

February 20, 1997

Senator Charles H Stewart, Senate Chair
Representative Irby N Arrington, House Chair
Members of the Human Services & Health Appropriations Subcommittee
Senator Stephen Rees, Senate Chair
Representative R Mont Evans, House Chair
Members of the General Government & Capital Facilities Appropriations Subcommittee

Subject: **Mailroom Issues** (Report #93-01)

Dear Legislators:

We have completed our review of issues involving state mailrooms. First, we found that the Multi-line Optical Character Reader (MLOCR) was purchased without an adequate needs analysis. Second, we found that information pertaining to mail delegation agreements for the Department of Human Services (DHS) and the Tax Commission was inconclusive. Third, we found that production mail is most efficiently barcoded by computer, a fact that may make the delegation question moot. Finally, we found that issues surrounding the proposed intelligent inserter purchase need to be more carefully considered.

This was not a typical review. We generally audit and make recommendations based on the outcome of past work. However, in this review we were asked to determine the best future course of action when important information is either unknown or uncertain. As a result, some of the opinions in this report are based on limited or incomplete data.

Inadequate Needs Analysis Was Performed

In our opinion, Central Mail did not perform a thorough needs analysis before the MLOCR was purchased. The MLOCR is a machine that reads an address and places a barcode on the mailpiece. By doing this, a postal discount is received because the zipcode is contained in the barcode and the barcode allows for machine processing. Because a thorough needs analysis was not done, two key assumptions made by Central Mail have not materialized. The first assumption was a projected high mail volume for the MLOCR and the second was the MLOCR's ability to process state mail (machine readability). Consequently, the MLOCR is not providing the state with the benefit expected.

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The first incorrect assumption Central Mail made was on the projected volume of mail available to be processed by the MLOCR. This is a critical assumption since volume of mail processed is one of the factors used in the break-even analysis on the MLOCR. Central Mail incorrectly assumed a volume of around 10 million pieces annually. However, the MLOCR actually processes around 5 million pieces of mail annually. Consequently, the MLOCR is not breaking even.

Our work indicates the estimate of mail available to be processed by the MLOCR was incorrect for two reasons. First, Central Mail failed to secure to their operation the processing of mail from other agencies. For example, Central Mail relied heavily on the fact that they would get to annually process about 4 million pieces of DHS mail. Second, Central Mail incorrectly projected the amount of mail available from other agencies for long-term processing by the MLOCR. For barcoding purposes, there are two categories of mail: production and white mail. According to a mail consultant, production mail, or computer generated mail, is most efficiently barcoded by the computer. However, white mail, or mail having no consistency (for example, weight or font style) within itself, is most efficiently barcoded and sorted using an MLOCR type machine. Based on this information, Central Mail's volume estimate for the MLOCR break-even analysis should have conservatively included white mail only. However, the mail consultant's work indicates that at least 50 percent of the projected volume used by Central Mail (10 million pieces) is production mail. In our opinion, 5 million pieces should have been the conservative volume estimate used in the break-even analysis. Had this figure been used, the MLOCR probably would not have been purchased.

The second assumption Central Mail made was concerned the machine readability of the mail. This is an important assumption because it directly affects the potential benefit the state will receive from the MLOCR purchase. Specifically, the benefit the MLOCR provides is a lower postal rate if the MLOCR can barcode the mailpiece. However, if the MLOCR cannot read the mailpiece, it cannot barcode it and no postal discount is received. Central Mail assumed, based on conversations with agencies, that 80 percent of the mail would be machine readable. However, Central Mail reports only 64 percent of the mail is actually machine readable although the rate is increasing with time. Because of the lower machine readability rate, the state is not receiving the postal discounts anticipated.

Because the MLOCR was purchased, there has been a very strong interest to increase the volume of mail the machine is processing. In particular, Central Mail is interested in acquiring the 4 million pieces of mail currently processed by DHS. As a result, there has been a strong interest in delegation agreements and centralizing all mail within Central Mail. Unfortunately, the information currently available does not allow a conclusive analysis of delegation agreements at this time. However, this report later indicates the issue of a

delegation agreement for DHS is irrelevant because the most efficient way to sort and barcode production mail is by computer rather than by the MLOCR. As a result, Central Mail is considering new tasks for the MLOCR

Delegation Agreement Information Inconclusive

The cost information necessary to make a decision regarding delegation agreements involving DHS and the Tax Commission is inconclusive. In order to obtain a conclusive answer, Central Mail must clearly identify its rates for production mail. In addition to cost considerations, service delivery considerations must be made. Specifically, DHS has concerns with timeliness of outgoing mail if Central Mail performs the outgoing mail function for them.

