

**STATE CONTROLLER'S SENATE EDUCATION COMMITTEE
TESTIMONY REGARDING EXEMPTING HIGHER EDUCATION
INSTITUTIONS FROM STATE FISCAL RULES - April 23, 2009**

1. The Office of the State Controller has worked diligently over the last ten years to improve the relationship with the Higher Education Institutions and has taken extra steps to ensure that Higher Education's input is obtained and incorporated into the Fiscal Rules. For example, a separate policy was written in coordination with Higher Education to provide flexibility specifically for Higher Education sponsored programs such as grants.
2. The Office of the State Controller has been in discussions with Higher Education for several weeks regarding the proposed exemption from Fiscal Rules.
3. Our most recent meeting was with Senator Boyd and the Majority Leadership staff in which the State Controller agreed to address a delegation issue under the existing Fiscal Rules that would not require a statutory change. My understanding from the meeting was that the request for the exemption from Fiscal Rules would be removed from the bill and be replaced with limited specific items that would provide Higher Education with additional flexibility. That proposal was supposed to be initiated by Higher Education and mutually agreed upon with the State Controller. However, I have not heard back from the individuals tasked with providing the replacement language.
4. I am told that amendments will be entered later in the legislative process to remove the Fiscal Rule exemption proposal. However, I feel it is my responsibility to inform the committee of the implications of a blanket Fiscal Rule Exemption. I have provided my written analysis of the proposal and the impact on exemption from each of the Fiscal Rules. The following are some of the more important examples of problems with the proposed exemption.
 - a. Nearly all of the Fiscal Rules are based on statutes. Exempting Higher Education from the Fiscal Rules will not remove the statutory requirement.
 - b. The State Controller remains responsible for managing the financial affairs of the state. It will take extensive legal work by the Attorney General's Office to define a new relationship between the Controller's responsibilities and the various statutes underlying the Fiscal Rules that will continue to affect Higher Education.

- c. Many of the Fiscal Rules provide additional flexibility to Higher Education based on authority statutorily granted to the State Controller in the rule making process. As a result of the proposed exemption, Higher Education would in many instances have less flexibility rather than more flexibility.
- d. One of the Fiscal Rules requires Higher Education to provide information to the state's official book of record. Without that Fiscal Rule the state would not have any direct reporting capability for Higher Education. The Legislature through the Joint Budget Committee frequently requests such information from the State Controller.
- e. Another of the Fiscal Rules requires a commitment voucher (Purchase Order or Contract) that spells out exactly what the state is agreeing to purchase. Without this Fiscal Rule Higher Education could enter commitments that are unlimited.
- f. The requirement for Higher Education to provide supplemental information to the State Controller to use in preparing the state's financial statements resides in the Fiscal Rule. Without this Fiscal Rule Higher Education could refuse to provide the need information, and the state could receive a qualified opinion on its financial statements, which would adversely affect the state's credit rating.

I will happy to answer any questions at this time or at your convenience.

**STATE CONTROLLER'S SENATE EDUCATION COMMITTEE
TESTIMONY REGARDING EXEMPTING HIGHER EDUCATION
INSTITUTIONS FROM STATE FISCAL RULES - April 23, 2009**

The State Controller has the following concerns regarding Section 14 of the Bill draft dated 3.11.09 and titled Higher Ed Research School Flexibility.

- 1) The bill allows the Governing Board to both adopt fiscal procedures and determine whether or not those procedures provide adequate safe guards. In all other instances of Higher Education opt out, the Legislature has preserved some authority of the state by requiring the adopted procedures be approved by the state central authority responsible for the activity. Examples include capital construction – State Architect/DPA Executive Director, Procurement Code – State Purchasing Director/DPA Executive Director, and Accounts Receivable Collections – State Controller.
- 2) The State Fiscal Rules are each individually based on statutory authority. Exempting Higher Education from the Fiscal Rules does not exempt Higher Education from the underlying statutes.
 - a. The State Controller is responsible in 24-30-201 for managing the financial affairs of the state. This bill does not remove that responsibility, but the main tool for carrying out that responsibility in relation to Higher Education is disabled.
 - b. The authority of the State Controller under 24-30-201 to enforce the statutes underlying the individual Fiscal Rules will have to be determined; most likely this will occur through extensive hours of legal review by the Attorney General's Office. It could take years to establish the new limits of authority.
 - c. The requirement for a central chart of accounts is in a section of the State Controller's statutes from which Higher Education is not exempted. However, the requirement to report information on the state's accounting system is in the Fiscal Rules. The ability to do all types of ad hoc and formal reporting involving Higher Education would be lost if Higher Education is exempted from the Fiscal Rules.
 - d. The bill would adversely affect the State's contracting process. With the passage of SB 07-228, all State agencies and institutions of higher education are required to report their contracts on the Statewide contracts management system and to perform contract monitoring. The primary mechanism of providing guidance to implement SB 07-228 is the State fiscal rules. Without fiscal rules, it will be difficult or impossible to have the reporting and improvements envisioned by the Legislature. Further, the lack of uniformity in the State's contracting process will cause confusion in the vendor community as each institution will be able to adopt its own contracting processes.
 - e. Higher Education remains a "state supported" activity and therefore presents significant risk to the Executive Branch and the Legislative

Branch if it does not have effective internal controls. The State Fiscal Rules are a very minimal baseline for those needed internal controls.

