

System Requirements and Estimated Costs - Colorado House Bill 10-1193
Expert Witness Opinion, Prepared by F. Curtis Barry & Company, September 16, 2010

~~Changes since yesterday in green.~~

**System Requirements and Estimated Costs
Resulting From the Colorado Statue House Bill 10-1193
Expert Witness Opinion**

Effective March 1, 2010 the State of Colorado enacted House Bill 10-1193, an act concerning The Collection of Sales and Use Taxes On Sales Made By Out-Of-State Retailers. These are the Systems Requirements to meet the Statute's requirements and the Estimated Costs that F. Curtis Barry & Company (FCBCO) believes retailers will be required to spend.

F. Curtis Barry & Company has reviewed the following documents:

- o State of Colorado enacted House Bill 10-1193
- o DMA Amended First Complaint
- o ~~DMA Exhibit 2 - Colorado Regulation 39-21-112.3.5~~

A. Conclusions

Note to Brann Law: This section will be rewritten once we have all the estimates and conclusions.

This is a large effort and cost expended for a small number of sales and customers annually affected by the Colorado law. The initial start up costs may be \$34,000 to \$46,000 for small to moderate sized companies. Larger companies may spend more because of Sarbanes/Oxley compliance.

How many customer Transaction Notices might result? The size of a business can be measured by the size of the 12 month customer file, which is a direct industry standard metric.

Companies larger than start ups may have 20,000, 12 month purchasers (affecting 320 Colorado customers) to 80,000, 12 month purchasers (affecting 1,280 Colorado customers). These estimates include:

- o Number of Colorado customers are based on Colorado having 1.6% of US population
- o Multiple purchases by a customer will only generate one Transactional Notice.

For larger companies which might have 200,000, 12 month buyers or more higher would affect 3,200 Colorado purchasers).

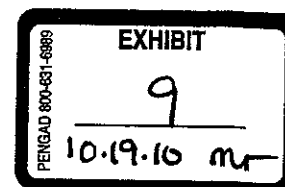
We have used these calculations in some of the annual cost estimates.

The annual on-going operational and postage costs could be several dollars per customer notice.

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Note to Brann Law: will insert cost ranges

The initial start up costs would take several years for companies to recoup the lost gross margin.

Because of the customer implications and need for accuracy of reported purchases we believe there will be additional set up and on-going expenses for outside compliance consulting.

B. Systems Requirements

1.0 New Customer Purchases and Sales Tax Reporting System to meet Colorado Statue

The Statue requires the retailer to notify and report customer purchases to customers and Colorado Department of Revenue with these requirements:

- Provide a Transactional Notice informing the purchaser (First Amended Complaint P11, #33)

This is required on every purchase. It can be done by inserting a disclosure in the outgoing package, attached to the computerized order form or printed on the order. Printing on the order form could be a major change for software vendors.

Note to Brann Law: If you notify the customer when they place a web order do you need to print and disclose on order?

Wording considerations of Transactional Notice:

FCBCO would expect that Statue's details would need to be disclosed similar to bank card and accounts receivable notices. However, retailers will want them to be more customer friendly in format and language than financial notices.

This may also require assistance from expert legal or accounting firms to ensure company's compliance and from the company's creative department to be as customer friendly as possible. Should it tell customer how and where to remit sales tax?

Would retailer need to calculate amount of tax for customer (would they want to provide as a service to customer)?

- Provide Annual Purchase Summary to purchasers (First Amended Complaint, P12 #37-44).

Would retailer need to calculate amount of tax for customer (would they want to provide as a service to customer)?

- Provide The Customer Information Report to Colorado Department of Revenue (First Amended Complaint P115, #45-53).
 - Standards for filing electronically?

2.0 Change to website platforms and order management systems described in section B2 above

There are a couple of major systems changes:

1. In order for an e-commerce website, order management or enterprise systems to be able to provide support to the call center inform the customer of tax liability and notices, this would require a major design change from current industry practices for sales tax logic.

This is a major potential problem if companies have to make this change or choose to make this change. Presently, systems use zip codes or geo codes combined with merchandise categories and dollar limits to determine if a customer is subject to sales tax. In all cases where there is customer tax liability (nexus), the system calculates it and stores the tax total on the ordering systems' customer order.

