COMMONWEALTH of VIRGINIA

Joint Legislative Audit and Review Commission
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January 13, 2016

MEMORANDUM

TO:	Members of the Joint Legislative Audit and Review Commission
CC:	Robert Vaughn; Staff Director, House Appropriations Committee Betsey Daley; Staff Director, Senate Finance Committee
FROM:	Kimberly Sarte, Mark Gribbin
SUBJECT:	Annual Review of Internal Service Funds

The Joint Legislative Audit and Review Commission (JLARC) is vested with responsibility for overseeing the internal service funds (ISFs) managed by the Virginia Information Technologies Agency (VITA), Department of General Services (DGS), and Department of Accounts (DOA). JLARC's oversight is generally limited to monitoring the health of ISFs, including whether they are maintaining appropriate balances, making reasonable projections of future revenues and expenditures, and charging appropriate rates to recover the anticipated costs of services. This memo comments on the financial health of the ISFs and on changes proposed in the governor's budget bill for the 2016–2018 biennium (budget bill). The ISFs overseen by JLARC had appropriations of $540 million in FY 2016.

Key findings

JLARC staff did not identify any major concerns regarding the health of the ISFs or changes proposed in the budget bill.

- Although some ISFs have negative balances due to long-term debt, the debt is being paid off and the ISFs have collected sufficient revenue to pay their operating expenses.
- Most ISFs appear to be maintaining appropriate cash reserves, but cash transfers from some VITA and DGS funds to the general fund in FY 2015 reduced reserves available for these funds.

- ISF revenues appear sufficient to pay for the appropriations requested in the budget bill, based on agency projections and actual historical revenues.
- The ISF rate changes requested in the budget bill were reasonably determined.
- The budget bill gives the governor authority to make technical changes to ISF overhead surcharge rates, or to create new rates, beyond those enacted in the budget, in order to implement actions approved by the General Assembly in the budget or other legislation. For example, under this new authority, the governor would be allowed to change ISF rates to account for changes in employee compensation that were approved by the legislature in the final Appropriation Act.

Background

Internal services funds (ISFs) are a financial mechanism used to recoup costs incurred by one agency when performing services or procuring goods on behalf of other agencies. For example, DGS leases office space in downtown Richmond to several customer agencies, which pay rent to DGS through an ISF. Likewise, VITA's IT services to customer agencies are paid through an ISF, as are DOA enterprise applications and payroll processing services.

Fund status

JLARC staff recommend that ISFs maintain positive fund balances. A positive fund balance indicates that a fund has regularly collected sufficient revenue to pay its expenses. Some funds have negative balances because they are carrying long-term debt. These funds should make steady progress towards reducing their debt.

Agencies that manage ISFs should maintain a cash reserve for unexpected expenses and revenue shortfalls. The appropriate reserve amount depends on the fund and its unique cash requirements. Some ISF agencies have access to lines of credit with the state and so can maintain smaller reserves.

Federal government guidelines allow agencies to keep ISF cash reserves equivalent to 60 days of operating expenses. The Department of Planning and Budget (DPB) has adopted this standard as a benchmark for Virginia's ISFs. Prepayments and other restrictions on cash held in an ISF should be taken into account when the reserve is calculated.

Appropriations

The General Assembly approves ISF appropriations annually in the Appropriation Act. The ISF agencies make appropriation requests according to their expenditure and revenue projections, which are based on anticipated demand for services from customer agencies. ISF appropriations should be close to projected expenditures and revenues.

The cost of ISF services are also included in appropriations requested by customer agencies, which pay for services using general and non-general funds. Customer agency spending drives total ISF spending.

Rates

ISF rates should be set to avoid both under- and over-collection from customer agencies. Rates must be sufficient to recover expenditures but not place an undue financial burden on customer agencies. Over time, rates vary depending on the demand for services and the expenses that need to be recovered, such as the costs of vendor services or employee compensation. Changes in ISF "overhead surcharge" rates must be approved in the Appropriation Act, and all other types of rate changes must be approved by DPB (§ 4-5.03).