3) The following clause added to 24-30-202 (13)(b), "AND SHALL NOT BE REQUIRED TO COMPLY WITH THE PROVISIONS OF THIS SUBSECTION (13), SUBSECTION (1), (9), (20.1), (22), OR (26) OF THIS SECTION OR PARAGRAPH (B) OF SUBSECTION (5) OF THIS SECTION", presents additional problems as follows:

- a. Subsection (1) – Subsection (1) requires the use of a commitment voucher for all payments. Exemption from this requirement will allow Higher Education to procure any good or service without a Purchase Order (PO) or contract. POs and contracts are essential to protecting the interests of the state. Without a PO or contract, if the vendor fails to deliver the agreed upon goods the state will have limited legal recourse and will not be protected from the risks that have been identified and mitigated by the states current procurement and contracting processes.
- b. Subsection (9) – Subsection (9) requires that expired warrants be cancelled and dictates the interaction between the expired warrants statute and the Unclaimed Property statute. Exemption from this subsection will allow stale warrants issued by Higher Education to remain outstanding indefinitely. This is not a sound fiscal policy. There are differing legal views on whether the Higher Education Institutions are subject to the Unclaimed Property statute that produces significant revenue for various state programs. If Higher Education is not required to expire its warrants, it could materially reduce the resources generated by the Unclaimed Property program.
- c. Subsection (20.1) authorizes the State Controller to allow agencies and institutions to maintain petty cash funds up to \$2,500 for small purchases as a draw against the appropriation. It is not clear whether the institutions intend to close their petty cash funds when the State Controller no longer has this authority for Higher Education.
- d. Subsection (22) authorizes the State Controller to control the types of perquisites and precludes any employee from awarding perquisites to him/herself or to any other employee under his/her supervision. It is not a sound fiscal policy to exempt any state employee from the latter requirement. History and current issues show us that perquisites in Higher Education receive intense media scrutiny. Without the fiscal rules that scrutiny is likely to cause embarrassment to the Legislature and the Executive Branch.
- e. Subsection (22) authorizes the State Controller to establish travel fiscal rules. Extensive out-of-state and out-of-country travel in Higher Education increases the importance of their being a consistent set of rules across state agencies and institutions of Higher Education.
- f. Paragraph (b) of Subsection (5) requires three appraisals for the purchase of real property with total purchase price over \$100,000. I do not believe this is an unreasonable requirement; it protects the interests of the state.

STATE CONTROLLER'S SENATE EDUCATION COMMITTEE TESTIMONY REGARDING EXEMPTING HIGHER EDUCATION INSTITUTIONS FROM STATE FISCAL RULES - April 23, 2009

Impacts of Higher Education Exemption from Individual Fiscal Rules March 23, 2009

Items shaded in gray represent instances where exemption from the Fiscal Rules will result in reduced flexibility for Higher Education because the Fiscal Rule currently provides additional flexibility to Higher Education that is based on the Controller's Rule-making authority.

Except to the extent that the following fiscal rule requirements exist in statutes and apply to Higher Education, an exemption from the State Controller's Fiscal Rules will have the following effects. If the requirements already exist in statutes and apply to Higher Education then an exemption from the State Controller's Fiscal Rules will not provide any substantive benefit to Higher Education, but it will remove the comprehensive listing of requirements that the Fiscal Rules represent.

- 1-1 The requirement for accounting and reporting under Generally Accepted Accounting Principles will be lost.
- 1-1 The requirement for certification of internal controls will be lost.
- 1-2 The requirements for use of the state's accounting system, interface approvals, feeding of aggregate data, and exemptions from GPPS will be lost.
- 1-3 The prohibition against information access to Higher Education accounting records except by approved central control agencies will be lost.
- 1-4 The limitation on electronic interfaces to the state accounting system will be lost.
- 1-5 The State Controller's right to delegate state accounting system security will be lost.
- 1-6 The State Controller's approval of Higher Education accounting systems used to produce financial statements will be lost.
- 1-7 The ability for the State Controller to delegate signature authority for contracts will be lost.
- 1-8 The delegation of preaudit responsibility will be lost. Preaudit of payments is an essential part of internal controls.
- 1-9 The delegation of responsibility for internal control structures adequate to prevent fraud, theft, and embezzlement will be lost along with the responsibility for the institution to report the incident outside the institution.
- 1-10 The requirements for consistent asset capitalization and inventorying will be lost.
- 2-1 The requirement for all expenditures to meet standards of propriety will be lost (a. for official business only, b. that the expenditure be reasonable and necessary).
- 2-2 The requirements for commitment vouchers will be lost. This Fiscal Rule was recently implemented after two years of rewrite including two hearings and extensive input from the Higher Education community. It lists requirements for: the use of purchase orders and contracts, exempt disbursements, authorization for certain advance payments, provisions for statutory violations, emergency situations, and use of vendor agreements. The Special

