



South Dakota Legislative Research Council

Issue Memorandum 95-27

OVERVIEW OF BILLING BY STATE AGENCIES

Introduction

For anyone reviewing the state budget, the billing for services from one agency to another creates significant complications. Most often, billing involves services provided by the bureaus of the Department of Executive Management. For example, the central services program in the Bureau of Administration receives an appropriation which consists mostly of other fund authority, with the revenue coming from billing to other state agencies. Although this is the most common type of billing between state government agencies, many other billing arrangements exist.

State government billing systems are extremely complex; some billed funds go off-budget, some are spent as other funds, and some billing agencies do not collect bills for general funds. Billing between state agencies is a widespread practice in South Dakota; in fiscal year 1994, state government operated twenty-five billing systems that involved a total of more than \$83 million.

Advantages of Billing

Despite the complications it introduces to the budgeting process, billing offers several advantages to the state. First, and most important, it allows non-general fund sources, such as highway funds and federal funds, to pay a share of the cost of central services. If the bureaus provided services without billing,

they could be appropriated only general funds, and the state would bear the burden of providing central services to agencies that receive significant funding from sources other than the general fund. In practice, the system by which state agencies bill other state agencies saves the general fund many millions of dollars each year.

To the extent that agencies must pay bills for central services, each agency's budget will indicate the full cost of its activities. For example, if an agency received all central services free, its budget would be artificially deflated because it would not include the cost of those services. Similarly, in some cases, requiring agencies to pay bills for central services encourages them to economize. Agencies can be expected to use fewer services if they are required to pay than if services are provided at no cost. Some central services, such as duplicating and printing, will be provided more efficiently under a billing arrangement, because state agencies could have such services provided in the private sector if the Bureau of Administration does not offer a good value. In some ways, internal billing systems make state government operate more like a business, since they often require state agencies to pay for the cost of the services they use, just as a private entity would.

Federal Regulations

In order to receive federal funding for central services, states must follow an extensive and

detailed conglomeration of regulations, which are described in OMB circular A-87. These A-87 regulations prescribe the manner in which state agencies may bill other agencies that receive federal funds. Each year, states must submit for federal approval a plan that outlines all billing arrangements including the rates charged for each service and the amount to be recovered in federal funds. The federal government holds the power to approve all rates for billed services and to audit states to determine how closely they are following their submitted plans.

When preparing plans, states are allowed to design billing arrangements where the costs transferred to agencies with federal funds are “reasonably” associated with benefits those agencies receive. States must also charge only for actual costs that the service agency incurs. These restraints and controls are intended to prevent states from profiting unfairly from federal funds. In practice, A-87 regulations impose significant paperwork requirements on state governments which must extensively document all of their internal billing arrangements.

A-87 regulations also include specific instructions to deal with various aspects of the billing process. For example, states may bill no aspects of the Governor’s or Legislature’s general governing activities to federal funds. Those agencies that bill for federal funds must be providing a service for other agencies that is not directly related to activities such as budget preparation, legislating, or advocacy. Once states establish a billing plan, A-87 instructs them to adjust rates regularly to adjust for any over or under recovery of costs. States are required to act quickly so that rate changes will take effect before the composition of the users of an agency’s services has changed dramatically, which could lead to the federal government being billed for an excessive

amount.

One aspect of A-87 that has a particular impact on state spending is the prohibition against billing for capital purchases. Under A-87, central service providers can bill state agencies for depreciation of existing equipment, but they cannot bill for the cost of proposed capital equipment acquisitions in any other way. Thus, in some cases, the state uses general funds to supplement capital purchases, because the amount recovered by billing out depreciation does not adequately provide for equipment upgrades. Despite the complexities and some difficulty obtaining federal participation in certain expenses under A-87, these regulations do effectively allow states to recover a roughly proportionate share of central service costs from federally funded agencies.

Budgetary Implications of Billing

The operation of billing systems has numerous implications for the size and design of the state budget. In the purest form of billing, a service providing agency sends a bill to other agencies for services provided, and the bill must be paid in full to the billing agency. In this case, the paying agency uses funds from any of its available sources, general, federal, or other, and the provider agency spends the proceeds of billing with other fund authority. Under such an arrangement, funds are counted twice, because they appear in the budgets of each agency. Thus, measuring the total size of the state budget becomes extremely difficult, because the total includes a significant amount of money that is counted twice. Ultimately, the complexities of modern budgeting, including billing systems and off-budget activities, make measuring the size of the state budget a nearly impossible task.

