

February 20, 1997

Representative Irby N Arrington  
House of Representatives  
318 State Capitol Bldg  
Salt Lake City UT 84114

Subject: **Universal Income Withholding Program Costs (Report #93-02)**

Dear Representative Arrington:

The state's role in collecting child support payments will soon expand, and there is a risk that Utah taxpayer costs will increase as well. A new federal law taking effect January 1, 1994, requires that new or amended child support awards include an order for income withholding. The state's Office of Recovery Services (ORS) is expected to collect the child support withheld by employers and distribute it to recipients. Unlike current child support enforcement activities, the bulk of which are federally funded, no federal financial participation is anticipated for this program expansion. Thus, Utah taxpayers will pay for all costs in excess of fees for the universal income withholding (UIW) program.

Depending on how the UIW program is implemented in Utah, significant additional costs could accrue to Utah taxpayers. Estimates developed by ORS assume that collection processing costs for the new type of client will be much lower than historical costs for existing clients and that costs will be further decreased when a new computer system becomes operational. Unfortunately, reliable data to estimate future costs is not available. However, based on the limited data available, we doubt that ORS' current \$2.50 per check fee will cover program costs. Our estimate indicates that costs could be as high as \$4.00 per check.

We initiated this review at the request of the Human Services Interim Committee. The committee chair asked that we limit the scope of our work so that we could report at this time because legislation to implement universal income withholding (House Bill 45) is being considered during the 1993 legislative session. House Bill 45 would increase child support awards by \$5.00 per month to cover the \$2.50 per check fee charged by ORS for two checks per month. Time constraints limited us to reviewing ORS' collection processing costs without investigating its efficiency. We did not determine if costs can be decreased by implementing efficiency measures.

## **New Program Costs Should Be Modest Compared to Current Child Support Program**

The UIW program will be much less costly than existing child support services because many fewer services will be performed. ORS currently provides child support enforcement services pursuant to Title IV-D of the federal Social Security Act. In addition to the client intake function needed to initiate service, "full services" include:

1. Parent location,
2. Paternity establishment,
3. Support order establishment,
4. Enforcement, and
5. Collections processing.

These full services are provided to two types of clients. ORS automatically collects child support owed families on public assistance (AFDC clients) in order to defray taxpayer costs of the welfare program. Upon request, child support services also have been provided to the general public (non-AFDC clients).

In contrast, the UIW program is expected to operate like a clearing house, simply receiving and disbursing funds. In addition to client intake, the "UIW services" are anticipated to include only:

1. Issuance of a notice-to-withhold to an employer, and
2. Collections processing.

Ideally, once a case is set up, only routine collection processing costs will be incurred. Routine collection processing costs include (a) receiving and posting the incoming payment, (b) disbursing and mailing the outgoing payment, and (c) case worker costs to set up and maintain the case and respond to public inquiries. Some equipment and support costs also will be incurred.

Because UIW services will be so limited compared to full child support enforcement services, costs will be much less. However, the cost of providing the full range of services is quite high. In fiscal year 1992, ORS spent about \$19 per check issued to non-AFDC clients. Of course, the total costs includes full services to all non-AFDC cases whether support was collected or not. Isolating just routine collection processing costs, we estimate

that it costs over \$5.00 per check issued to a full service non-AFDC client. While check processing costs for UIW clients should be less, we estimate they may be as high as \$4.00 per check.

While ORS' full child support enforcement services are expensive, they are largely federally funded. In addition to paying 66 percent of AFDC and non-AFDC program costs, the federal government pays the state an incentive based on collections. Furthermore, the state retains a portion of collections on AFDC cases, thereby generating revenue for the state. Figure I shows the net revenue to Utah from the AFDC and non-AFDC programs. While it cost about \$200,000 in state tax dollars to provide services to non-AFDC clients, that represents less than five percent of program costs. In contrast, Utah taxpayers will have to pay 100 percent of UIW program costs in excess of user fees.