Virginia Information Technologies Agency

The Virginia Information Technologies Agency (VITA) provides IT goods and services to most executive branch agencies. VITA provides IT infrastructure services, such as data center services, personal computers, and internet connectivity, through third-party vendors such as Northrop Grumman. VITA also provides security oversight and central support services directly to agencies. VITA collects revenues for all of these services through its Information Technology and Management ISF. VITA charges over 400 unique rates for its services.

VITA's total budgeted ISF appropriations for FY 2016 are $349.8 million. The services under this ISF fall under four different budget programs (Table 1). Almost 90 percent of VITA appropriations are "pass-through" payments to Northrop Grumman and other vendors that provide IT infrastructure services to state agencies.

TABLE 1
VITA services provided under the Information Technology and Management ISF

Program within fund	Services	FY 2016 appropriation
Vendor IT infrastructure services	Data center, personal computing, internet, and telecommunications services from Northrop Grumman and other vendors	$312.5 million
VITA administrative overhead	Agency operations costs not related to direct services or security, including staff costs for contract oversight, customer relations, and administrative functions	$22.9 million
VITA central support services	Support services directly provided by VITA including support for the Medicaid Information Technology Architecture initiative, collaborative software applications, and applications security testing	$11.8 million
VITA security oversight	Security oversight services directly provided by VITA including incident response and IT security audit reviews	$2.6 million
Total all programs		**$349.8 million**

Source: 2015 Appropriation Act, Chapter 665.

Fund status

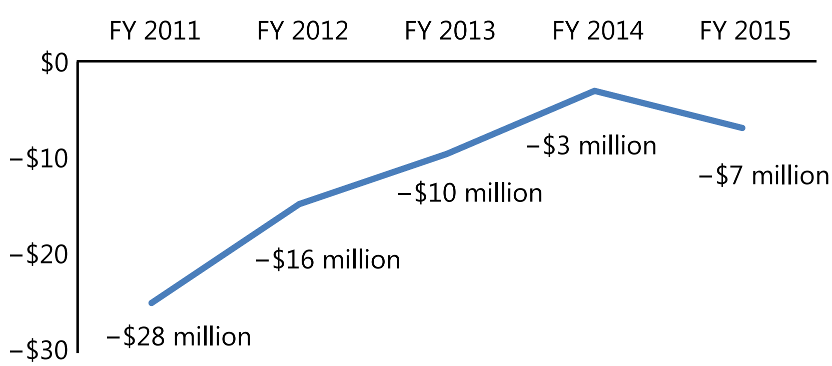
One key measure of ISF status is whether the fund maintains an appropriate positive fund balance over time. VITA's ISF had a negative balance of −$7.4 million as of the end of FY 2015, which was a net reduction of $3.4 million from the previous year (Figure 1). The fund balance went down because of a $4.5 million transfer of cash out of the fund. Most of the cash was transferred to the general fund to alleviate an anticipated shortfall in the state budget. The remaining portion was transferred to Virginia's Federal Repayment Reserve Fund, which was created in 2015 to hold funds in case the state is required to repay the federal government for unallowable expenses.

Although the negative balance is a concern, the fund itself appears to be stable. Operating revenues exceeded operating expenses for the fifth year in a row. If the cash transfer had not occurred, the fund would have gained $0.6 million and had a balance of −$2.9 million. While the fund's balance would still have been negative, it would have continued moving toward a positive balance.

A second measure of ISF status is whether a fund has a sufficient cash reserve to cover short-term operating expenses. At the close of FY 2015, the ISF had a $13 million cash reserve, which was sufficient to cover 14 days of operating expenses (Figure 1). The cash reserve is below the 60-day cash equivalent benchmark for ISFs. The small size of the reserve is not a major concern because VITA has access to a line of credit with the state, which can be used to borrow money in the event that VITA does not have sufficient cash on hand to cover expenses. However, future cash transfers from the fund should be limited until the fund's cash reserve and overall balance have increased.