Some state agencies operate billing systems which involve memo billing of general funds. In this case, any agencies that owe general funds for a service provided by another agency receive a memo indicating the amount for which they could be liable. However, agencies receiving such bills do not have to pay them. Under this system, the providing agencies receive general funds in their budget to cover the cost of their memo billing. Memo billing avoids transferring any general funds from a service receiving agency to a service providing agency, since such transfers make absolutely no difference to the amount of general fund dollars being spent. However, memo billing does not have some advantages of the true billing system, because agencies receiving services do not face the same pressure to be economical and their budgets do not reflect the true costs of their operations.

In some cases of memo billing of general funds, the federal and other non-general funds paid to service providing agencies are appropriated in their budgets as other fund authority, which means the service providing agency receives an appropriation of both general funds and other fund authority. In other cases, the providing agency receives an appropriation of only general funds, with any billed federal or other funds returned to the general fund. These approaches do not differ significantly, except in budgeting style. In both cases, billing agencies may receive subsidies of general funds such that the total they bill out, including memo bills, does not equal their total budget.

Some amounts billed by agencies go off the state budget entirely. For example, the Bureau of Personnel bills all agencies for employee health insurance. Of the amount billed, the Bureau of Personnel retains and spends only the cost of administration with its appropriated other fund authority. The remainder, which is used to cover employee health claims, does not

appear in the state budget. Federal regulations do not dictate the variety of budgeting practices to deal with billing; these decisions reflect the whims and preferences of the Legislature and executive branch. Such arrangements are, to an extent, necessarily complex; however, the considerable inconsistency in the budgeting of billed funds, in which basically identical situations are handled differently, creates confusion for those attempting to interpret the state budget.

Billing Rates

State agencies which bill other state agencies for services and collect federal funds in the process must establish rates; those rates must be designed to recover the actual costs of the services provided, and they are subject to approval by the federal government. Federal regulations require that agencies adjust these rates regularly to avoid significant deficits or surpluses in internal service funds. Each billing agency can choose the basis for these rates and can change them periodically; for example, the information services program has recently changed from billing agencies on the basis of each personal computer in operation to billing on the basis of actual support services received.

When agencies raise the rates charged for their services, that action has a ripple effect which increases the amount that other agencies must pay to receive the same level of service. In the state budget, recommendations for additional other fund authority for billing agencies often indicate such a rate increase. In some cases, however, additional other fund authority is recommended for an expansion of services. For example, the state telecommunications program has received several large increases in other fund authority in order to charge local governments which join the state system. These increases do not indicate that additional

costs were passed on to state government clients.

Because state agencies may bill users outside state government, the state budget does not illustrate the total amount involved or year-to-year trends in interagency billing. In order to

know whether state agencies face increasing costs for central services, one must examine the rates charged over time. The following table shows a sample of rates for central services from FY94 and FY96.

Rates Charged by State Agencies for Various Billed Services				
Billing Agency	Service Provided	Rates		Rate Basis
		Final FY94	Current FY96	
BOA	Record Filming	\$25	\$29	Per Cubic Foot
BOA	Mail Processing	\$0.054	\$0.060	Per Piece
BOA	Office Space	\$7.65	\$7.98	Per Square Foot Per Year
BOA	State Engineer	\$48	\$48	Per Hour
BOA	Purchasing	\$1.40	\$1.10	Per \$100 Purchased
BOA	Copying	\$0.046	\$0.044	Per Copy
BOA	Compact Sedan Use	\$0.20	\$0.16	Per Mile
BFM	Accounting Transactions	\$0.474	\$0.486	Per Transaction
BIT	Mainframe Use	\$800	\$830	Per Hour
BIT	Computer Program Development	\$39	\$39	Per Hour
BIT	RDTN Use	\$20	\$30	Per Hour
BOP	Health Insurance Administration	\$18.52	\$18.96	Per FTE Per Year

Billing Amounts

At the end of this memo is a table that illustrates the amounts billed by each state agency to others in fiscal year 1994, which is the most recent year for which such data is complete. The table shows the amount billed by each of the twenty-five state programs approved to bill for federal funds under A-87. To provide an indication of how billings are

distributed, these figures are broken down to show the amount paid by the Departments of Agriculture, Game, Fish and Parks, and Environment and Natural Resources, the Departments of Health, Human Services and Social Services, the Board of Regents, and the remaining agencies of state government.

