INTERNAL SERVICE FUNDS

Cost Structure and Budget Impact

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A Report to the Executive Appropriations Committee

Prepared by

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Overview

Scope and Summary

Item 9 of the 2002 Master Study Resolution (S.J.R. 15, 2002 General Session) requests a study of "Internal Service Fund cost structure, the impact of the cost structure on internal service fund budgeting, and the impact of cost structure/budgeting on internal service fund rates." This study attempts to address Item 9 by asking the following questions:

1. What is an Internal Service Fund (ISF)?
2. What are the advantages and disadvantages of ISFs?
3. Do ISFs adequately control costs associated with salary, incentive pay, and contract employment?
4. Do established ISF rates subsidize "free-of-charge" activities either within or without ISF organizations?
5. Do ISFs effectively manage rates so that they "break even?"
6. Can ISFs be used as sources for general revenue?

This study found that Internal Service Funds are advantageous to the State and should be maintained, rather than privatized or sent back to appropriated agencies. However, ISFs are not always considered beneficial by their customer agencies, so this report will recommend ways to improve transparency of information. It also found that ISFs do not vary significantly from appropriated agencies in wage increases or incentive pay, though they have had greater job security during the recent budget reductions. This study will outline ways to tighten FTE oversight as well as ensure rates for certain services are not subsidizing other services. Finally, this study examines equity as a better measure of financial position than retained earnings. A summary of recommendations is provided on the back page.

What is an Internal Service Fund?

Definition

Internal Service Funds are defined as funds used by the State to account for the financing of goods and services provided by one department or agency to other departments or agencies on a cost-reimbursement basis. They are set up to take advantage of economies of scale, to avoid duplication of effort, and to accurately identify costs of specific governmental services.

An Internal Service Fund sets its rates to recover the full cost of providing a particular service. Agencies have ISF costs built into their operating budgets, and each ISF bills agencies for services rendered.

Some agencies maintain their own Internal Service Funds to account for costs for data processing, warehousing, or fleet management. The Department of Administrative Services (DAS) operates large ISFs that provide consolidated services to all state agencies. Five of these ISFs are funded by state agencies and one (Debt Collection) is funded through collections on outstanding debts owed to the state. This report focuses on the five ISFs that are funded by charges to state agencies:

	FY03 Budget
• General Services (Copy Services, Central Mailing, and Central Stores)	$13,850,400
• Information Technology Services (ITS)	$54,890,800
• Fleet Operations (Motor Pool, Fuel Network, and Surplus Property)	$41,240,100
• Risk Management	$34,300,700
• Division of Facilities Construction and Management (DFCM)	$19,611,500
	$163,893,500

More financial information concerning each ISF can be found in the appendix.

Statutory Guidelines

Internal Service Funds are governed by explicit rules contained in the Budgetary Procedures Act (See UCA 63-38-3.5). In order to guard against abuse, and to ensure proper oversight of the size, mission, and fees charged by ISFs, the Legislature imposed the following controls:

1. The Legislature must approve all ISF budgets (operating and capital), rates, fees, and other charges.
2. The Legislature must approve the number of full-time equivalent (FTE) positions.
3. An ISF may not make capital acquisitions or receive transferred capital assets without legislative approval.
4. Working capital must be provided from the following sources in the following order:
   a. operating revenues
   b. borrowing
   c. appropriation
5. An ISF may incur long-term debt (borrowing) from the General Fund as long as:
   a. the debt is repaid over the useful life of the asset, and
   b. borrowing does not exceed 90% of the net book value of the agency's capital assets

What are the advantages and disadvantages of ISFs?

Advantages of Internal Service Funds

1. More efficient use of resources. ISFs allow equipment and staff to be fully utilized and costs to be shared across several users, rather than duplication of partially used equipment and staff within each agency. An ISF should be able to increase or decrease resources in response to demand from a broad base of users.

2. Allows more accurate accounting of the full cost of providing a particular service. This is much more difficult to determine from information in the traditional budget, where services can seem "free" because they are appropriated. These costs then send price signals that force users to respond with purchasing decisions that maximize benefits under limited resources. Additionally, this accounting allows the State to bill the federal government for cost reimbursement.

3. Market incentives. When rates are set to recover the full cost of the service (including the cost of equipment through depreciation schedules), users can compare the benefit of the service to the cost. If users decide to buy less of the service, the ISF must respond by reducing costs in order to break even.