In the past, both DHS and the Tax Commission have had delegation agreements. We were asked to examine DHS because the 4 million pieces of mail they process each year could help Central Mail reach the breakeven point on the MLOCR if Central Mail were to process the DHS' 4 million pieces. We were asked to examine the Tax Commission because Tax desires autonomy in making mail equipment decisions. Specifically, they have requested an intelligent inserter but Central Mail has denied their request. The subject of intelligent inserting is addressed in the last section of this report.

According to the **Utah Code**, *the director of Central Services may delegate his authority to perform mail services only when the delegation would result in net cost savings or improved service delivery to the state as a whole.* In making our analysis of delegation agreements, we examined only the presort function of the Tax Commission's and DHS's mailrooms. We limited our review to this function because this is the function performed by the MLOCR. Both the Tax Commission's and DHS's mailrooms perform other functions such as inserting and metering. In addition, DHS's mailroom has a departmental courier service operating between Ogden and Provo and the Tax Commission's mailroom processes all of its own incoming mail. We did not examine the inserting function because, at the time of this analysis, Central Mail was not performing the inserting function. We did not examine metering because inserting and metering are often a continuous function. Finally, we did not examine the courier service or incoming mail because Central Mail indicated for purposes of this study that they did not wish to centralize these functions.

Production Mail Rates Needed for Cost Analysis

According to our initial cost analysis, DHS should receive a delegation agreement to presort their own mail while the Tax Commission should not. However, our analysis is based on rates that Central Mail claims are for white mail only. Since DHS and the Tax Commission provide

primarily production mail, Central Mail maintains that production mail rates, which will be lower than white mail rates, should have been used in the analysis. However, Central Mail has not formally developed production mail rates. In our opinion, production mail rates should be declared before this cost analysis can be completed.

In developing our methodology to determine net cost savings to the state, we reasoned that we should compare how much each department spends in direct expenses to presort one mailpiece with how much it would cost the department if Central Mail presorted the mailpiece. We focused on direct expenses because these are the expenses a department would actually save if Central Mail were to process mail for them. Overhead expenses like rent and administrative support were not considered in our cost analysis. In addition, when determining Central Mail's cost to presort one mail piece, we focused on Central Mail's posted presort rate. Since Central Mail is an internal service fund, the rate charged should closely approximate the cost of the service.

It should also be noted that the cost figures used in our analysis are our best estimates. Since the costs of neither Taxes nor DHS's mailroom are accounted for separately, it was difficult to ensure that all costs were identified.

According to our analysis, it costs DHS an average of 25.5 cents to presort one mailpiece. This cost includes the direct costs of labor, machinery and postage. We reached this estimate through our observations of DHS's mail process and through employee time reports. On the other hand, it would cost DHS an average of 26 cents a mailpiece if Central Mail were to process mail for them. This cost is based on Central Mail's charge for presorting the mailpiece, plus postage. Based on this analysis, it appears that DHS should continue to receive a delegation agreement to presort their own mail.

On the other hand, it costs the Tax Commission 26.5 cents to presort their own mail. Again, this cost includes labor, equipment and postage costs and was determined using machine-generated production reports and employee time reports. Our analysis further indicates that it would cost the Tax Commission 26.5 cents a mailpiece if Central Mail presorted their mail for them. Again, Central Mail's cost includes their presort charge plus postage costs. Since the Tax Commission does not appear to presort a mailpiece more cheaply than Central Mail which is required by the Utah Code to receive a delegation agreement, Tax should not receive a delegation agreement to presort their own mail.