In this case the retailer would not be collecting taxes and there is no "info only tax field" to store the calculated field in, so in order to advise the customer, the order management system would have to be changed either by the software vendor or internally. This is no small change.

2. The disclosure is required on every purchase. It can be done by inserting a disclosure in the outgoing package, attached to the computerized order form or printed on the order. Printing on the order form could be a major change for software vendors.

C. Estimated Costs (See paragraph D for details)

1. Order management, enterprise and e-commerce systems

FCBCO has not estimated the dollars but it could be a \$50,000 one time cost. How the software vendor might charge for this is obviously unknown as it would be a shared expense. It is not a change they would prefer to make.

Company website developers would have an equally difficult time in making this change. This could be another \$30,000 to \$50,000 charge to inform the customer.

- o Potentially to notify customer at time of purchase
- o Disclosure of Colorado Statute (probably as FAQs)

Note to Brann Law: Should we follow up with 2 order management vendors to refine estimates?

2. Initial cost to set up internal company program

Total estimated costs: \$28,000 to \$38,000 per company. For larger companies it will cost more if they have Sarbanes/Oxley requirements and exposure.

Cost breakdown:

- Computer programming costs to develop system internally internal costs of \$8,000 to \$10,000
or
- New module from external service providing customer data base creation and update services that maintain customer master file. External programming by service to create system: \$15,000 to \$20,000
- Call center training program to instruct call center reps on the new Statute and company policy: \$2,000 to \$3,000. One week develop procedures and training materials. This does not include the actual training time which will vary by the call center size (i.e. number of reps).
- Consulting and Legal Expertise For Compliance Costs - \$3,000 to \$5,000
Initial costs of experts to set up disclosure and reporting and assure compliance. This is because of the customer sensitive nature of this information and the need for accuracy, it will be treated ore as a financial system than a marketing system.

Note to Brann Law: reduced down

3. Annual Costs

Total estimated costs:

Note to Brann Law: will be inserted when all costs are available.

These are the estimated costs to run the Annual Purchase Summary to purchasers and the Customer Information Report to Colorado Department of Revenue.

How many customers affected by the March 1 disclosures exceeding \$500?

This is important so to understand the number of customers that a company may be disclosing to in the March 1 timeframe. In general we feel there are several factors in this calculation?

- How large the 12 month buyer (purchaser) file
- The average order in dollars
- The number of times annually a customer purchases annually

Our conclusion is that not more than 20% of the Colorado purchasers on a company file will buy \$500 or more per year. We have used this in calculating the number of disclosures and the associated annual costs. This yields a relatively small number of customers for most out-of-state retailers.

Here are the details of these calculations and assumptions:

Size of company 12 month buyer file

As was mentioned in section A. Conclusions, the size of the 12 month buyer file was used to estimate the number of purchasers.

Examples

Small to moderate sized companies

Companies larger than start ups may have 20,000, 12 month purchasers (or 320 Colorado customers) to 80,000, 12 month purchasers (or 1,280 Colorado customers). This figures in the mailing response rate. We expect this will create a large number of inquiries.

For start ups up to 80,000, 12 month buyers, \$1,120 to \$5,120??? what is this???

For larger companies

For larger companies with 200,000, 12 month buyers.

Large company with 200,000, 12 month purchasers or higher (or 3,200 Colorado purchasers). \$11,200 to \$12,800

Average Order

Many consumer businesses are \$100 or less for average

Annual Customer Purchases

Most consumer catalogs are on the average less than 2 purchases annually.

Breakdown of Annual Costs

Our estimate is that on the average it will cost \$4 to \$5 dollars per customer disclosure with all costs.