4. Long-term outlooks. ISFs have the flexibility to carry funds over from year to year rather than operate on a yearly cycle (however they must annually account for their acquisition authority). Therefore they can plan for long-term break-even with no incentive to expend the full appropriation at year-end. ISFs also encourage better long-range planning regarding equipment purchases and other internal services necessary for state government.

5. Better cost comparisons. ISFs allow users to compare the cost of buying the service against the cost of that service in the private sector or in other state agencies.

6. Control and consistency. ISFs enable decision makers to more easily control goods or services delivered than if each agency has its own delivery point. They provide for consistency in service and in reporting. This makes agencies accountable and results in more useful and accurate information for decision makers.

7. Better planning for capital acquisitions. By charging for depreciation through their rates, ISFs systematically accumulate funds to replace their equipment when its useful life expires. This allows the Legislature to establish a base level of appropriation to cover the full cost of services without the need for fluctuations to meet specific purchase needs each year.

Disadvantages of Internal Service Funds

1. More complicated to understand. ISF financial reports are presented in a more complicated format than the appropriated budget reports. They require some understanding of accounting terminology to fully understand. Because they require more effort to analyze, and because they are not directly funded with General Funds, they do not always receive the same level of scrutiny as other budgets.

2. Disparate treatment. Internal Service Funds, through the DAS Internal Service Fund Rate Committee and the Legislature, set rates to recover costs. By definition, if costs increase, rates must increase (after approval through the budget cycle, although they are allowed to establish interim rates for <u>new</u>

services). However, appropriated agencies do not necessarily receive funding for their cost increases, especially inflationary increases. Moreover, ISFs are able to charge agencies the full cost of their services even during times when the Legislature has not fully funded rate increases in the agencies' base budgets, essentially creating a de facto budget cut for the customer agencies.

3. Customer disconnect. Because customer agencies do not directly manage ISF operations, they do not feel the ability to control costs, and as a result do not see a clear incentive to do so. Agencies do have the opportunity to participate in the ISF Rate Committee process, yet they often perceive, whether valid or not, that ISFs are not managing costs as tightly as everyone else. Some may resent that rates are developed externally and yet the agencies must "cut a check," or cut services, trusting that the Department of Administrative Services is managing efficiently.

4. Lack of choice. Customer agencies are encouraged and in some cases required to use the services of ISFs and therefore most ISFs do not have true competitive pressure to lower costs and improve customer service. It is unreasonable to expect the ISFs to go out of business if they are out-competed. However, the ISFs do experience pressure from their customers, the ISF Rate Committee, and from policy makers, and do use benchmarks to compare themselves to the private sector.

5. Overhead. There are some agencies that, individually, could provide services in-house more cheaply than the ISFs. To them, the ISFs are an overhead burden. However, state policy is that it is important to have a statewide perspective, and some increased overhead costs are necessary for accountability and overall state efficiencies.

Do ISFs adequately control costs associated with salary, incentive pay, and contract employment?

One of the goals of internal service funds is maximized efficiency through market forces. In theory, ISFs should match revenue to expenses. In-turn, one assumes that expenses are minimized.

As personnel management drives a major portion of expenses in most ISFs, and as it is also an area in which ISFs are perceived to have greater flexibility than appropriated agencies, the Fiscal Analysts examined for this report whether ISF personnel management differed from that of appropriated agencies.

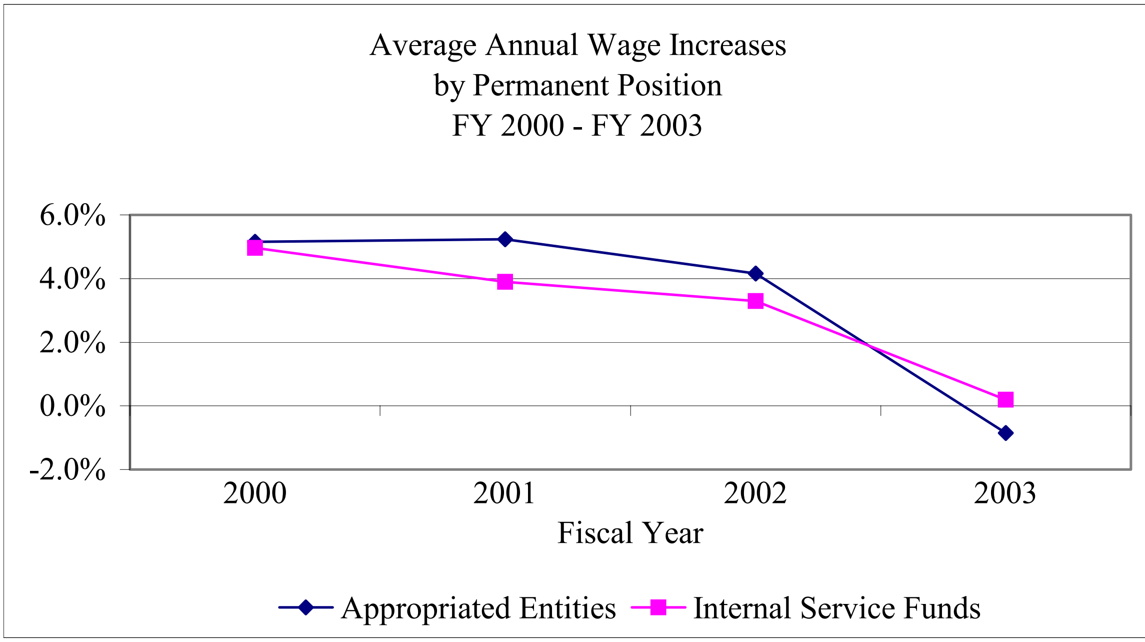
In appropriated agencies, personal service funding levels are bound by appropriations, and average annual increases are outlined by the Legislature through Cost of Living Allowances (COLAs), merit based wage increases

(Merits), and/or market comparability increases (MCAs). The Legislature also provides to appropriated agencies additional resources to fund these increases. While appropriated entities report FTE levels to the Legislature, they are not bound by those levels.

Internal Service Funds are not bound by appropriated increases, and thus ISF division directors may increase salaries and provide cash incentives to employees independent of legislative action. Conversely, ISFs do not receive "automatic" rate increases to cover raises, but do so after the Legislature meets within approved rate structures. As mentioned earlier, ISFs are bound by approved FTE levels and follow the same personnel rules as other agencies.

Administrative Salary Increases Track Closely to Appropriated Agencies

A comparison of internal service fund and appropriated agency wage increases found that trends for the two types of organization track very closely to one another over time. Further, average annual salary increases for internal service funds were slightly lower than those for appropriated agencies in all years but the most recent. This can be attributed to the many variables that exist when comparing averages, for example, position classifications, longevity increases, MCA payments, etc.



Methodology for Comparison

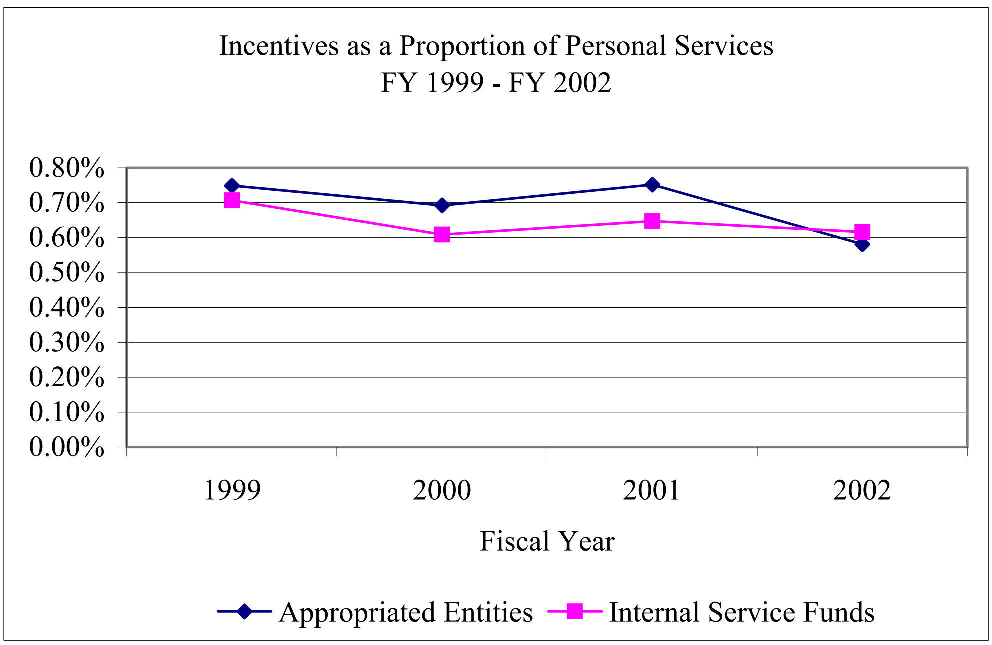
To create this comparison, the Analyst examined hourly wages for positions that continuously existed in State government from June, 1998 to August, 2002. Analysts determined the highest hourly wage in each fiscal year for each position. They then averaged these wages by organization, and calculated average annual percent increases per fiscal year. Finally, the Analysts compared grand averages for internal service funds with those for appropriated entities.