FIGURE 1
Key ISF status indicators

Fund balance



Cash reserve[a] as of June 30, 2015 — **$13 million**
Equivalent to 14 days of operating expenses

Source: VITA financial statements.
[a] Cash reserve equal to cash on hand less deferred revenue from agency prepayments. Operating expenses used to calculate cash reserve equivalent in days are equal to total operating expenses less non-cash depreciation expenses. Operating expenses do not include repayment of working capital advances or Treasury loans. Calculation methodology used in this report is different from the methodology used in JLARC's 2015 Annual Review of Internal Service Funds, so the numbers from that report are not comparable; methodology also differs from the methodology used by DPB to calculate the cash reserve for budgeting purposes. DPB uses cash-basis financial statements, whereas JLARC staff use accrual-basis statements. Operating expenses include VITA's vendor pass-through and other non-administrative costs.

Proposed appropriations

The governor's budget bill proposes an increase in the amounts appropriated for VITA's ISF of $17.5 million above the base budget in FY 2017 and $9.9 million above the base in FY 2018 (Table 2). The increase is mostly from increased agency spending on vendor IT infrastructure services, VITA administrative overhead, and security oversight. The budget bill anticipates that the state will begin transitioning IT infrastructure services away from the current Northrop Grumman contract to new service contracts with lower prices during FY 2017–FY 2018, which is why the requested appropriation amount drops in FY 2018.

- Vendor IT infrastructure services costs are expected to increase in FY 2017 due to increased demand for services, price increases for Northrop Grumman and telecommunication services, and a one-time project to increase internet bandwidth. Costs are expected to return to current levels in FY 2018, assuming the state successfully transitions to new infrastructure service contracts with lower prices.
- VITA administrative overhead spending would increase with the creation of new positions at VITA for overseeing and providing IT infrastructure services during and after the transition from the current Northrop Grumman services.
- VITA security oversight costs would increase with the creation of a shared IT security center that would provide customer agencies with security audit, security officer, and vulnerability scanning services. Agencies need these services to fulfill state security requirements. Also included in the budget are purchases of security software and hardware and creation of a security architect staff position.

JLARC staff compared the appropriations requested in the governor's budget bill with VITA's projections of ISF revenues for FY 2017 and FY 2018. JLARC staff found that projected revenues closely matched the requested appropriations. VITA's revenue projections assume that the rate

TABLE 2
VITA ISF budget and proposed changes program

		2015 Appropriation Act	**Governor's budget bill**	
Program within fund	**Program code**	**FY 2016** (Base budget)	**FY 2017**	**FY 2018**
Vendor IT infrastructure services	820	$312,536,026	$319,870,944	$312,755,567
VITA administrative overhead	899	$22,881,971	$27,121,075	$27,318,830
VITA central support services	824	$11,806,841	$12,061,385	$12,061,385
VITA security oversight	829	$2,599,913	$8,311,612	$7,560,868
Total for ISF (Fund 0600)		**$349,824,751**	**$367,365,016**	**$359,696,650**

Source: Performance Budgeting data, 2015 Appropriations Act (Chapter 665), and 2015 governor's budget bill.

changes requested for its ISF are approved and that it is allowed to begin transitioning to new IT services contracts.

The governor's budget bill also increases VITA's line of credit from $40 million to $60 million to allow it to pay one-time transition costs that are not captured in the budgeted appropriations. The Secretary of Finance and the Secretary of Technology would have to approve any drawdown of funds to pay for transition costs. Advances would be repaid through rates charged to agencies in future years.

Proposed rates

Each of the VITA rates includes a "fee" component and a "surcharge" component. The fee component recovers either the direct cost of vendor services or the costs of services provided by VITA staff, such as its central support services. The surcharge component recoups VITA's administrative overhead and security oversight costs.

The governor's budget bill proposes an increase in the VITA surcharge. A higher rate is needed to cover the administrative overhead expenses requested in the bill. A higher rate is also needed to offset the impact of an anticipated shift to lower-cost vendor services, because lower prices will reduce the amount of revenue that the VITA overhead surcharge generates. The bill proposes a VITA surcharge of 9.27 percent for FY 2017 and 9.08 percent for FY 2018. By comparison, the surcharge in place for FY 2016 is 7.91 percent.