The table shows the total amounts billed, which includes memo billing and amounts that are

spent off-budget by the receiving agency. In FY94, billed amounts totaled more than \$83 million, with the Board of Regents billed for 24% of that amount and the human and social service agencies billed for an additional 21%. The following is a description of the billing programs administered by each agency, including the purpose of each and how the proceeds are budgeted.

Bureau of Personnel

The Bureau of Personnel bills agencies to fund the operation of the civil service system, with the basis of funding the number of payroll warrants issued per agency. In addition, the bureau offers training opportunities that it bills out for each participant. The funds from these activities are spent in the bureau's budget with other fund authority; however, the bureau does memo billing to generally funded agencies, so the Legislature appropriates general funds to the bureau to cover those costs. Civil service costs are greatest for agencies with a large number of employees; however, because the Board of Regents operates their own personnel and payroll system, their costs from these billings are very low.

The Bureau of Personnel also bills agencies for the costs of employee benefits, including workers' compensation, unemployment insurance, and health insurance. Workers' compensation and unemployment insurance billings are based on the claims experience of each agency, while the health insurance charge, the billing program involving the most money in state government, is an equal amount for each employee. The bureau pays the benefits for all of these programs off-budget. The bureau retains a portion of each of these billings to cover the cost of administering the programs, and these funds are spent with the bureau's appropriated other fund authority.

Accounting System

The Bureau of Finance and Management operates a billing system for all aspects of the state's accounting system, including services provided by the State Treasurer and State Auditor. The bureau bills each agency for its use of the system, and the federal or other non-general fund portion that is due to the bureau is spent with other fund authority in the bureau's budget. The bureau also does memo billing for the generally funded portion of its accounting services, so the Legislature appropriates general funds to the bureau to cover those costs.

The Bureau of Finance and Management also issues memo bills for the general fund portion of services provided by the treasurer and auditor. In addition, the federal and other non-general fund portion of those services is reimbursed to the general fund, rather than being retained in the treasurer's and auditor's budgets. The Legislature appropriates only general funds for these offices each year. This method of billing the accounting system, in which the Bureau of Finance and Management operates billing for three offices, is quite complex, but it serves the purpose of receiving proportionate support from all available fund sources.

Bureau of Administration

The Bureau of Administration operates more billing systems than any other state agency, although many of its services have relatively small budgets. One such program is records management, which charges agencies for their use of centralized microfilming and storage services. The funds from this billing are retained by the bureau and appropriated as

other fund authority in the central services program budget. The bureau also bills out office space, with the proceeds used to support building and grounds maintenance. The bureau retains the revenue from this billing and spends it with other fund authority appropriated by the Legislature to the facility services program. The space billing involves more money than any of the bureau's other billing programs, despite the fact that the Board of Regents operates its own building and grounds division and is not billed for any space by the bureau.

The Bureau of Administration also provides centralized mail, supply, and duplicating services which are billed to agencies based on their actual use of these services. The bureau retains the revenue from these billings and spends it with other fund authority appropriated by the Legislature to the central services program. These services have relatively large budgets, and they are widely used by agencies in Pierre, which have the most access to them.

The Bureau of Administration also maintains a motor pool, with vehicles throughout the state, for use by all agencies. User agencies are billed for each mile they drive a pool car, and the bureau retains the revenue from this billing and spends it with other fund authority appropriated by the Legislature to the central services program. Because many large agencies, including the Board of Regents, operate their own vehicle fleets, the costs of the motor pool are not evenly distributed among agencies.

The Bureau of Administration also operates a risk management program, which is intended to reduce liability costs for state government. All agencies are billed for this program based on their number of employees, and the bureau retains the revenue from this billing and spends it with other fund authority appropriated by the

Legislature to the administrative services program. The bureau also includes the state engineers office, which bills state agencies for time spent reviewing construction projects. This billing mostly affects those agencies which are heavily involved in construction; for example, the Board of Regents was responsible for 30% of the billing in FY94. The bureau retains the revenue from this billing and spends it with other fund authority appropriated by the Legislature to the facility services program.

