

SENATE FINANCE COMMITTEE  
January 30, 2017  
9:05 a.m.

[9:05:23 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:05 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Anna MacKinnon, Co-Chair  
Senator Click Bishop, Vice-Chair  
Senator Mike Dunleavy  
Senator Donny Olson  
Senator Natasha von Imhof

MEMBERS ABSENT

Senator Peter Micciche

ALSO PRESENT

Kris Curtis, Legislative Auditor, Alaska Division of Legislative Audit; Senator Gary Stevens.

SUMMARY

^PRESENTATION: AUDIT and ACCOUNTING CONSIDERATIONS

[9:06:28 AM](#)

KRIS CURTIS, LEGISLATIVE AUDITOR, ALASKA DIVISION OF LEGISLATIVE AUDIT, shared that the Division of Legislative Audit had been asked by the committee to report on any important findings from over the past several years that could help inform budget discussions over the next several months. She relayed that the division conducted performance audits and sunset reviews that came before the legislature, as well as being the independent auditor of the legislature's financial statements and the federal audit of federal funds.

[9:06:55 AM](#)

Co-Chair MacKinnon recognized Senator Stevens in the gallery.

[9:07:10 AM](#)

Ms. Curtis focused on finding from the financial and federal compliance audits. She said that the most recent audit completed was for FY 15. She revealed that the audit had been markedly different from previous years; typically, the division had 3 to 5 financial recommendations, but in FY 15, the division had 15 recommendations. She stated that the recommendations stemmed primarily from the roll out of the new state Integrated Resource Information System (IRIS), and because of the new accounting standard set by the Governmental Accounting Standards Board (GASB), which dictates how to report pension activity. She discussed the implementation of IRIS, which had gone live in July 2015. She relayed that the impact the system had on the FY 15 financial reporting had been unexpected. She explained that IRIS was more complex than the 30-year-old legacy system that it had replaced. She said that state departments had work for several years to reevaluate their functions and develop new business rules for the system, which has several modules; the system is the financial accounting system book of record, but also has a procurement component that allows procurement transactions to interface automatically, a debt tracking module, and a payroll module. She noted that the payroll module had gone live one week ago. She said that her comments would be strictly to the financial roll out and not payroll. She stated that, in general, the financial roll out had gone well, much better than the roll out of the new Medicaid system, which had been a complete failure. She related that there were a significant number of problems with the system, but that vendors had been paid. She highlighted that certain departments had struggled more than others with the change, most notably the Department of Transportation and Public Facilities (DOT). She said that the division had worked with departments to identify and correct problems. She believed that the main problem was with the reporting package that reports from the information from the financial system. She explained that the information from the financial system was put in a data warehouse and a separate software reporting package reported from the system. She said that the upgrade to the reporting package had added thousands of elements to the possible reports, which had resulted in a struggle for the division and state

departments in making their reports accurate. She shared that the division had written three recommendations to correct conversion problems. The first two had been to DOT, which had been found to have problems recording expenditures and associated revenues in the wrong fiscal year, this resulted in an audit adjustment of approximately \$40 million, and another adjustment for earned and unbilled revenue of approximately \$21.6 million. She stated that another DOT/IRIS conversion error that had led to \$153 million of unrecorded revenue, and had been corrected via an audit adjustment. She said that a recommendation had been written to the Department of Administration (DOA) for several errors. She relayed that DOA had booked some transactions in the old system to help with the conversion to the new system, but then inappropriately pick those up, resulting in an error of \$103.6 million of overstated receivables and understated expenses.

[9:11:50 AM](#)

Senator Dunleavy asked about the failed Medicaid roll out.

Ms. Curtis replied that the roll out of the state's new Medicaid system in 2013 had been a failure. She explained that vendors had not been paid, which had led to litigation with Xerox that was ongoing. She relayed that further updates would be given about the Medicaid issue.

[9:12:32 AM](#)

Vice-Chair Bishop queried that archival process of IRIS, and asked whether procurement data would be chronicled by department.

Ms. Curtis replied that the current archival process maintained information for a set number of years. She shared that departments would be able to scan and attach using IRIS; support for their transactions was part of the system. She said that support for transactions would be accessible electronically.

[9:13:40 AM](#)

Vice-Chair Bishop understood that legislative requests for information would be processed more efficiently, but that documents retrospective to IRIS would be remain in hard copy.

Ms. Curtis responded that if the sought for information had been captured through accounting transactions of vendor, amount, or year, it would be in the data warehouse, which went back to FY 07. More informative invoice information would be on hard copy and would eventually be shredded.

[9:14:41 AM](#)

Co-Chair MacKinnon noted that the Medicaid roll out had been such a failure that it could not be audited, which was of great inconvenience to the state.

Ms. Curtis responded that the division qualified its opinion in FY 14, due to the inability to obtain evidence regarding the Medicaid system, which was so inoperable that it could not be audited. She said that in FY 15 the division had noticed improvements in the system. She said that the department had settled litigation with Xerox in September 2016. She noted that the contract the state held with Xerox was up for termination in September of 2017, which begged the question of the state's plan for the contract termination.

[9:16:37 AM](#)

Co-Chair MacKinnon lamented that the department had been stressed by the inability of the system to perform and had had difficulty answering audit questions and providing information to the legislature.

Ms. Curtis responded that there was some audit work done in FY 15 on the Medicaid roll out, out of concern for the defect resolution process. She said that there were three different types of defect resolution processes. She related that one type of process was being reviewed and approved by the Department of Health and Social Services (DHSS); however, the division had found errors in the other two processes, with the underlying issue remaining unresolved. She said that in some instances the defect had been fixed, but a mass adjustment was not processed to fix the claims that had been impacted by the defect. She shared that in one instance a mass adjustment had been closed because of an existing duplicate, but the duplicate had not contained all the claims of the original mass adjustment. She said that it had been determined that the things done to fix the defects were not working like they should. She stated that management at DHSS had stated that they planned to review

all the manual fixes before the federal oversight agency come into certify the system. She divulged that there had been over 5,300 manual fixes needed and the division doubted that the department had the resources to tend to each defect. She believed that there had been a risk present at the end of FY 15.

[9:19:54 AM](#)

Senator Dunleavy asked whether the state had failure to perform clauses in their contracts with Xerox.

Ms. Curtis replied that there had been plenty of basis for litigation, and that the litigation had resulted in a settlement.

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Senator Dunleavy stated that his conversations with doctors had led him to believe that they did not expect to be paid in full for their services. He furthered that some of them anticipated \$.30 on the dollar, which led him to believe that the system had been built around apparent flaws. He said that dealing with inefficiencies was a cost driver. He hoped for a deeper discussion of the issue.

[9:22:01 AM](#)

Co-Chair MacKinnon remarked that further discussion with DHSS concerning Medicaid was on the agenda for a future meeting.

[9:23:00 AM](#)

Senator Olson wondered whether the public had been harmed due to the Xerox system failure.

Ms. Curtis replied that she could not specifically address the question. She said that she did know that the state had advanced funds to health care providers and vendors to avoid a cash flow problem.

[9:24:11 AM](#)

Co-Chair MacKinnon thought that the conversation about advanced funds and cost recovery should be had with the DHSS commissioner.

[9:25:17 AM](#)

Ms. Curtis discussed the impact of the IRIS implementation. She shared that she had alerted the administration to and legislative leadership that there would most likely be a significant delay in audited financial statements. She said that the auditing of draft financial statements was 13 weeks late. She clarified that the audit was not stagnant; there was plenty of audit work that could be done without the draft financial statement. She said that the hope would be that the division would receive them soon, at which time it would take approximately 2.5 months. She lamented that it usually took the division 6 weeks to complete the process, but that there had been so many adjustments to correct that would each need to be scrutinized. She shared that in 2016, the division saw 60 audited adjustments, and expected a similar case in 2017. She stated that she expected the draft financial statements by mid-April, which meant that the final, audited amount in the state's savings account would not be known until after April.

[9:27:10 AM](#)

Co-Chair MacKinnon shared that none of the information supplied in today's meeting had been a surprise, and that the state had been following what had happened with Xerox implementation in Colorado, in comparison to the State of Alaska. She said that a finding was expected in the audit that related to the deficiencies of IRIS.

Ms. Curtis relayed that the results of the audit were unknown because it had yet to be completed. She said that the division anticipated the normal processes of bringing on a complex system. She offered that the first year of financial reporting would be difficult, not as the result of a specific deficiency, but because of the learning curve.

[9:27:29 AM](#)

Co-Chair MacKinnon interjected that the division had notified the committee of the auditing delay, which was not without consequences on the federal level.

Ms. Curtis replied that the repercussions from the statewide single audit from the federal perspective was that now the state would be considered a high-risk auditee,

which would result in higher audit coverage. She furthered that because of the rules for calculating major federal programs the designation would have little impact on the number of federal programs the state could choose from, but that the designation would stand. She added that each federal agency would make the decision about what to do when the single audit was not received on-time.