In the first and last year of the study, ISF and appropriated entity salary increases were within two-tenths of one percent of one another. In the middle two years, average ISF salary increases were almost a percentage point lower that appropriated entity salary increases. Across years, there is almost no variance in trends between ISFs and appropriated entities.

This evidence suggests that internal service fund directors do not provide dramatically different wage raises to their employees even given that their operations are "off budget."

Incentive Pay Also Tracks Closely to Appropriated Agencies

Another area in which the Analyst compared ISF personnel management with that of appropriated agencies is incentive pay – commonly known as "bonuses." Again, the Analyst found no significant difference between the practices of ISFs and that of appropriated entities. Incentive pay trends in the two types of organization tracked closely over time, and in all years but one, ISF bonuses were a lower proportion of overall personal services costs than were appropriated bonuses.



Methodology for Comparison

In conducting this comparison, Analysts gathered data on annual expenditure for incentive pay (object 5150 in the state's chart of accounts), as well as total annual expenditure for all personal services costs (object category AA). Analysts then calculated the proportion of total personnel costs allocated to incentive pay for each organization in each fiscal year from 1999 to 2002. Finally, the Analysts compared the average proportion for internal service funds with that for appropriated agencies.

In the first three years of the study, the proportion of total personal services expended on incentive pay for ISFs was slightly lower than that for appropriated entities. In the last year, ISF bonus proportions were four basis points higher than appropriated entities. In no year was the difference between ISFs and appropriated entities more than ten basis points. Across years, ISF and appropriated entity incentive pay correlates very closely.

Therefore, for incentive pay as well, ISF managers do not act dramatically different than their appropriated agency counterparts.

ISF Job Security

It is important to note here that, while ISF employees receive somewhat lower administrative salary increases and bonuses, they are more insulated from reductions-in-force. To date, budget cuts in appropriated agencies have not resulted in requests for less service from the ISFs. A look at state Full-time Equivalent (FTE) counts over the past two years illustrates that ISFs have not undergone the same personnel reductions as appropriated agencies during the budget downturn. The FY 2003 revised budget indicates approximately 466 fewer FTEs than the FY 2001 actual amount across state government. Yet the Internal Service Funds administered by the Department of Administrative Services show an FY 2003 revised budget at approximately two FTEs higher than FY 2001. The ISFs may be impacted later if customer agencies begin purchasing fewer services, but they could eliminate less mission-critical services just like any other agency.

Contract Employees

As previously mentioned, ISF divisions must get legislative approval for permanent FTE positions. Each year the Capital Facilities and Administrative Services Appropriation Subcommittee reviews FTE requests and provides a cap on the number of employees allowed.

However, FTE counts do not include contractors. This could lead to the inference that some ISFs are not meeting the spirit of the law when they hire contractors to perform work as part of an ongoing project. For example, the Division of Information Technology Services (ITS) has contracts for the equivalent of 6.8 FTE for work that seems to be part of their basic mission. This is work that figures into the rates charged to state agencies, but the FTE count is hidden in the details of the ITS budget.

There are advantages to the State in contracting for work rather than hiring permanent FTEs. Requiring legislative approval of each contract would be much too burdensome for the short time frame of a general session, and possibly would create legal concerns concerning separation of powers. ISFs do follow the same rules as appropriated agencies in signing contracts. The number of contracts is daunting. For example, the 6.8 FTE in ITS is spread over 84 contracts. DFCM manages dozens of contracts with janitorial contractors who clean state buildings. The motor pool outsourced cleaning and routine maintenance, eliminating state funded FTEs, but creating new jobs in the private sector. However, the ISFs should take reasonable steps to inform the Legislature of FTE comparables being contracted out.

Transfer Employees

Similarly, appropriated entities hire employees and then allocate their costs – but not their FTEs – to internal service funds. Two auditors hired by the Executive Director's Office, a half-time computer specialist for General Services, an accountant in the Division of Finance, and lawyers from the Attorney General are hired in appropriated agencies but funded through "transfers" from ISFs. This practice could also leave the impression that ISFs are avoiding FTE caps.

To improve oversight, the Analyst began noting during the 2002 General Session the use of transfers from ISFs to fund appropriated agency employees. This will become standard practice for budget reporting, allowing the Capital Facilities subcommittee to see changes in the "transfer" category and providing more transparency for user agencies.