JLARC staff reviewed VITA's surcharge calculations and found them to be reasonably determined. The proposed surcharges appear sufficient to recover the expenditures requested in the governor's budget bill.

VITA anticipates that its overall rates (fees plus surcharge) will increase by 6.70 percent in FY 2017, using a weighted average of rates. The increase is due to higher administrative surcharges and higher vendor fees charged by Northrop Grumman and telecommunications service providers. The fees charged by Northrop Grumman are expected to increase due to an annual cost-of-living adjustment and changes in customers' use of infrastructure services. Vendor fees are expected to be lower in FY 2018, assuming the state transitions to new IT infrastructure services. However, the state may also need to pay one-time transition fees to Northrop Grumman in addition to standard service fees.

Department of General Services

The Department of General Services (DGS) provides a variety of goods and services to executive branch agencies. These services are provided under nine different ISFs (Table 3). DGS charges hundreds of unique rates for the services it offers.

DGS's total budgeted ISF appropriations for FY 2016 are $165.8 million. Four DGS funds account for 93 percent of ISF appropriations: Real Estate Services, Maintenance and Repair Projects, Virginia Distribution Center, and Fleet Management. The five other DGS funds are substantially smaller and account for the remaining seven percent of appropriations.

TABLE 3
DGS services provided under ISFs

Fund	Services	FY 2016 appropriation
Real Estate Services	Administration of leases for agencies that rent office space that is not owned by the state	$63.1 million
Maintenance and Repair Projects	Lease and maintenance activities on state-owned property under the Bureau of Facilities Management	40.6[a]
Virginia Distribution Center	Sale of food and housekeeping products	32.0
Fleet Management	Management of cars, trucks, and fuel programs used by state agencies	19.0
Bureau of Capital Outlay Management	Assistance planning and procuring construction services	4.4
Analytical Testing Services	Laboratory testing of environmental, agricultural, and other samples	3.8
State Surplus Property	Sale or donation of state surplus items to agencies, nonprofits, and the public	1.9
Federal Surplus Property	Sale or donation of federal surplus items to agencies, nonprofits, and certain small businesses	0.9
Graphic Communications	Printing and graphic design services	0.1
Total all funds		**$165.8 million**

Source: 2015 Appropriation Act, Chapter 665.
Note: In addition to ISF services, DGS provides procurement services to state agencies and others through the eVA system. These services are provided through an enterprise fund instead of an internal service fund.
[a] Includes $109,000 reported as Administrative and Support Services (79900) under Item 80 of the 2015 Appropriation Act (Chapter 665). This funding is intended to pay for a new position to administer the DGS ISFs.

Fund status

Most of DGS's ISFs had positive fund balances as of the end of FY 2015 (Table 4). On aggregate, the funds had a balance of $30.1 million, which was a net increase of $2.6 million over the previous year's aggregate amount. The funds generally appear to be stable, with most funds experiencing small operating gains or losses in FY 2015.

The Maintenance and Repair Projects fund was the only fund with a negative balance, which was −$10.6 million at the end of FY 2015. The negative balance is attributable to a $2.7 million Treasury loan for the purchase of the Old City Hall building in Richmond and a $12.7 million contractual financing arrangement for three projects to improve the energy efficiency of state buildings. Although the fund balance is negative, it is trending in the right direction. The fund increased by $4.9 million in FY 2015. DGS staff indicated this was primarily from cost reduction measures taken by the department and a shift to using the DGS maintenance reserve fund to pay for some repairs and improvements, as authorized in the appropriation act.