In addition to its other services, the Bureau of Administration also operates centralized purchasing and surplus property management programs, which are designed to allow state agencies to acquire equipment as economically as possible. These programs are billed out based on the amount of property purchased or transferred by agencies; the bureau retains the revenue from this billing and spends it with other fund authority appropriated by the Legislature to the central services program.

The budget of the Bureau of Administration also included the Office of Administrative Hearings (OAH) during its brief operation in fiscal years 1994 and 1995. The data in the table, which is from FY94, indicates that OAH billed only a small amount for hearings provided for other state agencies. In FY95, OAH became more established and billed out considerably more hearings. During its most recent session, the Legislature abolished OAH and created the new Office of Hearing Examiners (OHE), which will have a much smaller scope than OAH. The Legislature also changed the budgeting practice for administrative hearings. Before its termination, OAH billed hearings to agencies and received full payment in return, with the revenue spent under other fund authority in the OAH budget. On the other hand, the Legislature appropriated only general funds to OHE. However, OHE will bill its clients for the

hearings it conducts, and the federal and other non-general portions of those bills will be reimbursed to the general fund. Thus, the change in hearings agencies reflects a different budgeting approach more than a different billing philosophy.

The Bureau of Administration also operates a liability pool, which covers the cost of tort claims against state employees. Each state agency must pay a bill which is based on their number of employees. The funds from this billing are administered entirely off-budget by the bureau; unlike similar programs, such as employee health insurance, the funding for claims payment and administration are both excluded from the budgeting process.

Bureau of Information and Telecommunications

The Bureau of Information and Telecommunications provides a variety of technological services to state agencies, and they receive considerable billed revenue because most all agencies of state government participate in these programs. One program operated by this bureau is the state telecommunications system, in which each agency is charged for its actual telephone usage. The telephone rates negotiated by the bureau are less than what individual customers receive because of the volume of users on the system. The bureau retains the revenue from this billing and spends it with other fund authority appropriated by the Legislature.

The Bureau of Information and Telecommunications also provides computer equipment and support services, including a mainframe and personal computer networks, to agencies, and they charge agencies based on the extent of their use of these systems. The bureau retains the revenue from this billing and spends it with other fund authority

appropriated by the Legislature. Like all of the bureau's programs, data processing receives no general fund subsidy so all of its costs must be recovered by billing.

The Bureau of Information and Telecommunications also administers the Rural Development Telecommunications Network (RDTN). The RDTN is an interactive video and audio service which is available for use by any state agency. In its early development, this service has been most heavily used by the Board of Regents, which uses it to widen the availability of educational opportunities; higher education accounted for nearly 60% of the billing in FY94. The bureau retains the revenue from this billing and spends it with other fund authority appropriated by the Legislature.

Legislative Audit

Legislative Audit is responsible for auditing each state agency annually. In order for the state to recover the cost of auditing federal and non-general funded agencies, Legislative Audit bills each agency for that portion of their agency not supported by general funds. In addition, legislative audit issues memo bills for the generally funded portions of each agency. The revenue collected from this billing is returned to the general fund, and the Legislature appropriates only general funds to support Legislative Audit. The general funds appropriated to this office include some subsidy, since the sum of all collected and memorandum billing by Legislative Audit does not equal their total budget.

Attorney General

The Attorney General's office issues memorandum bills to each state agency for which they do legal work. These billings cover only the portion of the work done by the

Attorney General's office for which the agency could have been billed for general funds; some agencies receive federal revenue to pay for a portion of the legal services provided by the office. The federal reimbursement for these services is returned to the general fund or used to replace general funds in agency budgets. This billing system saves some general funds, but state agencies transfer no money to the Attorney General's office in the process.

Retirement System

The South Dakota Retirement System (SDRS) bills agencies to recover the employers' contribution for employee pensions; these assessments are based on employee salaries. This billing program was the second largest in state government in FY94, with almost \$17 million collected by SDRS. Most of the collections from this billing are placed in the retirement fund, from which benefits are paid off-budget. However, SDRS retains a portion of the revenue from this billing to cover administrative costs, and the Legislature appropriates other fund authority to allow them to spend those funds.

Conclusion

When state agencies bill other state agencies for services provided, the state budget becomes more complex and difficult to interpret.

However, in return for greater complexity, the state gains the opportunity to use federal and other non-general funds to support centrally provided services. One reason for the confusion caused by billing between state agencies is the inconsistency of the budgeting practices used. When some agencies bill for general funds and some do not, and with the differences in the budgeting of this revenue by the billing agencies, it becomes difficult to look at an agency's budget and know the extent of its billing activities. For example, the Legislative Audit budget does not show that its services are billed to other agencies and produce considerable revenue.

The establishment of consistent budgeting practices for billed revenue, by adopting the approach used with the Bureau of Administration's programs where all bills must be fully paid and the revenue is spent with other fund authority, would make it easier for those reviewing the state budget to determine how much revenue agencies are raising and to what extent their services are subsidized by general funds. Despite the budgeting complications caused by interagency billing, the state will likely continue to practice it to the greatest possible extent as long as the federal government requires such a system in order to receive federal reimbursement for a portion of all centrally provided services.

This issue memorandum was written by Jeff Bostic, Fiscal Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.

Amounts Billed Between State Agencies in Fiscal Year 1994

Billing Agency	Billing Purpose	Paying Agencies				Total
		Agriculture, DENR and GF&P	Health, Human and Social Services	Board of Regents	Other State Govt.	
Personnel	Civil Service & Training	\$131,598	\$425,786	\$5,475	\$668,808	\$1,231,667
Personnel	Worker's Comp	\$305,199	\$1,719,906	\$977,128	\$729,825	\$3,732,058
Personnel	Unemployment Insurance	\$15,030	\$48,016	\$90,323	\$84,636	\$238,005
Personnel	Health Insurance	\$1,687,919	\$7,472,335	\$9,632,854	\$11,141,172	\$29,934,280
Auditor	Accounting	\$37,936	\$184,998	\$29,348	\$209,528	\$461,810
Treasurer	Accounting	\$9,161	\$18,041	\$5,435	\$64,586	\$97,223
BFM	Accounting	\$231,592	\$573,922	\$43,871	\$890,711	\$1,740,096
BOA	Records Mgmt.	\$11,213	\$54,611	\$9,462	\$154,307	\$229,593
BOA	Space	\$355,726	\$409,216	\$0	\$2,574,109	\$3,339,051
BOA	Mail	\$399,392	\$960,923	\$14,079	\$1,512,405	\$2,886,799
BOA	Duplicating	\$168,779	\$405,442	\$21,450	\$821,255	\$1,416,926
BOA	Supplies	\$79,957	\$274,434	\$32,095	\$795,631	\$1,182,117
BOA	Motor Pool	\$443,992	\$499,192	\$26,703	\$1,192,545	\$2,162,432
BOA	Risk Mgmt.	\$3,593	\$12,462	\$18,985	\$18,962	\$54,002
BOA	Engineering	\$98,438	\$2,678	\$320,661	\$655,211	\$1,076,988
BOA	Purchasing	\$73,208	\$73,403	\$119,480	\$346,334	\$612,425
BOA	Property Mgmt.	\$19,320	\$29,598	\$762	\$75,024	\$124,704
BOA	Administrative Hearings	\$0	\$0	\$0	\$22,960	\$22,960
BOA	Liability Pool	\$124,807	\$329,325	\$483,760	\$625,832	\$1,563,724
BIT	Telecommunications	\$359,800	\$785,171	\$1,840,624	\$2,678,891	\$5,664,486
BIT	Data Processing	\$417,986	\$1,775,182	\$51,380	\$4,382,007	\$6,626,555
BIT	RDTN	\$9,209	\$20,967	\$161,593	\$79,851	\$271,620
Legislative Audit	Auditing	\$37,845	\$174,335	\$136,384	\$635,638	\$984,202
Attorney General	Legal Services	\$121,467	\$22,214	\$2,618	\$397,589	\$543,888
SDRS	Retirement Benefits	\$1,039,893	\$3,377,068	\$6,039,213	\$6,481,628	\$16,937,802
Total		\$6,183,060	\$19,649,225	\$20,063,683	\$37,239,445	\$83,135,413