[9:28:37 AM](#)

Co-Chair MacKinnon shared that the division was working diligently to keep the state in good standing while the new system was implemented.

Ms. Curtis replied that the job of the division was to identify things that did not work. She opined that she rarely had the opportunity to offer positive comments about state departments, she stressed that the legislative and administrative staff that she worked with was professional and hardworking. She said that the fact that the statements were late should not be a reflection on the competency or dedication of said staff.

[9:31:48 AM](#)

Ms. Curtis continued that Governmental Accounting Standards Board (GASB) 68, was a new requirement on how pension plan participants recognized the liability of their portion of future pension benefits that were unfunded, and other pension activity. She said that all the people of the state involved in Public Employees' Retirement System (PERS) and the Teacher's Retirement System (TRS) had to report their portion of the unfunded net pension liability on their respective financial statements. She said that for the first-time allocation schedules had to be created that allocated the net pension liability out to participants, and those statements had to be audited by an independent entity. She shared that there was a special aspect of GASB-68, called "Special Funding", which said that if an entity was legally required to contribute to a pension plan on behalf of another entity, they would be considered a "special funder" and must take on the unfunded liability proportionate to their extra contribution. She noted that there was a statute that required the state to contribute on behalf of planned participants. She said that regardless of the statute, the executive branch argued in FY 15 that a special funding situation did not apply because of the

constitutional prohibition against dedicating revenue, and the requirement that one legislature could not bind future legislatures. She stated that GASB then came out with authoritative guidance that said that a statute on the books was enough to demonstrate legal obligation, and the binding of future legislatures did not matter - the funding would still be considered special funding. She relayed that the executive branch had a legal opinion drafted to support their argument, which had not been convincing, and the division subsequently received draft funding statements that had not included special funding for FY 15. She said that after corrections the audit was eventually posted. She shared that the state brought on \$2.4 billion in unfunded net pension liability for their own share as an employer, and an additional \$3.6 billion for the special funding situation, a total of \$6 billion in FY 15. She said that the total was reflected on the state's government-wide statement, which did not impact the general fund balance or the amount in the savings account, but was an accounting rule meant to foster transparency. She warned that in two years, the Other Post-Employment Benefits (OPEB) obligation would need to be brought onto the books.

[9:35:50 AM](#)

Co-Chair MacKinnon noted that state statute set a funding rate to create stability for PERS and TRS pension contributions from smaller communities and school districts throughout the state. She relayed that the limit for PERS was set at 22 percent, and anything above the 22 percent would be funded by the state. She furthered that the rate for TRS was 12.5 percent, and anything above 12.5 would be paid by the state. She argued that because of the base student allocation (BSA) the state typically engaged in supporting a large percentage of TRS unfunded liability. She continued that GASB-68 was now instructing that the liability above the chosen percentages should be transferred to the state.

Ms. Curtis clarified that prior to FY 15, no one was required to put the liability on the books; GASB-68 meant that for the first time, the unfunded net pension liability had to be reflected on the books. She noted that the statute stated "shall", and if the statute said "may" it would not be special funding; however, the school districts and municipalities would have to book the liability on their own books.

[9:38:37 AM](#)

Co-Chair MacKinnon suggested that the committee review the Debt Affordability Analysis distributed by the Department of Revenue's treasury division. She said that the ability for the state to bond anything was being leveraged by the unfunded liability, which affected the debt liability scenario. She lamented that the state's capability to borrow had been reduced from \$250 million over the next ten years, to between \$50 and \$175 million. She said that the debt analysis would be discussed further later in the week.

[9:40:07 AM](#)

Senator Dunleavy requested a meeting with legislative legal and legislative finance divisions to discuss the concept of limiting the actions of future legislators.

[9:41:27 AM](#)

Co-Chair MacKinnon thought that the conversation could be fruitful. She understood that the legislature could change state statute. She asked when GASB-68 had passed the accounting board, and whether it had been a direct reflection of the state challenge.

Ms. Curtis responded that GASB-68 had been issued several years before it was effective. She said that hearing other states address GASB at national conferences had revealed that many states were opposed to the complexity of the statement and wanted more time to implement the statement. She believed that not binding future legislators had been language specific to Alaska. She said that one special aspect if GASB-68 were the allocation schedules, which impacted all the participants, and had not been issued until the end of November 2015. The division had recommended that the allocation schedule be released earlier; this year it was late, but not as late.

