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State Governments' Expensive Secret:

The Cost Of Processing Paper

How to recoup millions of wasted dollars annually and put them back into your state's budget
Anyone who has gone online to file taxes, renew a vehicle registration or pay a traffic ticket appreciates the convenience of electronic government payment systems. And so do state officials and administrators. Online payments and filings substantially reduce collection and processing costs for a state's department of revenue (DOR), while improving citizen services and satisfaction.

There is still paper to deal with, of course, but not much by past measure. In some states the volume of tax returns, checks and other paper documents processed today is, in some cases, a fraction of what it was 10 years ago.[1] Yet for DORs in many states, the cost of handling those documents hasn't dropped commensurately. In fact, personnel, technology and infrastructure costs associated with paper processing continue to rise, totaling many millions of dollars annually. At the same time, some people will continue to file paper because they either don't have or want access to technology, or they lack the training to use online systems. So while processing volumes continue to fall as more filers adapt to the paperless world, states will need to continue dealing with some level of manual processing. These trends lead to diminishing economies of scale that fuel the upward trajectory of paper-handling costs.

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1. Alabama, for example, processed only 178,000 manual check deposits in 2011, down from 1.2 million in 2003.

The situation presents state governments with an important decision. Should they upgrade in-house systems with the aim of improving processing efficiency as the paper flow continues to dwindle? Or, is it better financially and operationally to turn processing over to a business partner to manage through an outsourcing arrangement?

The downward trend in paper processing volume and continuing increase in processing-related expenses (personnel, technology and infrastructure) lead to diminishing economies of scale that fuel the upward trajectory of paper-handling costs – and compel state governments to make a critical choice.

Choosing the right path is critical for states as they face growing demand for public services in a still struggling economy and simultaneous calls to control government spending. Improved paper processing can help states address both mandates. It can reduce costs, accelerate revenue collection and increase state deposit income. States can also generate new revenue needed to maintain vital programs by shifting people and resources from administrative tasks to enforcement and collections.

This white paper explores factors driving decisions on paper processing, presenting insights from two states: one that has upgraded internally; and another that outsources operations to a service provider.

The dilemma for many states—obsolescence

Regardless of how, or whether, a state chooses to upgrade its paper processing capabilities, the combination of shrinking volume, escalating costs and constantly evolving technology may make current solutions unsustainable.

Many legacy systems for check depositing, imaging, workflow and other processes are mainframe based and decades old.

These systems often lack the functionality to handle various DOR form types and form changes. They may also be incompatible with new optical character recognition (OCR) and intelligent character recognition (ICR) technologies, Web-applications, and taxpayer-portals. This scenario leaves states to develop standalone systems at an upfront cost of millions of dollars with annual maintenance costs of many thousands of dollars. And some software vendors may no longer support certain products, or soon won't, forcing states to keep patching old systems or invest in new ones at a cost of additional millions of dollars.

On a more positive note, legacy processing systems are possibly fully depreciated, bolstering the business case for technology investment and replacement. Also, some newer equipment may remain useful within the state through internal deployment or a service provider, even as advanced solutions are introduced.

Whether a DOR is leaning toward upgrading or replacing in-house capabilities or turning to a service provider, many factors come into play, and both paths involve spending and budgetary decisions that could have far-reaching mplications in the years ahead.

Taking an in-house approach

State DORs that choose to maintain in-house paper processing can have good reasons for doing so. Some may be innovators that have tackled the transition to new solutions head on, implementing advanced capabilities and deriving consistent return on their investments. They may be reluctant to relinquish the knowledge base and staff skills they have built up internally over the years, or explain to lawmakers why a substantial investment in systems should be abandoned in favor of an outsourcing solution.

DORs may also feel more confident in their ability to control the privacy and security of information, and money, internally. Or, they may want to maintain control of the actual data, whether in paper or electronic form, for operational reasons, believing it will be easier to retrieve.

There can also be workforce considerations. Keeping operations in-house could help avert labor-related issues and perceived displacement of state employees, even though new technologies can often also reduce personnel needs. All these calculations are also dependent in part, on the state's political environment.

Finally, states may not have a clear picture of the actual costs of performing the work themselves, so they may be hesitant to make changes. Particularly in states with relatively low government labor costs, lack of insight into the full cost of personnel can drive leaders to maintain the more familiar status quo rather than take a risk on any new approach, despite its potential benefits.

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> was able to to realize annual savings of $2.6 million.

As in any IT infrastructure transition, states that choose to upgrade internal processing capabilities will continue to need hardware and software support at a likely cost of significant dollars upfront and on an ongoing basis. They will also have to ensure that continually evolving security and privacy threats are met by constant updates to security systems and ongoing training for the personnel responsible for those systems.

