong strategic and project management experience and re-aligned reporting structures;
3. Implemented Strategic Operations Committee and IT Planning and Resource Committee which work to ensure that financial and staff resources are focused on the Department's highest priorities;
4. Incorporated user acceptance testing (UAT) into our change management process to ensure accuracy and integrity of programming modifications;

5. Re-validated data and programming fixes related to previous errors to ensure accuracy and reliability and developed validation model to verify the integrity of Returns Processing System (RPS) reporting ;
6. Implemented numerous new internal controls, reporting tools, and process changes to reduce potential for future errors;
7. Completing relocation and consolidation of returns processing center to new facility which will yield annual savings of over \$600,000; and
8. Executing aggressive outreach to businesses for early adoption of INtax online filing ensuring compliance with eFile mandate for January 1, 2013

REQUESTED FUNDING FOR PROGRAM INVESTMENTS:

Our request for the 2014 and 2015 Biennium Budget includes two priority initiatives requiring increased funding and investment. These two areas are 1) strengthening accuracy and reliability of our processing and reporting systems, and 2) increasing tax revenues through enhanced taxpayer compliance.

Strengthening Accuracy and Reliability of Processing and Reporting Systems

As we have noted, great strides have been achieved in improving our taxpayer customer service and operating efficiency. In order to ensure accuracy and reliability of our processing and reporting, additional investment in hardware and software enhancements and internal controls is essential at this time.

The Deloitte Operational Risk Assessment offered the following observations in their report:

1. The technologies for many key business applications appear to be outdated and inflexible;
2. There may not be an effective disaster recovery and business continuity plan for key business applications;
3. The organization may not have personnel or business analysts who are knowledgeable in both IT and business processes necessary to develop business requirements to correspond with IT changes;
4. Positions may not exist for those areas that may not historically have been a focus, such as financial reporting, accounting, and business and revenue analysis.

Management of the Department concurs with these assessments and has begun addressing these issues already, particularly through the addition of numerous qualified finance and IT professionals.

Additional professional staff additions remain necessary, however, and will require an increase in our funding. Management has also begun its evaluation of the IT applications necessary to perform its charged responsibilities and acknowledges that a comprehensive replacement of the foundational RPS operating system developed in the mid to late 1990's is not feasible at this time. Such an evaluation will require extensive research, would likely encompass a substantial capital investment, and would take

several years to implement. We look forward to reviewing recommendations from the audit as it relates to the RPS operating system, and may need to revisit this topic based upon the audit results. At this time, our funding request encompasses essential, though much smaller, investment in basic operating hardware and software which will be necessary to meet our basic operating needs and prudently address our current disaster recovery and business continuity deficiencies.

Increasing Tax Revenues through Enhanced Taxpayer Compliance

Ensuring fair and consistent compliance by taxpayers is a core underlying principle of our State. When all of our Hoosier taxpayers remit their taxes as they are legally responsible to do, our State receives the necessary funds to operate and tax rates are maintained at fair and equitable levels. Regrettably, not all Hoosier taxpayers comply with this responsibility which places increased strain on State finances and increased tax burden on compliant taxpayers. Within the Department our Enforcement Group and Collections Group are responsible to ensure fair and consistent compliance and payment of taxes which are legally due.

Non-compliance has been researched extensively in an attempt to quantify its impact. Robert E. Brown and Mark J. Mazur released a white paper in June, 2003 entitled, *IRS Comprehensive Approach to Compliance Measurement* in which they sought to estimate the percentage compliance. Their research indicated that there are three distinct types of non-compliance: a) return not filed, no payment made (9%), b) return filed, payment made, but income under-reported (8%), and c) return filed but no payment made (1%). If we apply these rates of non-compliance to the \$12.1 billion of individual and corporate income and sales taxes collected by the Department in FY 2012, we can extrapolate that non-compliance could be costing the State over \$2 billion annually. The successful Tax Amnesty Program concluded by the Department in 2006 yielded \$244 million illustrating the prevalence of non-compliance within our State.

It is unrealistic to achieve full compliance, however, we do believe that investment in additional staff resources, investment in third party statistical and compliance tools, and increased data base information sharing among Indiana state agencies will meaningfully improve the rate of compliance and increase tax revenues for the State. Our goal is to permanently convert non-compliant taxpayers into compliant ones going forward thus reducing the burden to all Hoosiers and ensuring businesses operate on a level playing field.

REDUCTION OR ELIMINATION OF PROGRAMS:

Taxpayer Administration

Increasing the adoption of the INtax online business filing platform, implementation of the eFile mandate, and process enhancements, will yield significant efficiency improvements in the next biennium. Our budget request assumes our tax administration area will reduce headcount requirements by 10-18 FTE's overall within the biennium through continuing migration to electronic

filing of returns. These reductions will be realized through natural attrition and backfills within tax administration and the Department. We have already announced our staffing plan to staff and have received strong acceptance. Savings from these headcount reductions will help offset the increases in staff in our Finance/Accounting and IT areas requiring additional investment necessary to strengthen internal control.

Returns Processing Center

As noted earlier, the relocation and consolidation of our returns processing center, Motor Carrier Services and Special Taxes will yield annual lease and utilities savings of over \$600,000. We are reducing our overall space needs from nearly 150,000 square feet to approximately 98,000 square feet. This relocation and consolidation, made possible by the reduced headcount and storage requirements resulting from changes in technology and processes, will also generate savings that can be applied to investments in IT and Finance/Accounting.

CLOSING:

Thank you for your consideration of our 2014-2015 Biennium Budget Request. We have serious challenges ahead of us to address the risks and deficiencies which have been identified, but believe we have made dramatic progress in defining the appropriate priorities and establishing the right cultural environment for success. We believe the increased investment is critical and will yield a rapid payback to the State of Indiana.

EXHIBIT A - ORGANIZATIONAL CHART:

