



# FUNDING MIX FOR COMPENSATION AND INTERNAL SERVICE FUND SERVICE COST ADJUSTMENTS

EXECUTIVE APPROPRIATIONS COMMITTEE  
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ISSUE BRIEF

## Summary

On December 30, 1994, the Executive Appropriations Committee (EAC) approved a set of criteria for determining the mix of funding sources for compensation and Internal Service Fund (ISF) service cost adjustments for state entities. EAC has not reaffirmed this motion for the past 22 years. During that time, the Office of the Legislative Fiscal Analyst (LFA) has primarily handled these questions of funding mix internally, guided by the 1994 criteria.

Although funding mixes for compensation and ISF service cost adjustments are a technical area of the budget, the fiscal impact can be significant. As an example, [S.B. 8](#), "State Agency and Higher Education Compensation Appropriations," 2016 General Session, cost \$79 million with \$47 million in state funds (from the General, Education, and Uniform School Funds) and \$32 million in non-state funds. If the bill was appropriated with different funding mix methodologies, the share of state funds could have been as much as \$32 million more or approximately \$9 million less.

Following a recent in-depth review, which is summarized in this brief, LFA suggests that EAC revisit and affirm the criteria for determining funding mixes. Draft criteria, intended as a starting point for discussion, are included in this brief in the next section. Once EAC makes a determination, LFA proposes opening a bill file for a resolution that will set the criteria in rule. This action would provide increased transparency and consistency for setting funding mixes and support alignment with legislative intent.

## Options for Legislative Action

There is an array of options for how the Legislature could fund compensation and ISF service costs.

1. **All state funds.** The Legislature could appropriate all budget changes from state funds. This option would be the simplest and would likely be preferred by state agencies. It would, however, require additional funding and would therefore limit the availability of funds for other legislative priorities. Based on S.B. 8 (2016 General Session), which included a two percent salary increase and other benefit adjustments, this option would have cost an additional \$32 million in state funds for FY 2017.
2. **Mostly state funds, but include federal entitlement funds.** Certain federal grant programs, such as Medicaid, allow more funds to be drawn down if the state contribution increases. Leveraging additional federal funds would reduce the cost to the State and would also minimize the increase in "maintenance of effort" requirements relative to using all state funds.
3. **Funding mix from base budget, with exceptions.** This option most closely reflects current practice and would have limited new budget implications. It also most closely aligns with the 1994 motion, although it may allow for additional exceptions. A draft version of this option is included in this brief on page 2.

This option would allow for exceptions to the base funding mix for statutory limitations, such as exist for certain agencies receiving Transportation Fund and certain restricted accounts, depending on associated statutory language. The draft presented by LFA includes a process for allowing other exceptions, either through LFA evaluation in consultation with the EAC chairs for small adjustments or through subcommittee and EAC approval for large adjustments. Pre-existing exceptions would need new approval through this process and re-approval each year.

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This option includes the use of non-state funds, which involves certain trade-offs: it minimizes state expenditure, but can present challenges to agencies. In many cases, federal funds, restricted funds, and dedicated credits availability does not actually increase despite additional appropriation by the Legislature. Because most agencies *must* give appropriated compensation increases to current employees, the implication is that other program expenditures may need to be reduced, potentially including services to Utah residents. However, specific concerns could be addressed through the exceptions process. Additionally, if an agency has federal funds that do not allow expenditures on compensation and/or ISF service costs, the agency could consider accounting for those funds in a separate appropriation unit/program. Further detail on potential exceptions by fund type is described in the Background section of this brief.

4. **Funding mix from base budget, without exceptions.** This option would use the base funding mix for the budget year, without any exceptions. Based on S.B. 8 (2016 General Session), which included a two percent salary increase and other benefit adjustments, this option would have saved approximately \$9 million in state funds for FY 2017, which could have been directed to other priorities. As with the first option, this would be relatively simple to implement, but the non-state fund issues described in option three could be exacerbated and could have negative unintended consequences for agencies.