The DGS funds had cumulative cash reserves of $16.7 million at the close of FY 2015. On a fund-by-fund basis, cash reserves were sufficient to cover from 12 to 1,319 days of operating expenses

Table 4
Key ISF status indicators as of June 30, 2015

Fund	Fund balance ($ millions)	Cash reserve[a] ($ millions)	Cash reserve equivalent[a] (days of operating expenses)
Real Estate Services	$2.9 million	$2.2 million	12 days
Maintenance and Repair Projects	−10.6	6.6	65
Virginia Distribution Center	11.4	1.8	21
Fleet Management	23.2	3.1	122
Bureau of Capital Outlay Management	0.9	0.9	82
Analytical Testing Services	0.3	0.5	51
State Surplus Property	0.1	0.1	33
Federal Surplus Property	1.7	1.4	1,319
Graphic Communications	0.05	0.1	318
Total all funds	**$30.1 million**	**$16.7 million**	not applicable

Source: VITA financial statements.
[a] Cash reserve equal to cash on hand less deferred revenue from agency prepayments and cash held by DGS from sales of third-party property that is pending distribution. Operating expenses used to calculate cash reserve equivalent in days are equal to total operating expenses plus leasing activity costs and costs of goods sold, less non-cash depreciation and bad debt expenses. Operating expenses do not include repayment of working capital advances or Treasury loans. Calculation methodology used in this report is different from the methodology used in JLARC's 2015 Annual Review of Internal Service Funds, so the numbers from that report are not comparable; methodology also differs from the methodology used by DPB to calculate the cash reserve for budgeting purposes. DPB uses cash-basis financial statements, whereas JLARC staff use accrual-basis statements.

(Table 4). Although some funds had high cash reserves, most reserves were close to or below the 60-day cash equivalent benchmark for ISFs.

Two funds had relatively low cash reserves: Real Estate Services and the Virginia Distribution Center. DGS staff indicated that low cash reserves in the Real Estate Services fund (12 days) and Virginia Distribution Center fund (21 days) were not problematic because the funds have steady cash flows and do not experience large, unexpected expenses.

The Fleet Management and State Surplus Property cash reserves were both affected by cash transfers out of the funds. In FY 2015, $1.7 million was transferred out of the Fleet Management fund and $0.7 million was transferred out of the State Surplus Property fund. The transfers were directed under the 2015 Appropriation Act to alleviate an anticipated shortfall in the state budget. In addition to reducing the funds' cash reserves, the transfers resulted in the funds recording a net loss of income for the year. For Fleet Management, less cash means that DGS is not able to purchase new vehicles outright and must instead finance vehicle purchases through loans. Future cash transfers from the funds should be limited to allow cash reserves to increase.

Two of the small funds, Federal Surplus Property and Graphic Communications, had large cash reserves relative to operating expenses, but the actual reserve amounts were small. The Federal Surplus Property fund had a $1.4 million cash reserve, equal to 1,319 days of operations. The fund collects proceeds from DGS-administered sales of federally owned property. Cash cannot be removed from the fund except for specific purposes, which is why the cash reserve is large relative to the fund's operating expenses. The Graphic Communications fund had a $125,484 cash reserve, which was a small dollar amount but was equal to 318 days of operating expenses.

Proposed appropriations

The governor's budget bill proposes an increase in the amounts appropriated for DGS's ISFs by $1.6 million above the base budget in FY 2017 and FY 2018 (Table 5). Half of the increase is from a proposed increase in spending under the Analytical Testing Services fund. DGS indicates the additional appropriation is needed to keep pace with higher staffing costs and invest in new equipment. The remaining half is mostly from technical adjustments to the base budget, which account for salary increases and other changes that were approved in the 2015 Appropriation Act.

TABLE 5
DGS ISF budget and proposed changes by fund

		2015 Appropriation Act	**2016 governor's budget**	
Fund	**Fund code**	**FY 2016** (Base budget)	**FY 2017**	**FY 2018**
Real Estate Services	601	$63,064,232	$63,058,520	$63,059,428
Maintenance and Repair Projects	604	40,580,393	41,390,090	41,393,837
Virginia Distribution Center	600	32,000,000	32,196,261	32,196,940
Fleet Management	610	18,993,189	19,004,522	19,005,140
Bureau of Capital Outlay Management	607	4,420,800	4,737,063	4,737,932
Analytical Testing Services	606	3,762,854	4,668,330	4,668,665
State Surplus Property	603	1,865,000	1,573,928	1,574,380
Federal Surplus Property	605	936,900	606,796	606,840
Graphic Communications	602	145,600	145,600	145,600
Total all funds		**$165,768,968**	**$167,381,110**	**$167,388,762**

Source: Performance Budgeting data, 2015 Appropriations Act (Chapter 665), and 2015 governor's budget bill.

JLARC staff compared the appropriations requested in the governor's budget bill with DGS projections of ISF revenues for FY 2017 and FY 2018. For funds where no projections were available, JLARC staff compared the requested appropriations to actual ISF revenues for FY 2015. For most funds, JLARC staff found that projected and historical revenues were reasonably close (within 10 percent) of the requested appropriations.

Proposed rates

Each of the DGS rates is structured differently depending on the ISF and service provided. Some service rates are flat fees, such as hourly fees for construction inspection services, and others are fixed percentage markups charged on top of the price paid for each good or service a customer buys.

DGS has proposed changing the rates charged under the Analytical Testing Services fund. These include 279 rates for testing services provided to the Virginia Department of Agriculture and Consumer Services (last changed in 2010) and the Department of Environmental Quality (last changed in 1996). These rate changes are not set forth in the budget bill, but they are reflected in the request to increase the appropriation for this fund. DGS staff indicated that the rates need to be changed to better capture the cost of services, including higher staffing costs and investment in new equipment. DGS staff indicated that the proposed changes have been discussed with the customer agencies, and the customer agencies recognize the need for rates to be increased.

The governor's budget bill proposes changing the hourly billable rate for design services provided under the Graphic Communications fund. The rate would increase from $75 to $85 per hour. The new $85 rate appears sufficient to recover the costs of providing design services. The rate change does not have an impact on the appropriations requested for the fund. The budget bill also lists a 115 percent pass-through rate charged by DGS for third-party services. This rate has been in place for several years but was not previously set forth in the Appropriation Act.

JLARC staff reviewed DGS's rate calculations for the Analytical Testing Services fund and the Graphic Communications fund and found them to be reasonably determined. The proposed rates appear sufficient to recover the expenditures requested in the governor's budget bill.

Department of Accounts

The Department of Accounts (DOA) oversees ISFs that support financial services provided to state agencies. The costs for these financial services are recovered through two enterprise applications ISFs and the Payroll Services Bureau ISF (Table 6). The enterprise applications ISFs recover costs related to the development, implementation, and operations of the Cardinal accounting system and the Performance Budgeting system. The Payroll Services Bureau is a shared services center for processing payroll, leave, and other employee benefits at 59 state agencies.

DOA's total budgeted ISF appropriation for FY 2016 is $24.5 million. The Cardinal fund accounts for almost three-quarters of ISF appropriations.

TABLE 6
DOA services provided under ISFs

Fund	Services	FY 2016 appropriation
Cardinal enterprise application	Central financial reporting services	$18.0 million
Performance Budgeting enterprise application	Central budget reporting services	4.0 million
Payroll Service Bureau	Agency payroll, leave, and other employee benefits processing services	2.5 million
Total all funds		**$24.5 million**

Source: 2015 Appropriation Act, Chapter 665.