<b>Figure I</b>			
<b>Net Revenue From</b>			
<b>ORS Full Service Child Support Program</b>			
	<b>AFDC Cases</b>	<b>Non-AFDC Cases</b>	<b>Total</b>
Total Costs (Net of Fees)	(\$9,345,000)	(\$4,590,000)	(\$13,935,000)
Federal Reimbursement	6,196,000	3,080,000	9,276,000
Utah Retained Collections	3,936,000	0	3,936,000
Federal Incentive Payments	1,132,000	1,302,000	2,434,000
<b>Net Revenue to Utah</b>	<b>\$1,919,000</b>	<b>(\$208,000)</b>	<b>\$1,711,000</b>

### **Estimated UIW Cost Per Payment Depends on the Assumptions Made**

The cost of the UIW program will depend on what functions are performed by ORS and how efficiently they are performed. While ORS envisions very limited services provided to very straightforward cases, there are many unknowns about future program costs. For example, the efficiency of ORS staff in handling the UIW cases is unknown. In addition, ORS' cost accounting system makes it difficult isolate the computer costs of the collection processing function. Furthermore, ORS is expecting a new computer system to become

operational during 1994 which could significantly change its cost structure.

Because there are so many unknowns, no current estimate of UIW program costs is very reliable. While some costs may be estimated using fairly reliable data, other costs must be estimated using untested assumptions or questionable cost allocations. Figure II shows three estimates based on different assumptions: two estimates provided by ORS and a third estimate developed by the Office of the Legislative Auditor General (OLAG).

<b>Figure II</b>			
<b>Estimated per Payment Costs Associated with UIW Cases</b>			
	<b>ORS First Estimate</b>	<b>ORS Second Estimate</b>	<b>OLAG Estimate</b>
Paper Supplies and Postage	\$ .30	\$ .30	\$ .30
Labor Cost of Mail Sorting	.04	.04	.04
Labor Cost of Research And Posting	.93	.45	.85
Labor Cost of Warrant Processing	.79	.40	.30
Labor Cost of Caseworker	.52	.46	.50 - 1.00
EDP Costs Associated with Processing	.47	.94	.30 - .75
Miscellaneous Overhead Charges			
- Caseworker Supervision	.06	.00	.06 - .12
- Personnel, Training and Finance Units	.10	.00	.10
- Building Operations and Supplies	.42	.00	.23 - .35
- Top Management	.18	.00	.12 - .18
- Customer Service Unit	.00	.00	.10
Total	\$3.81	\$2.59	\$2.90 - 4 .09

The first ORS estimate is based on fiscal year 1992 cost data and assumptions about how productive case workers in the UIW program will be. In addition, it is assumed that computer costs are properly allocated on a per person basis, and that overhead costs should be included.

The second ORS estimate adjusts the first estimate for assumed greater labor productivity of accounting staff and higher computer costs after a new computer system is operational. The second estimate also excludes the overhead costs because it is assumed that total ORS overhead will not increase. ORS officials state that their second estimate may be too optimistic.

The OLAG estimate is a range to reflect the unreliability of the available data. Our estimate is similar to ORS' first estimate in that it is based on fiscal year 1992 cost data. We have no basis to assess the impact of the new computer system. Except for "paper supplies and postage" and "labor cost of mail sorting" amounts which are identical on all three estimates, the difference between the assumptions we made and those of ORS are explained below.

### **Labor Cost of Research and Posting**

ORS' first estimate of \$.93 per receipt was based on the fiscal year 1992 expenditures of the accounts receivable cost center divided by the total number of account postings. Thus, the estimate represents the average cost per posting for all types of receipts.

ORS' second estimate is based on an assumption that accounts receivable's staff productivity will double when their new computer system becomes operational. Thus, ORS divided the historical average amount in their first estimate in half.