Upon completion of our analysis, Central Mail objected to our methodology. They indicated that their posted rates apply to white mail only and that it is unfair to apply those rates to mail that is primarily production mail. When we asked for their production mail rates, they indicated that these are negotiated on a case-by-case basis. Specifically, they have negotiated a rate with Employment Security and the Tax Commission. While we used the negotiated production rate in our analysis of the Tax Commission, Central Mail has indicated that they want to increase that rate because Tax's mail readability is not as high as expected. If Central Mail does increase

Tax's rate, our analysis indicates that Tax could probably process their own mail more cheaply.

In our opinion, it is very important to conduct this analysis using Central Mail's rates since those rates are what it actually costs other departments to use their service. In our opinion, Central Mail must develop production mail rates before an analysis of delegation agreements can be completed.

Once cost issues have been considered, **Utah Code** indicates that service issues also need to be considered. DHS maintains that if Central Mail were to process their mail, service to the state as a whole may suffer. Specifically, DHS officials have expressed a concern that time-critical mail may not be mailed in time if Central Mail were to presort DHS's mail.

The Department of Human Services Has A Concern With Timeliness

DHS has indicated that much of their mail is time-sensitive. Specifically, self-sufficiency checks and medical cards must be in a client's mailbox by the first of the month based on the state plan submitted to the federal government. If the recipients receive their checks late, it is possible that the welfare recipients could sue the state. DHS officials believe that Central Services cannot provide the time-sensitive services they currently provide for themselves. However, Central Services claims they effectively provide time-sensitive services for Tax and Employment Security. To see if this concern was common, we called Human Services in six western states: Colorado, Idaho, Washington, Arizona, Oregon, and New Mexico. The results are inconclusive.

Of the six western states called, three (Colorado, Idaho, and Washington) have centralized mail functions. Of these three states, Colorado and Idaho handle Human Services mail. However, only Idaho processes time-sensitive mail such as self-sufficiency checks. In Colorado, time-sensitive mail is processed at the county level. In Washington, Human Services handles its own mail because they feel it is too time-sensitive to go to a centralized function. Therefore, Washington validates what DHS maintains while Idaho invalidates it, reporting no problem with a centralized agency performing its mail function. While Idaho has taken the risk and apparently suffered no problems, Washington is unwilling to take the risk. These data provide no clear indication of which agency could provide the best service, but there is a risk associated with allowing Central Mail to process DHS's time-sensitive mail.

While the question of delegation agreements cannot be answered without more information, in our opinion the question is being asked too late. Instead, this question should have been asked and answered when the MLOCR was purchased. Now there is a new factor to consider that will allow production mail to receive the barcode postal discount without using the MLOCR and, as a result, may make the issue of delegation agreements, particularly for DHS, a moot point.

Production Mail Most Efficiently Barcoded On Computer

A barcode can be placed on a mailpiece in three ways: (1) using a manual encoding station; (2) using an MLOCR-type machine; or (3) using a computer with a laser printer. According to a mail expert, production mail is most efficiently barcoded using a computer. State Information Technology Services (ITS) has purchased the necessary printer font and software to enable ITS to barcode and sort production mail running off the state's laser printer. Further, ITS estimates that it will cost .3 cents to barcode a mailpiece. While Central Mail has not yet done a thorough analysis of what it would cost the MLOCR to barcode one piece of production mail, the cheapest production rate they have negotiated to date is 1.7 cents per piece. Based on these data, it seems unlikely that the MLOCR can barcode a piece of production mail more cheaply than the laser printer at ITS.

Approximately 80 percent of DHS's 4 million pieces of mail is production mail that is run on ITS's mainframe and laser printer. DHS is very interested in having their mail barcoded by the computer and have been actively working on the project for about a year. They have successfully placed a computerized barcode on two of their mail applications. Most importantly, DHS estimates that in six to eight months programming changes will be completed so that mail generated by the welfare system (PACMIS), which is DHS's largest mail application, will have the barcode applied directly by the computer printer.

In our opinion, the information regarding the PACMIS system is of particular importance. Given this information, it makes little sense for DHS to send their mail to Central Mail (even if the delegation analysis supports that) when they are so close to processing all production mail on the computer. Rather, DHS should continue to process their own mail while waiting for the programming changes to be made that will allow the barcode to be placed on the majority of DHS mail by computer. In other words, given the status of computer barcoding technology, we think the issue of a delegation agreement for DHS presort activity is moot.