[9:45:17 AM](#)

Co-Chair MacKinnon noted that pensions would be discussed further in the week.

Ms. Curtis relayed that the division was working with the division of finance to make sure that the statements were accurate. She said that errors had been found in the

Statutory and Constitutional Budget Reserve Funds (SBR, CBR), and the amounts reported in those funds. She stated that DOR had struggled in FY14 and FY15 to make sure the corporate income tax and oil and gas production tax receipts went into the CBR. She related that adjustments totaled approximately \$32.4 million. She furthered that DOA had struggled with correctly reporting activity related to those funds, which had resulted in \$3 billion adjustment for the funding from the one-time transfer of CBR funds to pension plans. She stated that a \$5.4 million adjustment had been made to fix a formula error in their spreadsheet related to the transfer from the SBR to the General Fund. She continued that a \$6.9 billion adjustment related to investment activity reporting between accounts within the CBR.

[9:46:54 AM](#)

Ms. Curtis commented on the Governor's vetoing of the oil tax credits. She stressed that there was still an obligation to pay them. She suggested that the credits could have their own row on the state's financial statement so that it didn't get buried within something else. She admitted that vetoing the credits reduced the draw from the CBR, but stressed that it was still a liability and would be reported in the statements.

[9:47:46 AM](#)

Co-Chair Hoffman queried the process of giving the credits their own line item on the spreadsheet.

Ms. Curtis replied that materiality of the numbers would necessitate a dedicated row on the spreadsheet.

Co-Chair Hoffman understood that no legislative action would be required.

Ms. Curtis replied no.

[9:48:17 AM](#)

Vice-Chair Bishop argued that the deferred maintenance schedule should have its own line.

Ms. Curtis replied that the schedule would have to be measurable and qualify under GASB.

[9:48:49 AM](#)

Vice-Chair Bishop believed that it was an issue of prudent bookkeeping. pointing out that private sector business carried deferred maintenance as an individual line item.

[9:49:23 AM](#)

Co-Chair MacKinnon thought that there had been a ruling from GASB on deferred maintenance, specifically on road projects.

Ms. Curtis explained that there was guidance on deferred maintenance and other types of liabilities, and how to report capital assets. She thought that GASB-34 had brought infrastructure on the books, but that she couldn't offer a specific example of deferred maintenance.

[9:50:12 AM](#)

Vice-Chair Bishop highlighted that in times of economic stability the legislature increased the Capital Budget to pay for deferred maintenance.

[9:51:36 AM](#)

Ms. Curtis revealed that the division had found that in FY15, some of the funds deposited in the National Petroleum Reserve Fund (NPR) had not been granted out to impacted communities as required by law. She explained that the funds must be used by the state for construction, maintenance, and operation of essential public facilities - giving priority to municipalities most directly impacted by oil and gas development. She furthered that the law dictated that it was the intent of the legislature that each year all the NPR funds would be available for impact mitigation grants. She said that the fund had received \$6.7 million of revenue, but due to miscommunication and timing of receipts, the full available funding had been unknown. She said that the state received application for approximately \$8.5 million for grants in FY15, but that the department had believed that only \$4 million had been available to grant out. She said that this had resulted in \$2.8 million left in the fund at the end of the year, which under statute were to be given to the Alaska Permanent Fund and the Public School Fund. She stated that the funds that should have been available for the impact grants was

transferred to the Alaska Permanent Fund and the Public School Fund. She said that the division had recommended that work should be done with DOL to regrant the funds, and to change procedure to make sure it did not happen again in the future.

[9:54:06 AM](#)

Co-Chair MacKinnon understood that the timing issue of understanding what had been in the NPR fund had led to the improper disbursement of money.

Ms. Curtis replied that the extra \$2.8 million had been received in March of that fiscal year, and that rather than seeking a supplemental appropriation, which was required by law, there had been a communication breakdown that required corrective action. She said that reporting procedures had since been put into place, as well as changing the nature of the appropriation to allow excess receipts to carry forward.

[9:55:17 AM](#)

Ms. Curtis spoke to the topic of shortfalls. She shared that FY15 had not included recommendations regarding shortfalls because the new accounting system was unable to generate reports that identified potential shortfalls.

Co-Chair MacKinnon discussed housekeeping.

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ADJOURNMENT

[9:57:02 AM](#)

The meeting was adjourned at 9:57 a.m.