### **LFA Recommendation**

Based on the 1994 motion, LFA compiled these draft criteria for discussion regarding how the funding mix for compensation and ISF service cost adjustments should be determined:

1. Except as explicitly directed in or limited by statute, compensation and Internal Service Fund service cost adjustments shall be funded with a mix of sources proportionate to the mix of ongoing appropriations contained in base budgets, as defined under [Joint Rule 3-2-402](#), at the program/appropriation unit level for the same budget year.
  - a. In cases where the use of one or more funding sources is directed by or limited in statute, the Legislative Fiscal Analyst shall deduct the excluded source from base budget amounts at the program level, recalculate proportional distribution among remaining sources, and distribute the appropriate budget adjustment amounts accordingly.
  - b. Federal funding sources shall be included in the funding mix according to applicable match rate or maintenance of effort requirements for personnel/administrative expenditures and in such a way that state costs are minimized.
2. Federal funds, restricted accounts, dedicated credits, and sources other than unrestricted General, Education, and Uniform School funds shall be used proportionately regardless of the availability of additional funds. In this case, program reductions, reprioritizations, and reallocations, or requests for fee increases may be required if additional funding is appropriated but not realized.
3. Compensation and Internal Service Fund service cost adjustments for Internal Service Fund agencies shall be included in the rates set for services, either: a) on a prospective basis for the budget year, based on an estimated amount, or b) on a one-year lag basis. The lag option would require sufficient operating reserves to maintain the fiscal integrity of the specific Internal Service Fund.
4. In consultation with Co-Chairs of the Executive Appropriations Committee, the Legislative Fiscal Analyst has discretion to make reasonable adjustments to funding source mixes that have a negative impact on state General, Education, and Uniform School funds that are less than \$10,000 per program/appropriation unit in that budget year, given a one percent salary increase and other applicable compensation changes or the expected adjustments for Internal Service Fund service costs.
5. Exceptions not described in items one through four above must be approved by the Executive Appropriations Committee. Exceptions must be re-approved annually.

**Background**

*What is a funding mix for compensation and Internal Service Fund service cost adjustments?*

During each General Session, the Legislature determines whether to make adjustments to state agency funding for employee compensation (inclusive of salary, health insurance, and other benefits) and the costs of ISF services. These funding changes are accomplished with a mix of funding sources. Some funding is from *state funds*: the General, Education, and Uniform School Funds. Other funding is from *non-state funds* such as federal funds, restricted funds, and dedicated credit collections.

The total state budget includes a mix of funding sources to accomplish legislative priorities (see Figure 1). Generally, agency-level funding mixes for compensation and ISF service costs mirror the funding mix for their total budget, based on the direction provided by EAC in 1994 (see Appendix C). Over time various exceptions have evolved, based on statutory limitations for the use of certain funds, from the action of legislative appropriations committees, or through LFA analysis in consultation with the agency. LFA has suggested that EAC revisit the funding mix issue as a result of this variability: the discussion would be an opportunity to consider the array of options available for funding compensation and ISF service costs, as well as improve consistency and bring greater transparency to any exceptions.

*What is the current funding mix?*

During the 2016 General Session, the Legislature passed [S.B. 8](#), “State Agency and Higher Education Compensation Appropriations,” which appropriated \$79 million for compensation, with \$47 million in state funds and \$32 million in non-state funds. The Legislature also passed [H.B. 8](#), “State Agency Fees And Internal Service Fund Rate Authorization And Appropriations,” which appropriated \$1.8 million for ISF service costs, with \$1 million in state funds and \$800,000 in non-state funds. The figure below compares the mix of funding sources for the full state budget with the mix of funding sources for S.B. 8, and shows that compensation is funded with a higher proportion of state funds.

Note: ISF service costs are funded using a mix, usually one that is similar to the mix for compensation, but the amounts depend on the approved rate changes and whether those rate impacts are funded in a given year, leading to wide variability across fiscal years. As such, this brief includes ISF service costs in the discussion but most of the analysis and examples focus on compensation.