The OLAG estimate is based on the historical average costs of income withholding receipts. Although we thought the cost of receiving and posting income withholding receipts might be much less than non-income withholding receipts, available data indicates the difference is slight. We had ORS staff sort and post separately batches of income withholding receipts and non-income withholding receipts. ORS' accounting technicians were able to post the income withholding receipts about 20 percent faster than non-income withholding receipts. As noted, ORS' \$.93 per receipt estimate includes a mix of both types of receipts. Thus, our test indicates that the average for just wage withholding receipts might be about 10 percent less than the overall average, or roughly \$.85 per receipt.

### **Labor Cost of Warrant Processing**

ORS' first estimate of \$.79 per payment for "labor cost of warrant processing" was calculated as the total expenditures of the accounts disbursement cost center divided by the number of accounting transactions. The cost center's transactions include checks issued plus account transfers and adjustments.

ORS' second estimate is based on an assumption that accounts disbursement's staff productivity will double when their new computer system becomes operational. Thus, ORS divided the historical average amount in their first estimate in half.

The OLAG estimate is the historical average costs of only those checks arising from income withholding receipts. In reviewing the workload of the accounts disbursement staff, we discovered that labor costs varied significantly for different types of transactions. In fact, much of the staff's time was spent on manual refunds, transfers, and adjustments. In contrast, those checks which are automatically generated by the computer caused virtually no workload. Since approximately 90 percent of outgoing checks are computer generated without staff involvement, labor costs are really associated only with manually initiated checks, transfers, and adjustments. Based on historical data, it appears that UIW cases are less likely to require staff effort than full service cases. Our overall conclusion is that the UIW labor cost of warrant processing is roughly 35 percent of the historical average costs, or about \$.30 per check.

### **Labor Cost of Case Worker**

ORS' first estimate of \$.52 for case worker labor cost was calculated by dividing the expected salary and benefits cost of a technician (\$25,000 per year) by the expected number of payments per case worker (48,000 per year). ORS is assuming that one case worker can handle 2,000 cases per year for case set-up, maintenance, correspondence, and telephone time. ORS further assumes that each case will average 24 payments per year. ORS staff acknowledge that there is no reliable basis to know whether they will be able to achieve their assumed productivity level of 48,000 receipts per case worker.

ORS' second estimate of case worker costs is based on a lower expected wage cost for a technician (\$22,000 per year), lowering the cost to \$.46 per receipt.

The OLAG estimate is based on our opinion that ORS' assumption that a UIW case worker will generate 48,000 receipts is optimistic. Because there is no reliable data to estimate future productivity of UIW case workers, we have used a range to estimate these labor costs. While we cannot rule out ORS' figure of roughly \$.50, we think the cost could easily be double that amount, or \$1.00 per receipt. Some of factors causing us to question the 48,000 receipt per case worker assumption are listed below.

The feasibility of UIW case workers producing 48,000 receipts per year depends on the level of service provided to clients. By way of comparison, collection function case workers in the full service program only average about 18,000 receipts per year. While the UIW case workers should be more productive, it is unknown whether they can generate almost three times as many receipts per person. While UIW case workers will not complete tasks

which the full service case worker does (such as monitoring back-payments owed), they will have to complete some additional functions (such as case intake and issuing notices-to-withhold to employers).

One factor that may increase case worker costs is that some UIW cases may not be reliable payers. For the past couple of years, ORS has operated a small UIW program for individuals who requested the service. During a recent three-month period, existing UIW cases averaged only 1.7 payments per month rather than 2 per month as assumed in ORS' estimates. Missed payments generate phone calls and other work for the case worker.

Case turnover in the UIW program also will add to workload. ORS estimates that 75 percent on the UIW cases may transfer into the full service program every year, representing a case turnover of about 125 per month. In addition, some UIW cases which remain in the program will experience job changes requiring new notices-to-withhold to the new employers. Consequently, case workers may be frequently corresponding with clients and employers.