It is appropriate for ISF rates to include costs for professionals who provide direct service to the ISF program. However, executive branch managers must be careful to ensure that any consolidated professional services directly relate to the provision of centralized services.

Only General Services and Risk Management's appropriated entities allocate employee costs to the ISFs based on actual work performed. Auditors' time in the Executive Director's office is allocated to ISFs based on a projected level of utilization. This practice has the potential for allocating costs from one agency onto that of another agency. The Analyst thus recommends that all ISFs take reasonable steps to account for employee costs and bill external entities accordingly.

Given the importance of transparent government, the Analyst believes that more oversight of personnel contracts and transfer employees is warranted. As such, the Analyst recommends that employee time billed as "transfers" be treated like a contract, and that a report of contracted personnel costs as well as associated full time equivalent measures be presented with internal service fund budget requests in each Legislative General Session.

Do established ISF rates subsidize "free of charge" activities either within or without ISF organizations?

If ISFs strive to maximize efficiency and minimize costs, one assumes that costs being recovered by ISFs relate directly to services provided. On the contrary, the Analysts discovered that some internal service funds divert money from one authorized revenue stream to another unrelated service or external activity.

Cross-subsidy Among Services

The Analysts found a number of instances in which ISFs use funds from one service to cover the costs of another service within an ISF. These instances include, but are not limited to, the use of mainframe computing and mass storage revenue to offset the cost of web development and hosting, open-systems management, and application development within the Division of Information Technology Services (ITS).

While such cross-subsidy may be necessary to establish a new service (or do research and development), long-term cross-subsidization corrupts price signals upon which users base consumption decisions.

Example: Tape Back-Up of Computer Data

For example, if in July, 2002, a user agency investigated options for backing-up its computer data, it would have found that the Division of Information Technology Services ISF's rate for tape storage was $0.08 per megabyte per month. At a quantity demanded of 20 gigabytes storage per month, the ISF cost for back-up would be $19,200. By comparison, the incremental cost of purchasing and operating a tape back-up unit in-house at a user agency would have been about $13,100. The user agency's logical choice in this scenario would be to purchase and operate a tape back-up in-house.

The true cost recovery rate for tape storage is $0.04 per megabyte per month, making the annual cost of ISF storage $9,600 and therefore the more cost effective option. The revenue generated by the four cent rate disparity presumably subsidized other services for which a rate was not established or for which a rate was too low.

In this example, the inflated rate also sent an incorrect signal to user agencies that purchasing and operating their own tape back-up units was cheaper than using an ISF, and could have resulted in unnecessary capital investment by the State as a whole.

To address this issue, the Analyst recommends the Legislature consider requiring ISFs to establish a fee for any new ISF product or service after a reasonable incubation period.

Non-ISF Costs Paid Through ISF Rates

The Analysts also discovered instances in which executive branch managers have used internal service fund revenue to offset costs whose relations to ISFs were, at best, tenuous.

In addition to regular ISF employees, ISF rates have in the past included costs for a Deputy Chief Information Officer and a product management specialist. While these positions were employed by an ISF, they performed core functions of an appropriated entity – the Governor's office. The costs associated with the positions were not billed to the Governor, and therefore inflated rates for other ISF services.

Even though the amount of money in consideration is a small part of the overall budget, the Analyst believes that appropriated agencies should pay the full cost of professional services provided by ISF employees.

Do ISFs effectively manage rates so that they "break even?"

Assuming ISFs manage operations in a way that minimizes expenses, the next question is whether rates are set to recoup only those expenses. When ISFs miss their revenue target, they create either an operating deficit or a profit. If an operating deficit occurs, the division must find a way to cut costs or raise revenue to eliminate the deficit position.

Since the goal is to manage operating costs to match expenses, ISFs attempt to set rates for recovery costs only. As costs and/or volumes change at a pace different than projected, deficits or surpluses can be generated rather quickly. These deficits or surpluses are represented as Retained Earnings. The table below shows that, in total, ISFs are generating income in excess of expenses. Of note are negative retained earnings in State Publishing and State Surplus Property. Although the reasons for their operating deficits are beyond the scope of this report, it should be noted that the Legislature addressed the Publishing issue during the 2001 General Session and heard a report on the Surplus issue earlier in the 2002 Interim.