- Provisions required in all state purchase orders have been developed over time by the Attorney General in cooperation with the State Controller.
- 2-3 The requirement for receiving reports to document that goods or services have been received will be lost.
- 2-4 The requirement for institutions to pay timely to take advantage of purchase discounts will be lost.
- 2-5 The requirement for paying interest on late payments (after 45 days) will be lost.
- 2-6 The ability of the State Controller to resolve interagency disputes will be lost.
- 2-7 The requirement for official functions and training to be held only to achieve program objectives will be lost as will the assignment of responsibility for this high risk area to the Chief Executive Officer or delegate.
- 2-8 The ability of the State Controller to establish allowable perquisites for approval of the Governor will be lost (Honorariums, transit benefits, sponsored events, meals, educational courses, state owned housing, temporary housing for visitors, and guests, uniforms, book store discounts, and authorized commuting). Exceptions to the statutory perquisite prohibition that are authorized in fiscal rule will be lost by Higher Education.
- 2-9 The State Controller's ability to establish acceptable reimbursements to Higher Education employees that are part of the state personnel system for moving and relocation costs will be lost.
- 2-10 The Rules related to the use of the Procurement Card will no longer be applicable; these rules authorize the agreement allowing agencies and institutions to participate.
- 3-1 The requirements for contracts will be lost, which are based on at least 30 citations from the constitution, Governor's Executive Orders, and individual statutes. This Fiscal Rule was recently implemented after two years of rewrite including two hearings and extensive input from the Higher Education community. It provides all the definitions that allow consistent interagency and external communications regarding contracts. It lists requirements for: the types of contracts, required content by type, approved forms, central agency approval, legal review, State Controller review, accounting, contract monitoring, independent contractor relationships, and exceptions to the rule. The statutes require the State Controller to sign all contracts; the State Controller delegates this responsibility to most of Higher Education based on consistent compliance with the Fiscal Rules, which will no longer be applicable. The Special Provisions required in all state contracts have been developed over time by the Attorney General in cooperation with the State Controller.
- 4-1 There are six separate statutory cites for this fiscal rule that are likely to continue to apply even after exemption from the fiscal rules. The requirement for use of contracts when controlled maintenance exceeds \$100,000 will be lost. The requirements that allow for use of bilateral Purchase Orders up to \$100,000 will be lost as will required compliance with building codes and bonding requirements.
- 4-2 The prohibition against use of internal workforce on General Funded capital construction projects will be lost as will the 6 months rule.
- 4-3 The requirement for retainage to be held on projects will be lost.
- 5-1 24-30-202(26) requires the State Controller to develop equitable travel rules and the statutes provide no further direction. Exempting Higher Education

from the fiscal rules and this portion of the Controller's statute will leave Higher Education Institutions without the coverage that is currently provided by the existing and proposed travel fiscal rule. Since Higher Education has already represented that it is exempt from the rule making requirements of Article 4 of Title 24, its self-generated rules will lack the accountability to citizens that comes from an open and participatory rule making process.