The annual production run, insertion, postage and mailing of the customer disclosures is a variable cost based on the number of disclosures. The marketing service bureaus will probably work on the basis on a set up cost (which will be several hundred dollars) and a per customer mailing. These are the tasks or services:

- Production run time costs annually. This will be either internal or through a marketing service bureau. These will include a minimum charge and a cost per 1000 names processed.
- Mailing service costs to run and insert Transactional Notices and Annual Purchase Summary. We have figured this as 2 inserts and an envelop.
- Annual Purchase Summary must be mailed First-Class Mail: \$0.44
- Supply costs for #10 envelop and two pieces of paper

Information Technology Processing Costs

In a generalized way these are the IT production processing steps we would envision for the new Colorado system:

1. The new system will use as it's base data a high data integrity marketing or operational customer purchase file. It must have all detail order/purchase activity data and customer name and address and ship tos.
2. Extract by state of Colorado purchases by customer for the year
3. Extract by state of Colorado ship tos and gift recipients names and addresses?
4. Run preliminary Transactional Notices and Annual Purchase Summary to customer
5. Accounting would make a visual check and approval. Are there any corrections?
6. Make any corrections and Gain approval from accounting department
7. Run final Transactional Notices and Annual Purchase Summary purchasers and ship to and gift recipients
8. Output disclosures to magnetic media or transmit to mailing house
9. Mailing house produces disclosures and mails first class
10. IT runs Customer Information Report for Department of Revenue
11. IT transmits to Customer Information Report Colorado Department of Revenue (electronic filing software or standards which will add costs?)

If the company chooses to run the new Colorado system at an outside service bureau, then they would pass the year end file of purchases, if the company hasn't done so for marketing updates earlier, to the customer file to the service bureau. Many companies update the customer files at the service bureau monthly or quarterly.

- o Customer service call center costs to answer inquiries and complaints.

Colorado is 1.6% of the house file based on Colorado population and a cost per 4 minute call). Fully loaded cost per call is between \$3.50 and \$4.00. Fully loaded includes direct hourly wages, management, employee benefits, space, telecom, etc. These are industry benchmarks. Our estimate is that 50% of the customers will call with questions.

This cost will vary with the size of the house file.

4. On-Going Compliance Costs

On-Going Compliance Costs: \$1,500 to \$2,000

Because of the customer implications and need for accuracy of reported purchases we believe there will be additional set up and on-going expenses for outside compliance consulting.

- Assign to internal company accounting person to be sure of accuracy. Because of year end closing and payroll 941 and W2 processing, a Jan 31 date is a high work load time for accounting.
- Internal person on site at mailing service to assure privacy when running and inserting Transactional Notices and Annual Purchase Summary.
- On-going costs of experts to insure compliance (disclosure and reporting).

D. Detail Estimation of Costs

Note to Brann Law: I need to make this section dovetail with the section C above. You may say cut section.

Initial Set Up

1. Internal systems development to provide a) Transactional Notice informing the purchaser; b) Annual Purchase Summary to purchasers; c) Customer Information Report to Colorado Department of Revenue

Estimated costs: one man month of effort to create the initial system.

Internal costs of \$8,000 to \$10,000. This includes the software design specifications, programming and testing, implementation and documentation.

Based on \$80,000 annual salary with 30% benefit rate. Total \$104,000 in salary and benefit cost.

External programming by service bureau to create system: \$15,000 to \$20,000

Based on licensing module costs which service companies develop. We need to keep in mind this is a financial transaction system with high visibility and risk for the service bureau.

2. Call center training program on new Statute for call center reps – one week develop training materials: \$2,000 to \$3,000

Training reps not included as it will vary by size of call center/reps:

Customer service call center costs (1.6% of the house file representing Colorado based on state's population * cost per 4 minute call). Fully loaded cost per call is between \$3.50 and \$4.00. Fully loaded includes direct hourly wages, management, employee benefits, space, telecom, etc.

E. Potential Costs Not in Estimate

- Settling customer privacy and legal challenges by customers arising from inadvertent disclosure or customer privacy issues of the Statute.

Questions For Brann Law

From First Amended Complaint

- Is B to B part of this? Is it by purchaser or site or top level entity?
- With consumer is it individual? What about different names at same address (Curt Barry, F. Curtis Barry, Fred Barry – all me). What about same person different addresses (home and work)?
- P13, #39 “Purchases by category of product”
 - Many smaller companies do not use merch categories. Detail transactions OK? Any taxing by category of product?
 - Would retailer need to calculate amount of tax for customer (would they want to as a service)?