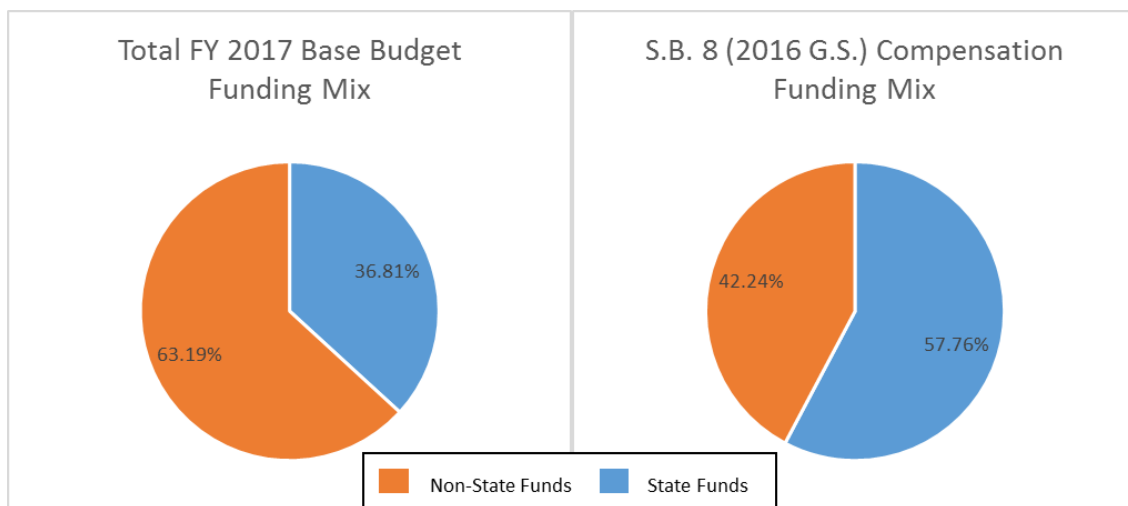


Figure 1. Total State Budget Funding Mix Compared to Compensation Funding Mix in S.B. 8 (2016 General Session)

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## *How are funding mixes determined?*

### Governor's Office

The Governor includes funding mixes for compensation and ISF service costs in his budget considerations and shares his proposal with LFA. Historically the Governor's Office and the Legislature determined funding mixes for compensation separately, but in recent years there has been an effort to coordinate more closely between the Governor's Office of Management and Budget (GOMB) and LFA.

To determine compensation funding mixes for his budget recommendations, the Governor uses the compensation funding mix from the previous legislative General Session and then solicits agency input in adjusting funding percentages (additional detail is provided in Appendix B). This process can carry forward exceptions from year to year, which can be efficient but may also allow exceptions to be included without review each year.

### Legislature

To determine funding mixes, the LFA uses the motion taken by EAC in 1994, which identified the following tenets:

1. Compensation increases for single revenue source agencies and programs should be funded from the single source.
2. Programs funded with state matched federal funds should provide increases at the appropriate match rate.
3. Increases for agencies or programs with a mix of revenue sources should generally be adjusted with a proportionate increase in rates or tuition increases to cover the proportionate share of the increase.
4. Increases for programs that include some funding from fixed federal grants for administration should be funded from free revenue (state funds) or through program adjustments.
5. Compensation for Internal Service Fund and Enterprise Fund agencies should be funded in the rates set for the service of the agency.
6. Pass through compensation increases to counties operating state funded programs will be proportionate to the funding sources for the program.<sup>1</sup>

LFA also considers the Governor's recommendations, agency comments, statutory limitations for certain funds, and legislative appropriations committee action, and conducts internal analysis. Staff then incorporates the mixes when drafting compensation and ISF service cost bills.

Legislative appropriations subcommittees generally do not discuss funding mixes. Discussions regarding compensation and ISF service costs typically occur after subcommittees have finished their General Session meetings. Compensation and ISF service cost bills are heard in EAC and proceed to voting by the full Legislature, usually close to the end of General Session.

## *What are current exceptions to a proportionate funding mix?*

Exceptions to a funding mix that is proportional to an agency's base budget fall into several categories.

1. **Statutory limitations** restricting the use of certain funding sources.

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<sup>1</sup> H.B. 357, "Budgetary Amendments," 2014 General Session, rendered item six from the 1994 motion obsolete. The bill repealed section 63J-1-201.7, which provided that the Legislature would consider granting funds to local entities to match compensation increases given to state employees.

A primary example is the Transportation Fund. The amount of Transportation Fund that can be appropriated to agencies other than the Department of Transportation is capped in statute, limiting any additional appropriations for compensation or ISF service costs.

Some restricted funds also have statutory requirements that limit spending on certain types of expenditures.

2. **Previous legislative action** altering the funding mix to increase state funding.

In 2007, EAC voted to fund compensation for higher education employees (not including those at the Utah College of Applied Technology) at a standardized mix of 75 percent state funds and 25 percent dedicated credits from tuition. This action was intended to limit tuition increases to fund compensation. Because the current base funding mix is about 57 percent state funds and 43 percent dedicated credits, this policy constitutes the largest shift of the compensation burden from non-state to state funds. Based on S.B. 8 (2016 General Session), about \$7 million more in state funds was spent on higher education compensation than would have been the case using the base budget funding mix.

A Health and Human Services Appropriations Subcommittee (now known as Social Services) motion authorized treating certain Department of Human Services federal funds as state funds for compensation adjustment purposes. This exception was inadvertently omitted from S.B. 8 but has historically been included and would have resulted in approximately \$200,000 more in state fund expenditure.

3. **Capped fees** where state funds were increased to acknowledge that additional fee revenue would likely not be forthcoming.

In many cases, agencies do not actually collect more dedicated credit funding from fees for compensation and ISF service cost purposes, despite appropriation by the Legislature. Agencies may request fee increases in a future budget cycle. Analysts may also determine that more state funding is required in order for intended compensation and ISF service cost adjustments to be realized.