Another factor that could decrease case worker productivity is the inclusion of complicated cases. For example, the current UIW case worker told us that one of the cases currently in the UIW program requires special attention every month. The individual whose income is withheld receives retirement benefits from the State Retirement System. Rather than withholding only the amount due, the State Retirement System submits the individual's full retirement check. ORS management intervened with the State Retirement System to get only the child support owed sent to them, but without success. In addition to the case worker's attention, the accounts disbursement department must manually initiate account adjustments and two outgoing checks so that the child support due is paid to the recipient and the remainder is paid to the retiree. To control UIW program costs, ORS will also need to exclude complicated cases, if they can legally do so.

### **EDP Costs Associated with Processing**

ORS' first estimate of \$.47 for computer costs was calculated using a cost allocation method. ORS' total computer costs of \$2.1 million are allocated to work units based on employee counts. Two issues associated with ORS' estimate of computer costs are what costs should be included and how they are allocated.

ORS' second estimate is based on an assumption that computer costs will double when their new computer system becomes operational. Thus, ORS doubled the historical average amount in their first estimate.

Because we could not get reliable information to isolate the computer costs of UIW cases, OLAG developed a range estimate of \$.30 to \$.75 per payment. Allocating only direct computer storage and processing costs on a per case basis and assuming a UIW case will

include 24 payments per year results in a \$.30 per payment estimate. If total computer costs are allocated the same way, the average cost increases to \$.75 per payment.

ORS' computer cost estimate includes its total computer costs, even though some may not increase with additional cases or transactions. It can be argued that only direct computer storage and processing costs should be considered in calculating the per unit computer costs. However, ORS staff were unable to help us determine how increases in the number of cases or in the number of accounting transactions would impact total computer costs. One information analyst did estimate for us that about \$860,000 or 40 percent of the fiscal year 1992 computer costs varied with case activity. The lower range of the OLAG estimate includes only these variable costs, while the upper range of our estimate includes all computer costs.

A second issue involves how computer costs are allocated. Because ORS' cost accounting system cannot directly assign computer costs to organizational units, a cost allocation method is used. The weakness of any cost allocation is that the factors influencing costs may not correspond to the base used to allocate them. Staff at the state Information Technology Services told us that their charges to ORS depend on the amount of data stored and the number and complexity of computer transactions. Thus, computer costs might be better allocated on a per case or a per transaction basis rather than a per employee basis. Case counts are easily obtained and apparently correspond well to computer storage costs. While cases receiving many payments or having other functional activity certainly are more costly than cases without activity, we were unable to isolate those costs. Although no method is without drawbacks, we decided to estimate computer costs based on case counts.

### **Miscellaneous Overhead Charges**

ORS' first estimate of \$.75 for overhead was calculated using a cost allocation method. Similar to computer costs, overhead charges are assigned to organizational units based on employee counts.

ORS' second estimate excluded all overhead charges because it is assumed that they will not increase due to the UIW program. While fixed overhead costs may reasonably be excluded, incremental costs should be included in any cost estimate.

The OLAG estimate includes overhead charges for "personnel, training, and finance units" and "caseworker supervision" because they appear to be directly related to employee effort. We used a range for "building operations and supplies" and "top management" because it can be argued that there will be no incremental costs, so a full allocation is not warranted. In addition, we added a charge for the "customer services unit" because the UIW clients probably will use its services. Our rationale is explained below.

Costs which increase with expansion in the number of employees needed in the account



posting, warrant processing, or case worker areas should be included in cost estimates. Direct supervision of the accounts receivable and warrant processing staff is already included in the costs assigned to those areas, but not for the case worker. Since the case workers handling the UIW cases will have a supervisor, that cost should be recognized. We feel the \$.06 per payment estimate developed by ORS is reasonable if their assumed level of case worker productivity is attained. However, since case workers may not be as productive as assumed, and supervision costs will increase accordingly, we included a range of up to \$.12 per payment for estimated supervision costs. We accept ORS' personnel, training, and finance units' costs estimate of \$.10 per payment which is based on staffing needs per transaction in accounting as well as for the case worker.

