

System Requirements and Estimated Costs - Colorado House Bill 10-1193
Expert Witness Opinion, Prepared by F. Curtis Barry & Company, September 15, 2010

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

Note to Brann Law: Treat as DRAFT. Need to get your input and I need to complete cost estimates.

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 Curt will insert 3rd doc title

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.

Note to Brann Law: Where does multiple disclosures come in?

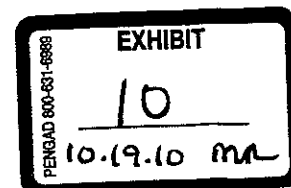
For larger companies which might have 200,000, 12 month buyers or more higher would affect 3,200 Colorado purchasers).

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

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DRAFT REPORT



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

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)

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?

- 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, #4553).
 - Standards for filing electronically?

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

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.

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)

2. Initial cost to set up internal company program

Total estimated costs: \$34,000 to \$46,000 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 - \$5,000 to \$7,000
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.

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 Transactional Notices, Annual Purchase Summary and to purchasers and the Customer Information Report to Colorado Department of Revenue.

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

Small to moderate sized companies

20,000

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

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

Note to Brann law: This is figured at 100% of customer receiving Notice. Assumptions?

Cost breakdown:

- Mailing service costs to run and insert Transactional Notices and Annual Purchase Summary

Note to Brann Law: Waiting several estimates.

- Annual Purchase Summary Mailing First-Class Mail: \$0.44 + supply costs

Note to Brann Law: Will insert supply cost. Probably be expressed as a) set up costs and b) cost per 1000 notices.

- Production run time costs annually

There are two options to operationally running the new system:

Internal production

OR

External service

Note to Brann Law: Will insert processing costs. Tough so far.

Information Technology Processing Costs

These are the IT production processing steps we would envision for the new Colorado system described in section B above:

Assumes there is a high data integrity marketing customer purchase file
Extract by state of Colorado purchases by customer for the year
Extract by state of Colorado ship tos and gift recipients names and addresses?
Run preliminary Transactional Notices and Annual Purchase Summary to customer
 Calculate sales taxes? Taxing different by merchandise category?
 Any corrections/reruns
Gain approval from accounting department
IT runs final Transactional Notices and Annual Purchase Summary to purchasers and
 ship to and gift recipients
IT runs Customer Information Report for Department of Revenue
IT transmits to Customer Information Report Colorado Department of Revenue
(electronic filing software or standards which will add costs?)

- 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.

Note to Brann Law: figured at 100%

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

- P12, #37 Purchases which are deemed “de minimis” – define - what effect on requirements?
- P13, #37 “Will be required to send one or more Annual Purchase Summaries”? Effect requirements.
- P13, #38
 - “Annual Purchase Summary to customers outside of Colorado”? Effect requirements?
 - Services taxable?
 - Gifts and ship tos included from what I see.
- 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)? Would this require a tax service update like Vertex?
 - Tell customer how and where to remit?
 - Accuracy is key to Colorado and customer.
- P15, #45 March 1 versus Jan 31 to Colorado purchasers on P12, #37 Customer Information Report to Department of Revenue?
- In our conversation, I thought we mentioned on total annual purchases of \$500 or more. Where in compliant? Did not figure into this study.

Curt’s Noddle LIST

- Require a tax software product like Vertex or Taxware?