4. **Capped restricted funds** where state funds were increased to acknowledge that additional restricted fund revenue would likely not be forthcoming.

The use of restricted funds may lead to the same issues as described with dedicated credits from fees. Analysts may make adjustments toward state funds based on limited funds in a restricted account, particularly if revenue to the fund has been declining.

5. **Fixed or restricted federal grants** where state funds were increased to acknowledge that additional federal funds would either not be forthcoming or were restricted in their uses.

As with dedicated credits from fees and restricted funds, federal funding may not increase with legislative appropriation. Analysts may make associated adjustments, depending on the particular situation.

In some cases, federal funds have restricted uses that do not allow for expenditures on personnel or administrative costs. They may also be passed through to local or other entities, such that those funds do not support state-level costs even in the base budget.

Of current exceptions, higher education represents the largest share of the shift from non-state to state funds, at \$7 million out of \$9 million for S.B. 8. A table included in Appendix A identifies other exceptions that led to more than \$50,000 of shift in a single appropriation unit/program. These larger exceptions, including much of higher education, amounted to \$7.6 million of the \$9 million; all smaller exceptions amounted to a total of \$1.4 million.

*Why is the Minimum School Program not included in this discussion?*

The Minimum School Program is excluded because the compensation of local school district and charter school employees is determined by local boards of education and not the Legislature. The Legislature may provide a percentage increase in funding in a given year by increasing the dollar value paid for each Weighted Pupil Unit (WPU) within the program. Local boards may use this increase, as well as other funding available to them, to increase employee wages, benefits, or meet other locally-determined priorities.

## Appendix A

Exceptions Table								
Appropriation Units/Programs with Base Funding Mix Exceptions Equivalent to More than \$50,000 from State Funds								
<p><i>To compile this table, analysts compared appropriations for compensation from S.B. 8 (2016 G.S.) with what appropriations would have been if the straight base funding mix was used. The individual appropriation units/programs listed here include those that received more than \$50,000 more in state funds with the S.B. 8 funding mix than would have been the case with the base funding mix.</i></p>								
Agency	Line Item	Program	GF/EF/USF	Federal	Ded. Credits	Restricted	Other	Exception Type
<i>EOCJ</i>								
Corrections	Corrections Programs and Operations	Adult Probation and Parole Programs	\$96,781	\$0	(\$96,037)	(\$745)	\$0	Capped Fees
Courts	Administration	Juvenile Courts	\$53,320	(\$62)	(\$22,799)	(\$30,459)	\$0	Capped Fees, Capped Restricted Funds
Public Safety	Public Safety Programs and Operations	Highway Patrol - Commercial Vehicle	\$84,161	\$0	\$0	\$0	(\$84,161)	Statutory Limitations
Public Safety	Public Safety Programs and Operations	Highway Patrol - Field Operations	\$74,321	\$0	(\$2,409)	(\$602)	(\$71,310)	Statutory Limitations, Capped Fees
<i>Higher Education</i>								
Dixie State University	Education and General	Education and General	\$245,786	\$0	(\$242,214)	\$0	(\$3,572)	Previous Legislative Action
Salt Lake Community College	Education and General	Education and General	\$485,270	\$0	(\$485,270)	\$0	\$0	Previous Legislative Action
Snow College	Education and General	Education and General	\$73,860	\$0	(\$73,860)	\$0	\$0	Previous Legislative Action
Southern Utah University	Education and General	Education and General	\$397,031	\$0	(\$397,031)	\$0	\$0	Previous Legislative Action
University of Utah	Education and General	Education and General	\$2,670,008	\$0	(\$2,670,008)	\$0	\$0	Previous Legislative Action
University of Utah	School of Medicine	School of Medicine	\$80,635	\$0	(\$80,635)	\$0	\$0	Previous Legislative Action
Utah State University	Brigham City Regional Campus	Brigham City Regional Campus	\$132,177	\$0	(\$132,177)	\$0	\$0	Previous Legislative Action
Utah State University	Education and General	Education and General	\$796,682	\$0	(\$769,959)	\$0	(\$26,723)	Previous Legislative Action

