Fiscal Highlights

An Update on Internal Service Fund Rates - Sean C. Faherty

On November 15th, the Executive Appropriations Committee heard an update on internal service funds.

An internal service fund (ISF) agency is a state entity that provides goods or services to other government agencies on a cost-reimbursement basis. Each fiscal year ISF agencies propose new rates based on expected costs; the Legislature then makes funding decisions based on those proposals. The two types of ISF rates are those that are consumption or use based, such as vehicle/fleet management or information technology services and those that are determined actuarially such as property or liability insurance.

ISF agencies employ business practices to take advantage of economies of scale, to avoid duplication of effort, and to provide an accounting mechanism to identify costs of certain governmental services. There are two primary advantages to using internal service funds within government. First, ISFs charge customer agencies at rates set by the Legislature, and the price mechanism motivates customer agencies to find efficiencies to reduce expenses for ISF services so that operational budgets can be utilized elsewhere. Second, agencies can use federal and restricted funds to pay for ISF services rather than relying solely on General Fund and Education Fund appropriations.

The state's major ISFs are operated by the Department of Administrative Services (DAS), the Department of Human Resource Management (DHRM), and the Department of Technology Services (DTS). When making funding decisions during the 2016 General Session, the Legislature did not fund all impacts and agencies for these ISFs and they have had to work within their own budgets to manage those differences.

The combined impact of the proposed DAS, DHRM and DTS rates, if approved for the 2017 General Session would be $2.24 million ($1.35 million GF/EF), all from discretionary/consumption based rates.

The Legislative Fiscal Analyst made the following three recommendations to the Executive Appropriation Committee (EAC):

1. Due to the differences between actuarially-based and consumption-based rates, LFA recommended that the EAC include actuarially-determined rate impacts in its discussion of major cost drivers each fall.
2. LFA also recommended that EAC refer all other ISF rate impacts to the appropriations subcommittee with jurisdiction over the ISF for review and new funding prioritization.
3. To support agencies that did not received ISF funding for Risk Management during the 2016 General Session, LFA recommended the Legislature consider providing $1.2 million ($0.7 million GF/EF) one-time in FY 2017 and $1.2 million ($0.7 million GF/EF) ongoing beginning in FY 2018 for Risk Management rate changes.