Deciding to outsource

Turning processing over to a service provider offers some attractive benefits, while raising important considerations. Among its key advantages can be lower costs, more effective use of resources, and even economic development, as the Alabama DOR has experienced in recent years.

Like other states, Alabama was burdened with aging, expensive systems to process dramatically fewer paper transactions as ACH and electronic payments and e-documents became the norm. In 2011, the state's DOR processed only 178,000 manual check deposits, down from 1.2 million in 2003.

By outsourcing its processing operations, Alabama was able to re-assign or eliminate 165 full-time equivalent (FTE) staff positions. Some staff members have moved to new duties,

while others have left state employment through attrition. With fewer personnel required for processing, the state has shifted resources to auditing and collection roles, opening the door to generating additional revenue. In staffing costs alone, this move provided the state with annual savings of $2.6 million after factoring in service provider costs.

Significantly, the work that the service provider took over is still being performed by Alabamans. The service provider now handles payments and documents for the state at a facility it built in Georgiana, AL, an economically challenged area of the state. Creating jobs there and reallocating some former processing personnel within the department to other value-added jobs became a winning combination for the state.

And the savings have gone beyond personnel costs. While government-owned buildings are a fixed cost for states, outsourcing paper processing can free space for other, higher-return purposes. For example, in Alabama over 100,000 square feet of real estate previously dedicated to processing is now being used for a state-of-the-art classroom and conference facilities.

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> - Lewis A. Easterly,
> former department secretary,
> Alabama DOR

Quality has improved, as well, with error-free processing exceeding 99 percent. Service provider personnel are trained to handle cash deposits, foreign checks and other exceptions that cannot flow through electronic processes. And, service level agreements (SLAs) between the state and the provider help ensure standards are maintained and issues are quickly addressed.

Outsourcing has also brought "peace of mind" benefits, such as insulating state facilities and people from potential mail-borne threats. Suspicious mail is now handled by service provider personnel trained to deal with such situations, in facilities removed from the state physical plant. Rigorous background checks and employment standards, in addition to the SLAs, also help strengthen the security of state assets and proprietary information.

Lewis A. Easterly, former department secretary of the Alabama DOR, sums up the benefits the state has gained from outsourcing: "Most bureaucrats are terribly afraid of giving up any control of a processing function they are involved in," Easterly said. "They feel that giving up control somehow diminishes their worth to the organization.

"In a revenue department exactly the opposite is true. By giving up control of a processing function, they can then focus more on the enforcement and technical issues that will ultimately produce more revenue."

States may also consider demographics to "rate" their need for a solution. For example, states with a high volume of agricultural workers might receive more paper tax returns than a state with higher white collar employment. And, as a state's population increases, so does the volume of returns. Either way your state would benefit from a technologyenhanced workflow process.

Factors to weigh in the decision

In deciding which path to take in upgrading paper processing capabilities, states can benefit from considering several key decision points:

Review state law. A DOR may be primed and ready to convert as much as possible to electronic processes. But current state law may dictate that individuals and businesses file sales tax returns on prescribed forms, which would no longer exist in an electronic environment. It is important for a DOR to consider what changes will provide the greatest benefit and, if laws need to be changed, what role the department should have in such a legislative initiative.

Rethink current processes. All aspects of the existing environment, including IT infrastructure, workflow, physical plant and personnel, should be considered. Of particular concern will be the unique economy-of-scale issues associated with a shrinking paper processing operation.

Scale services for substantial ROI. As you evaluate areas to be streamlined, rely on potential service providers to help identify opportunities that will produce a return on investment that is clearly definable, achievable and of sufficient size to justify the change and encourage future innovation.

Capture undocumented knowledge. When employees leave, knowledge leaves with them. And the longer their tenure, the more knowledge is potentially lost. Regardless of how a state chooses to pursue processing modernization, documenting how things have been done up to now is critical to planning and executing a successful transition.

Take control of the paper trail

Despite the phenomenal growth in state transactions and reporting being conducted online, it's hard to envision a future in which paper goes away entirely. State DORs will continue to see checks and hard-copy forms – and even the occasional envelope of cash – arrive in the mail. The challenge for states will be to process these items as efficiently as possible, while maintaining the high levels of service your citizens expect and deserve.

Whether paper processing is kept in house or entrusted to a capable service provider, understanding the benefits and challenges of both options can help officials and administrators make the most informed decisions that provide the greatest benefit to your citizens, both in better services and a healthier state financial picture.

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