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Utah State University	Tooele Regional Campus	Tooele Regional Campus	\$80,996	\$0	(\$80,996)	\$0	\$0	Previous Legislative Action
Utah Valley University	Education and General	Education and General	\$1,230,950	\$0	(\$1,230,950)	\$0	\$0	Previous Legislative Action
Weber State University	Education and General	Education and General	\$667,140	\$0	(\$667,140)	\$0	\$0	Previous Legislative Action
Utah Education and Telehealth Network	Utah Education and Telehealth Network	Technical Services	\$82,790	\$0	(\$79,567)	\$0	(\$3,224)	Capped Fees
<i>Public Education</i>								
State Board of Education	State Office of Education	Career and Technical Education	\$51,752	(\$59,954)	(\$585)	(\$557)	\$9,344	Fixed or Restricted Federal Grants
<i>BEDL</i>								
Tax Commission	Tax Administration	Motor Vehicles	\$215,373	\$0	(\$79,801)	(\$98,602)	(\$36,969)	Statutory Limitations, Capped Restricted Funds, Capped Fees
<i>Social Services</i>								
Workforce Services	Operations and Policy	Eligibility Services	\$51,923	(\$47,651)	\$13,873	\$0	(\$18,144)	Fixed or Restricted Federal Grants
			<b>SUBTOTAL</b>	\$7,570,955				
			<b>Other Exceptions SUBTOTAL</b>	\$1,403,135				
			<b>Exceptions TOTAL</b>	\$8,974,090				

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## Appendix B

Governor's Office of Management and Budget (GOMB) process for determining funding for compensation, benefits, and ISF increases

- *Funding for Compensation and Benefit Increases*  
"The Governor's Office of Management and Budget (GOMB) uses the following process to determine the funding spread for compensation and benefit increases funded in the Governor's Budget. First, GOMB populates Comp Prep with the funding spread utilized for compensation increased during the prior legislative session. The funding page in Comp Prep identifies funding sources for each appropriation. Second, agencies review and update funding spreads in Comp Prep at the same time that they review and update personnel estimates in Comp Prep. GOMB instructs agencies that the funding spread should reflect the spread of funding sources for personnel services expenditures. Finally, GOMB reviews any updates made by agencies and requests additional justification for changes, when necessary."
- *Funding for ISF Impacts*  
"GOMB uses the following process to determine the funding spread for internal service fund (ISF) impacts funded in the Governor's Budget. First, GOMB populates a spreadsheet with the funding spread utilized for ISF impacts during the prior legislative session. The spreadsheet identifies funding sources for each appropriation. Second, agencies review and update the spreadsheet. GOMB instructs agencies that the funding spread should reflect the spread of funding sources used for ISF expenditures. Agencies are also required to submit a justification for any changes made to the prior year funding split. Finally, GOMB reviews any updates made by agencies and requests additional justification for changes, when necessary."

From GOMB email provided to LFA, dated 8/16/2016

## Appendix C

Executive Appropriations Committee 1994 motion on funding mix.

See attached scanned PDF.



Dec 30, 1994

### Guideline for Funding Compensation Increases

Based on the policy followed in the past that the Legislative Fiscal Analyst does not generally recommend increases in revenue sources, particularly tax increases, the following guidelines are proposed for legislative fiscal analysts in recommending funding sources for compensation increases.

1. Compensation increases for single revenue source agencies and programs should be funded from the single source. If the single source is not adequate to meet the increased cost, recommendations should be made to adjust program levels to provide sufficient funds. The Legislature may choose to increase the revenue source for compensation purposes rather than approve program adjustments. If so, the increased revenue can be used as needed.
2. Programs funded with state matched federal funds should provide increases at the appropriate match rate.
3. Increases for agencies or programs funded with a mix of revenue sources should generally be based on:
  - a. The proportionate share of those revenues to the agency budget.
  - b. Reservation of revenue sources other than the free revenue portion for recommended compensation purposes so that these projected revenues will not all be allocated to other budget purposes.
  - c. If the Governor's recommended budget has not reserved revenue for compensation purposes other than the free revenue portion of a mixed revenue budget, the analyst may need to make program adjustments to provide funds from these sources for compensation. This should have the effect of suggesting appropriate rate changes by the agencies in succeeding years to cover compensation increases.
  - d. In higher education budgets, if tuition increases are proposed to fund the recommended budgets, the dedicated credits from this revenue source should bear their proportionate share of increased compensation costs based on the ratio of tuition to the free revenue sources in the current budget.
4. Increases for programs that include some funding from fixed federal grants for administration should be funded from free revenue or through program adjustments.
5. Recommended compensation increases for Internal Service Fund and Enterprise Fund agencies should be included and funded in the rates set for the services of the agency, either a) on a prospective basis for the budget request year or b) on a one year lag basis. The lag option would be the most accurate but would require sufficient operating reserves to maintain the fiscal integrity of the specific fund. The analyst should use the lag option unless the executive branch has specifically

provided for compensation increases in the proposed rates for the agency or program.

6. Pass through compensation increases to counties operating state funded programs will be proportionate to the funding sources for the program.