If DHS mail does not go through Central Mail, and we think it should not, Central Mail is going to have to carefully consider what to do with the MLOCR. Without DHS's volume, the MLOCR will not have the volume necessary to break-even. One possible use for the MLOCR that has recently evolved is to sort incoming mail. While this may present a possible solution and allow the MLOCR to be kept, it is also possible that Central Mail may have to consider selling the MLOCR.

As has been demonstrated, problems can occur when a needs analysis is not performed to determine if a purchase is really necessary. The Department of Administrative Services staff need to ensure that similar problems do not occur with the proposed intelligent inserter by conducting a thorough needs analysis.

Issues Surrounding Intelligent Inserter Need To Be Addressed

Insufficient statewide information has been gathered that would justify the purchase of one or more intelligent inserters. The limited information available on agency demand for an intelligent inserter and the time limitations of this audit did not allow us to determine if an intelligent inserter is justified. However, we recommend that Central Mail begin collecting this information for all state agencies so an accurate determination of demand and a thorough cost benefit analysis can be made. This report also identifies other concerns that need to be considered in addressing the need for an intelligent inserter.

Basically, there are two kinds of inserting. The first, and most common, is mechanical inserting. Mechanical inserting is used when all mailpieces get exactly the same inserts. For example, each envelope is going to receive a check and a newsletter. Currently, the Tax Commission, DHS, and Central Mail all do mechanical inserting. The second kind of inserting is intelligent inserting. Intelligent inserting is used when different envelopes receive different inserts. For example, one envelope may receive a bill while another receives a bill and a delinquency notice. Since an intelligent inserter is more sophisticated than a mechanical inserter, there is a considerable difference in purchase price. A mechanical inserter costs around \$60,000, while an intelligent inserter can cost between \$150,000 and \$250,000.

The issue over intelligent inserting began when both the Tax Commission and DHS indicated that they would both like to purchase intelligent inserters. The Tax Commission went so far as to place a request with the Department of Administrative Services for the purchase of a \$200,000 intelligent inserter. The Department of Administrative Services, however, felt that demand was such that one machine was sufficient and proposed that Central Mail buy an intelligent inserter that everyone could use. However, neither the Tax Commission nor DHS liked this proposal. Because these two departments each wanted an intelligent inserter, the Legislature asked us to determine if this function should be centralized.

A Thorough Needs Analysis Has Not Been Done

Statewide needs analysis has been insufficient and does not justify the purchase of an intelligent inserter. While inserting data has been collected, data specific to the question of the need for an intelligent inserter has not been collected. The Tax Commission has done an analysis of intelligent inserter needs but we have concerns with their analysis. In our opinion, an adequate statewide needs analysis should be performed on the intelligent inserter to determine if this purchase would, in fact, be a benefit to the state.

Central Mail has performed no statewide analysis that would identify the need for an intelligent inserter. Central Mail has collected information on the amount of inserting different departments do. However, little is known about how much of this inserting demand requires an intelligent machine. This is important because, as we have noted before, the difference in costs between a mechanical inserter and an intelligent inserter is significant. Further, Central Mail has collected no information on what inserting, using their present methods, currently costs departments. As a result, we do not know if savings would occur if we were to purchase an intelligent inserter.

The Tax Commission is the only agency to have analyzed current demand for an intelligent inserter. They have also performed an analysis on the cost of their current insertion method and the possible savings if an intelligent inserter were purchased. However, we have a concern with their analysis. Specifically, the Tax Commission has developed two significantly different estimates of the cost to manually insert one mailpiece. One cost estimate is 2.3 cents per piece and the other is 12.9 cents per piece. If the 2.3 cent cost analysis is correct, then an intelligent inserter does not appear to be a cost-beneficial purchase. If the 12.9 cent cost analysis is correct, then the intelligent inserter appears to be a cost-beneficial purchase. Based on our data, we feel the cost of 2.3 cents to manually insert one mailpiece is the more reasonable figure. However, we feel that a more thorough analysis of the Tax Commission's actual manual insertion costs should be made.