Fund status

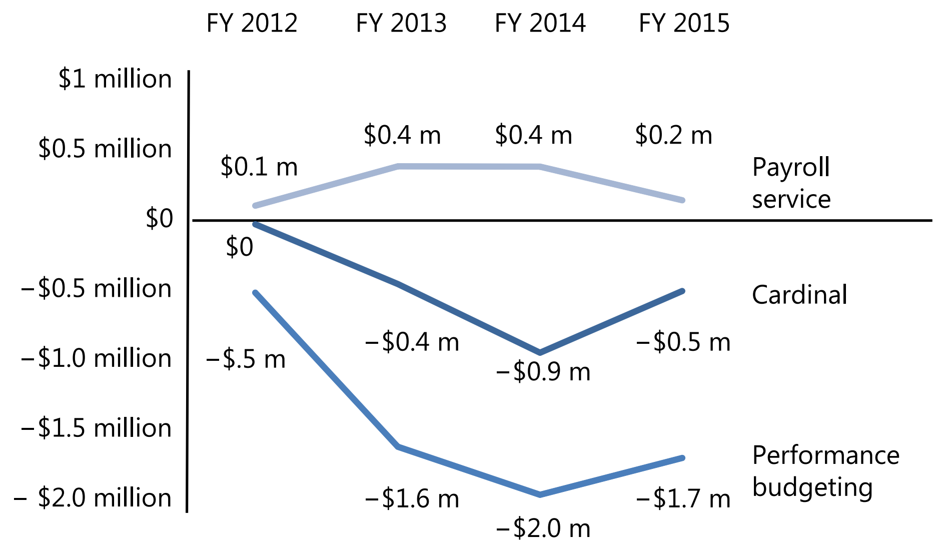
DOA's two enterprise application ISFs had negative fund balances at the end of FY 2015 (Figure 2). The Cardinal fund balance was −$0.5 million and the Performance Budgeting fund was −$1.7 million. The negative balances reflect debt used to fund the development and implementation of the respective systems. The Cardinal fund balance increased by $0.4 million in FY 2015, but is expected to decrease substantially in FY 2016 as DOA draws down additional funds to complete system implementation. The fund's balance is expected to improve once DOA begins collecting additional revenue to repay the debt. The Performance Budgeting fund balance increased by $0.3 million in FY 2015. DOA has already started collecting additional revenue to pay down the debt that was used to develop and implement this system.

Cardinal had a $0.8 million cash reserve and Performance Budgeting had a $0.5 million reserve. Cardinal's reserve was sufficient to cover 19 days of operating expenses, and Performance Budgeting's reserve was sufficient to cover 78 days. Each fund's reserve was close to or below the 60-day benchmark for ISFs. The Appropriation Act authorizes a Treasury loan in the event that these funds do not have sufficient cash to cover expenses.

The Payroll Service Bureau fund, which is more established than the enterprise application funds, has maintained a positive balance. However, the balance began to decline in FY 2015 as expenditures outpaced revenues. To address this issue, DOA has proposed rate changes that will allow the fund to recover sufficient revenues in future years. The fund's $0.2 million cash reserve was sufficient to cover 36 days of operating expenses, which is below the 60-day benchmark for ISFs. The Appropriation Act authorizes DOA to use a $400,000 line of credit in the event that the fund does not have sufficient cash to cover expenses.

FIGURE 2
Key ISF status indicators

Fund balance



Cash reserve[a]
as of June 30, 2015

Cardinal
$0.8 million
Equivalent to 19 days of operating expenses

Performance Budgeting
$0.5 million
Equivalent to 78 days of operating expenses

Payroll Service
$0.2 million
Equivalent to 36 days of operating expenses

Source: DOA financial statements.
[a] Cash reserve equal to cash on hand less deferred revenue from agency prepayments and anticipated repayments owed to the federal government. Operating expenses used to calculate cash reserve equivalent in days are equal to total operating expenses less non-cash depreciation expenses. Operating expenses do not include repayment of working capital advances or Treasury loans. Calculation methodology used in this report is different from the methodology used in JLARC's 2015 Annual Review of Internal Service Funds, so the numbers from that report are not comparable; methodology also differs from the methodology used by DPB to calculate the cash reserve for budgeting purposes. DPB uses cash-basis financial statements, whereas JLARC staff use accrual-basis statements.

Proposed appropriations

The governor's budget bill proposes an increase in the amounts appropriated for DOA's ISFs by $2.3 million above the base budget in FY 2017 and $3.4 million above the base in FY 2018 (Table 7). Almost 90 percent of the increase is from a proposed increase in spending under the Cardinal ISF. Spending is increasing because Cardinal is now being put into statewide operation, which increases system operations and maintenance costs. Most of the remaining increase is from technical adjustments to the base budget that affect all three of the funds. These adjustments account for salary increases and other changes that were approved in the 2015 Appropriation Act. A small portion of the

TABLE 7
DOA ISF budget and proposed changes by fund

Fund	Fund code	2015 Appropriation Act FY 2016 (Base budget)	2016 governor's budget FY 2017	FY 2018
Cardinal (enterprise application)	609	$17,973,016	$20,059,694	$21,062,678
Performance Budgeting (enterprise application)	615	$3,961,775	$3,967,981	$3,967,981
Payroll Service Bureau	608	$2,495,148	$2,653,260	$2,783,466
Total all funds		$24,429,939	$26,680,935	$27,814,125

Source: Performance Budgeting data, 2015 Appropriations Act (Chapter 665), and 2015 governor's budget bill.

overall increase is due to an increase in appropriations to the Payroll Service Bureau to more accurately reflect the cost of payroll processing services.

JLARC staff compared the appropriations requested in the governor's budget bill with DOA projections of ISF revenues for FY 2017 and FY 2018 and found that projected revenues closely matched the requested appropriations. However, the appropriation for the Performance Budgeting fund includes a working capital advance repayment expense of $1,473,397 per year. Working capital advance repayments are typically not included in the appropriation of the ISF service agency.

The governor's budget bill proposes changing the working capital advance amount that is available for developing enterprise applications. Previously, DOA was allowed a working capital advance of $75 million to pay for development and implementation of Cardinal and other approved statewide systems. With the Cardinal system almost fully implemented, the budget bill authorizes a smaller working capital advance of $25 million and limits its use to two specific purposes. First, up to $10 million may be used to assist with unforeseen costs associated with final implementation of the Cardinal system. While implementation is scheduled to be completed in FY 2016, DOA may incur additional costs in FY 2017–FY 2018. Second, DOA can use the working capital advance to develop a new payroll system to replace the Commonwealth Integrated Payroll/Personnel System. This project is still in the planning phase.

Proposed rates

DOA has proposed changing the rates charged under the Cardinal fund from the current $0.9048 per transaction to $1.5549 per transaction in FY 2017 and $1.6050 per transaction in FY 2018. These rate changes are not set forth in the budget bill, but they are reflected in the request to increase the appropriation for the fund. DOA indicates the rate change is needed for two reasons. First, the Cardinal transaction rate needs to account for greater use of the system as it is deployed into full statewide use. The adjusted rate captures the higher operations and maintenance costs associated with the fully deployed system. Second, DOA needs to begin collecting additional revenues to pay back the working capital advance that was used to pay for system development and implementation. This approach is consistent with the original plan for financing development of the Cardinal system.

The governor's budget bill proposes changing the fee structure for services provided by the Payroll Service Bureau. Instead of charging a flat fee of $110 per W2 processed, DOA would charge a different fee depending on the type of service provided, with higher fees charged for more complicated processing services (Table 8). Most of the fees charged under the new schedule would be higher than the current $110 flat fee. That fee was implemented in 2010, and DOA staff indicated staffing and rent costs have since increased. DOA staff said that they were able to absorb some cost increases through productivity improvements, but rate increases are needed to maintain the fund's solvency.

JLARC staff reviewed DOA's rate calculations for the Cardinal fund and the Payroll Service Bureau fund and found them to be reasonably determined. The proposed rates appear sufficient to recover the expenditures requested in the governor's budget bill.

TABLE 8
Proposed change to the Payroll Service Bureau's fee structure

	Fee per W2 processed		
Type of W2	**FY 2016** (current)	**FY 2017** (proposed)	**FY 2018** (proposed)
Wage, automatic leave processing	$110 (flat rate)	$106.34	$111.55
Wage, manual leave processing		$118.85	$124.67
Salaried, no leave processing		$125.11 (base rate)	$131.23 (base rate)
Salaried, automatic leave processing		$131.36	$137.79
Salaried, manual leave processing		$143.87	$150.92

Source: Performance Budgeting data, 2015 Appropriations Act (Chapter 665), and 2015 governor's budget bill.