DAS - Retained Earnings History (Actuals)					
	FY 1997	**FY 1998**	**FY 1999**	**FY 2000**	**FY 2001**
General Services					
Mail	$16,021	($78,988)	($392,212)	$258,256	$676,219
E-Purchasing	(16,311)	(265,624)	(331,434)	(244,132)	(131,054)
Publishing	(324,028)	(320,320)	(430,885)	(1,089,633)	(1,064,511)
ITS	1,725,262	5,915,762	15,815,553	15,786,700	14,181,600
Risk Management					
Liability/Property	1,494,000	2,306,000	1,510,800	3,702,000	3,706,500
Workers' Comp	875,800	1,744,700	2,144,800	2,171,600	3,871,500
Fleet Operations					
Motor Pool	1,019,316	395,312	(725,167)	3,464,195	3,789,305
Fuel	(254,149)	(50,710)	341,947	(309,759)	(294,845)
Federal Surplus	368,463	45,339	73,093	178,667	(10,021)
State Surplus	159,018	67,146	(284,727)	(437,383)	(517,688)
DFCM ISF	999,188	884,127	683,449	371,657	711,202
Debt Collection	0	16,900	195,100	474,754	600,262
Total Retained Earnings	$6,062,580	$10,659,644	$18,600,317	$24,326,922	$25,518,469

Equity Position is More Important than Retained Earnings

Retained Earnings show the difference between revenues and expenses since program inception, but do not tell the whole story of how ISFs are positioned financially. A negative retained earnings position may indicate that the program has a debt to the General Fund, but does not necessarily mean that the agency is in a negative equity position. Equity considers both retained earnings and contributed capital – in effect, ownership of assets. The table on the next page identifies each program's equity position. If an agency were to discontinue business, their equity would roll back to the General Fund (and to the Federal Government). With the exception of State and Federal Surplus Property, each program carries a positive equity balance.

DAS - ISF Equity History (Actuals)		
	FY 2000	**FY 2001**
General Services		
Mail (FY 2001 Fixed Assets = $481,500)	$509,765	$927,728
E-Purchasing (no fixed assets)	537,778	650,856
Publishing (FY 2001 Fixed Assets = $3.8 million)	565,820	590,942
GS Subtotal	*1,613,363*	*2,169,526*
Fleet Operations		
Motor Pool (FY 2001 Fixed Assets = $57 million)	25,575,424	30,388,556
Fuel Network (FY 2001 Fixed Assets = $1.2 million)	503,791	518,705
Federal Surplus (FY 2001 Fixed Assets = $434,000)	185,020	(3,668)
State Surplus (FY 2001 Fixed Assets = $715,000)	(420,291)	(500,596)
DFO Subtotal	*25,843,944*	*30,402,997*
DFCM Maintenance (FY 2001 Fixed Assets = $165,000)	*543,377*	*893,140*
ITS (FY 2001 Fixed Assets = $18.6 million)	*22,378,400*	*20,773,300*
Risk Management		
Risk Admin (FY 2001 Fixed Assets = $18,100)	3,382,400	4,091,900
Workers' Comp (No fixed assets)	2,871,600	4,571,500
Risk Mgmt Subtotal	*6,254,000*	*8,663,400*
Debt Collection (No fixed assets)	424,754	600,262
Total Equity	$57,057,838	$63,502,625

Structural Challenges

Internal Service Funds are established with the intent to operate more like a business than an appropriated government agency, and realize all of the ensuing advantages listed above. However, current state policies create several obstacles that limit their ability and flexibility to respond to market forces in a timely manner.

First among these is the time lag between when rates are set and when they become effective. Rate proposals are delivered to the State Rate Committee beginning in July of each year; if approved by the Rate Committee and the Legislature, they go in effect the following July. Few private businesses are able to survive by establishing prices a minimum of one year before goods or services are sold.

Another problem related to the time lag is a lack of flexibility to respond to unexpected changes in work volume or cost of goods sold. While the ISF can make adjustments to its internal costs, it cannot make upward rate adjustments until the rate-setting cycle is complete. Currently, for example, FY 2002 is still not closed, yet ISFs are providing proposed rates to the Rate Committee for FY 2004. If a cost driver occurs in December, they must wait until January to propose a rate change, then wait until the following July for the rate to become effective. Meanwhile the impact is absorbed in Retained Earnings. One exception is State Mail, which has been authorized to pass-through postage rate increases immediately to customer agencies.

By placing statutory restrictions to guard against abuses, the Legislature has decided it wants the ISFs to remain more like state agencies than private businesses. Whereas a private business ultimately charts its course according to customer demand, an ISF's first responsibility is to maintain the course set by the Budgetary Procedures Act, and then respond to customer needs.