Fixed costs may be excluded from the estimated costs of the UIW program on the basis that they will not increase due to the program. For example, the "top management" can be excluded because these costs are incurred regardless of whether a UIW program exists. Similarly, if no additional space will be needed to house the UIW program, then rent costs also may be excluded. However, while ORS has excluded rent costs from its second cost estimate, it also reports a critical shortage of office space. Given ORS' claim that it needs additional space, it may be appropriate to include rent. Similarly, it is reasonable to include additional telephone charges for the UIW program. However, we excluded the postage portion of the "building operations and supplies" allocation because postage costs were considered separately in the "paper supplies and postage" category.

A problem with excluding overhead costs because they are considered fixed is that even if expenditures do not increase, federal funding for overhead could be reduced. Under its federally approved plan, ORS allocates overhead based on employee counts. Federal auditors probably will require that the UIW program be assigned a share of costs. Thus, even though additional costs are not incurred, federal funding for fixed overhead may be reduced. Since the federal government pays 66 percent of full service program costs, we used that percentage to determine the lower end of our range for "top management" and "building operations and supplies."

One cost which we included, but ORS did not, was associated with the "Customer Services Unit" (CSU). The CSU assists case workers by handling many inquiries from clients. When a payment is delayed for any reason, the client typically calls ORS to inquire about it. If the CSU does not shield case workers from many client inquiries, their productivity would be decreased. ORS' staff agrees that UIW cases will generate additional calls to the CSU. We estimate a CSU cost at about \$.10 per payment.

## **Conclusion**

A variety of limitations with existing data and unknowns about future costs make it difficult

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to reliably estimate future UIW program costs. While costs should be modest compared to the historical full service program, they could be significant. In fact, at existing

fee levels, costs probably will exceed program revenue forcing Utah taxpayers to subsidize the program. Because no federal financial participation is expected, Utah taxpayers will pay all of the program's net costs.

Apparently, UIW program revenue will be limited to fees collected on payments processed. Currently, fees are set at \$2.50 per check up to \$5.00 in a month. Because of the monthly limit, not all outgoing checks are charged fees. For example, an employee on a biweekly payroll receives three checks in a month two times each year. For employees on weekly payrolls, over half the transactions processed by ORS have no fees assessed. We estimate the revenue shortfall resulting from transactions without fees to be about 10 to 20 percent. Thus, at the current \$2.50 per check fee, the UIW program revenue would average only about \$2.00 to \$2.25 per check.

UIW program costs are more uncertain than program revenue. As shown in Figure II and discussed above, estimated costs per check vary considerably depending on the assumptions used. Even with questionable assumptions of very high worker productivity and no program overhead costs, slightly over \$2.50 per check is estimated. Other assumptions raise costs to around \$4.00 per check. Realistically, all the per check cost estimates may be too optimistic because they ignore costs related to program start up and growth. For example in 1991, ORS informed the Legislature that the equivalent of five employees would be required to implement the program in the first year. As the program grows gradually, the employees may not always be fully productive.

If program fees do not cover costs, Utah taxpayers will make up the difference. ORS anticipates that it will process approximately 72,000 payments in fiscal year 1994 and 192,000 payments in fiscal year 1995. If there is no loss per payment, then taxpayers will not be affected. However, our estimates indicate a significant taxpayer contribution could occur. For example, if costs exceeded revenue by \$1.50 per payment, taxpayers could have to contribute nearly \$300,000 in fiscal year 1995, the first full year of the program. Because of the uncertainty in both UIW program revenues and costs, we feel this topic should be restudied in 1995 when there is program data to review.

**Recommendation:**

We recommend that the Legislature consider raising the fee amount included in House Bill 45 above \$5.00 per month or else recognize taxpayer subsidy of the UIW program will be required.

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We hope this letter provides you with the information you need on these issues. If you have any questions or need additional information, please let me know.

Sincerely,

Wayne L Welsh  
Auditor General

WLW:RDC/lm