- 6-1 The requirement for prompt deposits of cash receipts and month end cutoffs will be lost for all Higher Education Institutions except for those institutions managing their own Treasury.
- 6-2 The practical ability for the State Controller to authorize petty cash and change funds at the Higher Education Institutions will be lost with an exemption from Fiscal Rule 6-2 and 24-30-202(20.1) except for those institutions managing their own Treasury.
- 6-3 The practical ability for the State Controller to authorize imprest cash accounts for the Higher Education Institutions will be lost with an exemption from Fiscal Rule 6-3 except for those institutions managing their own Treasury.
- 6-4 The practical ability for the State Controller to authorize entertainment expense cash accounts for the Higher Education Institutions will be lost with an exemption from Fiscal Rule 6-4. Without the existence/applicability of Fiscal Rule 6-4, Higher Education Institutions will be required to deposit their entertainment expense cash in the State Treasury except for those institutions managing their own Treasury.
- 6-5 An exemption from Fiscal Rule 6-5 on loans and advances will provide little benefit to Higher Education Institutions because the requirements in the rule are effectively equivalent to the 24-75-203. The rule restates the statutory requirements in plain language to facilitate application.
- 6-6 The ability of Higher Education to credit expense accounts for certain refunds or reimbursements rather than recording revenue will be lost by Higher Education. The related statute specifies crediting to the fund but does not address how that credit will be operationalized. Exemption from this rule will limit Higher Education's flexibility in recording refunds and reimbursements.
- 6-7 24-30-202(25) mandates that the State Controller set insufficient funds (short checks) penalties through fiscal rule. If Higher Education is exempt from this fiscal rule then it will not be able to charge insufficient funds penalties.
- 6-8 An exemption from Fiscal Rule 6-8 will provide little benefit to Higher Education Institutions because the rule simply requires compliance with Federal Cash Management Improvement Act and the State Treasurer's statute. Those two requirements will remain in effect even if Higher Education is exempted from this rule.
- 7-1 An exemption from Fiscal Rule 7-1 (approval by OSPB and the State Controller for nonappropriated spending) will have no effect on Higher Education Institutions because the Rule itself already exempts Higher Education as follows: "This fiscal rule does not apply to non-appropriated funds in the Department of Higher Education."
- 7-3 An exemption from Fiscal Rule 7-3 (expiration and rollforward of appropriations) would potentially be detrimental to Higher Education because the rule is simply a restatement of 24-75-102; however, the rule provides for exceptions that are authorized but not enumerated by the statute. If Higher Education is exempt from the rule then the statute will rule and the State

~~Controller would have to consider any rollforward requests on the individual merits rather than based on the three automatic exemptions provided in Fiscal Rule 7-3.~~

- 7-4 An exemption from Fiscal Rule 7-4 will remove the limitation on nonappropriated expenses (limited in the rule to OSPB/OSC approved spending authority, revenue plus fund balance, and governing board approved budget), and the State Controller and Attorney General will have to establish whether legislative or constitutional authority exists to prevent overexpenditures by Higher Education Institutions.
- 8-1 An exemption from Fiscal Rule 8-1 will remove the requirement for State Controller review and approval of Higher Education Institution financial statements which is based directly on the Controller's responsibility listed in 24-30-201(1)(d). This will likely result in the individual Higher Education Institution financial statements not agreeing with or reconciling to the state's financial statements. The requirement for Higher Education to do financial statements based on Generally Accepted Accounting Principles would be lost. The requirement for Higher Education to provide financial statement disclosure information resides only in the fiscal rules; under an exemption of Higher Education from this fiscal rule the state could not prepare complete financial statements and is likely to receive a qualified audit opinion which would adversely affect the state's credit rating and borrowing costs and/or borrowing capacity.
- 8-2 Fiscal Rule 8-2 requires agencies to ensure that the State's accounting system is updated and current at the close of each fiscal quarter. If Higher Education were exempted from fiscal Rule 8-2, the State would not have a reliable database upon which to prepare its own quarterly or more frequent reports. This Fiscal Rule also requires that revenue and expense be recognized within the quarters of the fiscal year based on benefit received or time expired; this is to ensure valid interim financial and ad hoc reporting at the statewide level.
- 8-3 Fiscal Rule requires the state and state agencies to allocate overhead costs based on an equitable service/benefit relationship to federal grants and to cash funds. This requirement is based on the large number of cash funds having full costing requirements which would include indirect costs such as statewide overhead. If Higher Education is exempt from this Fiscal Rule there is no basis for requiring Higher Education to recover indirect costs.
- 9-1 ~~This Fiscal rule establishes the requirement to use the Central Personnel Payroll System unless the State Controller has approved an exception. A Higher Education Institution exemption from this Fiscal Rule would conceivably cancel all the documents currently allowing Higher Education to use their own payroll systems because those documents were likely written as exceptions to the Rule rather than as authority not to use CPPS.~~
- 9-2 Fiscal Rule 9-2 requires direct deposit of payroll dollars for all employees paid from the state payroll system. To the extent that any Higher Education Institution is required to use the CPPS, an exemption from this rule will cause us to lose the requirement for direct deposit.
- 9-3 Fiscal Rule 9-3 requires payment within three days of involuntary termination of employment by an agency or Higher Education Institution. An exemption from this rule could result in terminated employees being treated inequitably.
- 9-4 Fiscal Rule 9-4 establishes the treatment of overpayments made to employees by limiting error recovery to the first two years of overpayment and by requiring approval of the State Controller for repayment plans in

excess of six months. These requirements do not exist elsewhere in the statutes, so exempting Higher Education from this fiscal rule could result in inequitable treatment of employees or repayment plans that are not in the best interest of the state.