Can ISFs be used as sources for general revenue?

Taken as a whole, the DAS Internal Service Funds comprise a $165 million state agency. This is nine times the size of the DAS appropriated divisions and would make ISFs one of the ten largest agencies in state government if considered in the same way as a tax funded agency. With a budget so substantial, it stands to reason that the Legislature would look there to find savings during times of budget constraint.

Surpluses and deficits are closed into retained earnings on the balance sheet each year. Since non-liquid asset purchases and depreciation affect the balance sheet and net income, not all retained earnings are available as cash or cash equivalents (unless the Internal Service funds are discontinued and the non-liquid assets are sold.) In fact, appropriating equity balances from the Internal Service Funds that don't have cash available is essentially appropriating money that doesn't exist. Furthermore, when retained earnings are appropriated from the Internal Service Funds to the General Fund, a percentage of those funds must be returned to the Federal Government if they participated in the programs offered.

Sources of Revenue

The primary source of revenue for ISFs is "intra-governmental revenue" – fees charged to other agencies for services or premiums. Many ISFs pass savings along to local governments as well. The ability of local governments and school districts to take advantage of state savings and administration for purchasing and risk management is often an overlooked benefit provided by the Legislature to political subdivisions.

DAS - Sources of Revenue						
	Dedicated Credits - State Agencies	**Dedicated Credits - Local Govt.**	**Interest Earnings**	**Premiums**	**Fees**	**Approps/ Transfers**
General Services						
Mail	Yes	Yes				
E-Purchasing	Yes	Yes				
Publishing	Yes	Yes				
ITS	Yes	Yes				Yes
Risk Management						
Liablity/Property	Yes	Yes	Yes	Yes		
Workers' Comp	Yes	Yes		Yes		
Fleet Operations						
Motor Pool	Yes	Yes			Yes	
Fuel	Yes	Yes			Yes	
Federal Surplus	Yes	Yes				
State Surplus	Yes	Yes			Yes	
						Yes
DFCM ISF	Yes					
Debt Collection			Yes		Yes	

ISFs establish accounts to ensure that money is expended on programs that benefit those providing the revenue. For example, money that came into DFCM for management of a Health Facility cannot be used for a roofing repair on a UDOT maintenance shed. The table below shows how each agency "sorts" funds that could be used for general appropriation in a time of need (assuming a positive cash balance in the account).

DAS - ISF Sources Available for Expenditure	
General Services	**Fleet Operations**
Retained Earnings	Motor Pool Retained Earnings
	Fuel Dispensing Retained Earnings
DFCM ISF	**Risk Management**
Facility Mgmt. Retained Earnings	Asbestos Litigation Fund
	Workers' Comp Retained Earnings
	Liability Insurance Retained Earnings
	Contributed Capital
Debt Collection	**ITS**
Cash Retained Earnings	Retained Earnings

While these sources are available for expenditure in times of crisis, these accounts should not be viewed as general revenue. Since the goal of an ISF is to break even while providing consolidated services, any excess retained earnings should be rebated in the form of lower rates to user agencies. At that point, the Legislature may use the funds in the agency to fund other priorities. As noted earlier, not all retained earnings are cash, and when funds are taken from retained earnings, the Federal Government demands that their share of the balance be returned as well. This is true not only for ISFs but for any fund in which the Federal Government participates. Over the past five years, DAS rebated more than $6 million to the Federal Government – approximately $1 million of that was directly attributable to a Legislative appropriation of retained earnings.