Based on the limited data that have been collected, we have no way of knowing if an intelligent inserter purchase is justified. As a result, we feel a statewide needs analysis should be performed to determine if an intelligent inserter purchase would be beneficial to the state. In our opinion, an appropriate analysis to help in making this decision would include a determination by department of current demand for intelligent inserting, then a comparison of current costs to insert these pieces with costs to insert these pieces using an intelligent inserter. The collection of these data would allow the performance of a cost-benefit analysis that could be used to analyze the prudence of an intelligent inserter purchase. If this

analysis supports the need for an intelligent inserter, then the Legislature and the Department of Administrative Services can determine if the function should be centralized. However, there are factors other than demand that might impact the centralization issue.

Other Issues Need To Be Considered

Both the Tax Commission and the DHS have identified two risk factors that may affect the state's ability to centralize the intelligent insertion function. These risk factors are: confidentiality and timeliness of information. In doing the statewide needs analysis, the potential effect of these risk factors should be taken into account.

The Tax Commission has indicated that their mail is both confidential and, in some cases, time sensitive. In other words, if the Tax Commission's mail were given to Central Mail, the state would be taking the risk of a breach of confidentiality or a critical time delay. Of these two risks, the one appearing to be of the biggest concern to the Tax Commission is the issue of confidentiality.

In making their argument regarding confidentiality, the Tax Commission asserts that any mail to leave their custody unsealed would breach their contract with the Internal Revenue Service (IRS). This contract calls for all federal tax information to remain confidential. The issue of confidentiality is also a concern in the State of Washington. Because of concern over a possible breach of contract with the IRS, we contacted an IRS disclosure officer. We were told that the Tax Commission could use Central Mail for inserting if all IRS security guidelines are met by Central Mail. Failure of Central Mail to meet the IRS security guidelines could result in a termination of the exchange of tax information agreement between the state and the IRS. Thus, while there is a risk, it appears from an IRS standpoint that the Tax Commission could let Central Mail do inserting for them.

The Tax Commission also brought up the issue of time-sensitive mail. This was also a concern of the State of Colorado with whom we talked. The Tax Commission wants to maintain control over its mail because some of the mail must be sent or received by a particular date. The Tax Commission fears that time deadlines would be less likely to be met by Central Mail since Central Mail does not have the same level of commitment. It is not possible for anyone to guarantee that Central Mail or even the Tax Commission, for that matter, will always be able to meet time deadlines. However, Central Mail has indicated that they will do all that is necessary to insure that the Tax Commission's mail deadlines are met.

In addition to the Tax Commission, DHS also indicates that their mail is both confidential and time sensitive. In DHS's case, however, the time sensitive issue seems to be the most critical issue from their standpoint. The basic argument of DHS is that they must get

assistance checks to the clients on the first of the month as per their federal contract. Because timeliness is so critical, DHS maintains that they need to control the inserting function themselves.

Of the three western states having a centralized mail service that we called, we found one state, Idaho, that allows a central mail agency to do inserting for Human Services. This inserting includes welfare checks and medical cards. Idaho Human Services reports no problems with time delays or with breeches of confidentiality as a result of using this central mail agency. These data indicate that a central mail agency can provide confidential and timely service required for human service mail.

The **Utah Code** gives Central Services statutory authority over mail services. In other words, Central Services can demand that agencies use their service unless an agency can prove cost or service concerns. While we are unsure whether these departmental service concerns are reasonable or not, the potential effect of these concerns on the Tax Commission's and DHS' willingness to centralize should be taken into consideration when the needs analysis is conducted. If only one machine is justified but this justification depends upon the Tax Commission and DHS demand, then it would be wise to ensure that both Tax and Human Services will commit to using a centralized inserter. If this not done, it is possible that a situation similar to that of the MLOCR purchase will occur again.

Recommendations:

1. We recommend that the Tax Commission and the Department of Human Services pre-sorting continue as it is, until a thorough analysis of delegation agreements can occur.
2. We recommend that the Department of Administrative Services determine if there are other uses for the MLOCR or if the MLOCR should be sold.
3. We recommend that the State Information Technology Services sort and bar code all production mail generated by their computer as soon as programming will allow
4. We recommend that the Department of Administrative Services do a thorough needs analysis for an intelligent inserter as well as any other mail equipment requested.

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We hope this letter provides you with the information you need on these issues. A response from the Department of Administrative Services is attached. If you have any questions or need additional information, please let me know.

Sincerely,

Wayne L Welsh
Auditor General

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