Internal Service Fund Rebates to the Federal Government

Fund #		Fed %	FY1998	FY1999	FY2000	FY2001	FY2002	Grand Total
620	**Public Employees Group Insurance**							
	State of Utah Medical Program Experience Dividend	16.74%	1,004,100					
	Long Term Disability Program Experience Dividend	17.98%			615,233			
	Long Term Disability Program Experience Dividend	17.98%				608,165		
								$ 2,227,498
603	**Risk Management Workers Compensation**							
	Appropriation FY99 Session S.B. 1 Item 18	17.86%		143,076				
	Appropriation FY99 Session H.B. 1 Item 73	17.98%			120,916			
	Federal Portion of Excess Retained Earnings at 6/30/2000	19.34%				291,641		
								$ 555,633
670	**Information Technology Services**							
	Appropriation FY00 Session H.B. 1 Item 31	28.1333%			648,266			
	Federal Portion of Excess Retained Earnings at 6/30/2000	29.2349%				990,422		
	Federal Portion of Excess Retained Earnings at 6/30/2001	29.4383%					1,148,092	
								$ 2,786,780
831	**Unemployment Insurance Agency Fund**							
	Federal Portion of Excess Retained Earnings at 6/30/2000	19.42%				115,065		
								$ 115,065
609	**Division of Fleet Operations Motor Pool**							
	Federal Portion of Excess Retained Earnings at 6/30/2000	19.4815%					420,429	
								$ 420,429
100	**Interest Earned by State Treasurer on General Fund Cash Balance**							
	For Fund 672 Dept. of Health Data Processing ISF Terminated in FY1997							
	Federal Portion of Imputed Interest on Average Cash Balance							
	Accumulated from FY1993 to 1997	69.22%					2,913	
								$ 2,913
	TOTALS		$ 1,004,100	$143,076	$ 1,384,415	$ 2,005,293	$ 1,571,434	$ 6,108,318

Source: Utah Division of Finance

Recommendations

1. The Analyst recommends that Internal Service Funds not currently open to outsourcing from the private sector remain as such. In spite of the disadvantages of not having true competition from the outside, and in spite of the fact that some agencies might be able to find cheaper alternatives, the Analyst believes the loss of statewide efficiencies and accountability would more than offset any potential benefits.

   However, the Analyst recommends that during each budget cycle the ISF agencies and the Analyst provide the Legislature with benchmark data to compare ISF rates to private sector rates.

2. The Analyst also recommends that Internal Service Funds purchasing professional services from appropriated entities through transfers do so under contract with the appropriated entity.

3. The Analyst further recommends that, beginning in 2003, ISFs submit to the Capital Facilities and Administrative Services Appropriation Subcommittee a list of contracts exercised in the preceding year. The ISFs should also take reasonable steps to provide the number of FTE comparables funded through contracts.

4. To avoid excessive cross-subsidization of products and services, the Analyst recommends that the Legislature consider requiring ISFs to establish new rates for new products/services within a reasonable incubation period.

5. Finally, the Analyst recommends that any time spent by an ISF employee that does not directly meet the goals of the division should be tracked and charged to the appropriate agency to ensure that specific costs are not generally distributed.

Appendix A

Information from Comprehensive Annual Financial Report (CAFR) for FY 2001

The Internal Service Funds are maintained to account for the operation of state agencies that provide goods or services to other state agencies and other governmental units on a cost-reimbursement basis.

Water Resources Loan Fund

This fund provides loans to local governments, water districts, and other entities for the purpose of upgrading water storage facilities and other related structures. Capital for this fund has been provided from the General Fund or from general obligation bonds that are repaid from general tax revenues. Additional funds have been generated by issuing revolving fund recapitalization revenue bonds that are secured by notes receivable in the fund and will be repaid from the collection of these loans.

Information Technology Fund

This fund is responsible for providing data processing services and voice and data communication services to state agencies.

Employees Group Insurance

This fund offers several health insurance programs to state and local government employees. These programs include plans operated entirely by the State, as well as plans offered by private insurance carriers.

Community Impact Loan Fund

This fund provides loans to local governments to alleviate the social, economic, and public financial impacts resulting from the development of the State's natural resources. Working capital for this fund is provided from federal mineral lease funds transferred from the General Fund.

Transportation Infrastructure Loan Fund

This fund was created as a revolving loan fund to provide infrastructure assistance to state and local government to expedite construction projects. The fund was capitalized with federal grant and state matching appropriations.

General Services Fund

This fund administers office supply contracts and provides statewide copy and mail services to state agencies.

Fleet Operations Fund

This fund provides automobile rental, fuel dispensing, and surplus property services to state agencies.

Human Services/Internal Service Fund

This fund provides computer-programming services for the Department of Human Services and the cost of renting and maintaining facilities used by the Department.

Office of Education/Internal Service Fund

This fund provides copy and mail services to the Office of Education.

Natural Resources/Internal Service Fund

This fund operates the Department of Natural Resources' motor pool and central warehouse services.

Risk Management Fund

This division of the Department of Administrative Services provides insurance coverage and loss prevention to state agencies, institutions of higher education, and participating local school districts. Coverage is provided using a combination of self-insurance and private excess insurance.

Property Management Fund

This fund has statutory responsibilities for the operation and maintenance of facilities used by state agencies.

State Debt Collection Fund

This fund provides a central collection process for the delinquent receivables of the State. It is funded through collection fees.