

HB

186

HOUSE COMMITTEE ON STATE AFFAIRS

**RECAP OF
HB 186**

State Warrants As Negotiable Instruments

Received February 20, 1989
by Rep. Gruenberg

Heard March 22, 1989

Committee Substitute adopted March 22, 1989

Passed Out of Committee March 22, 1989
4 Do Pass
1 No Recommendation

TABLE OF CONTENTS

HB 186: State Warrants As Negotiable Instruments

- Item 1: HB 186 by Rep. Gruenberg
- Item 2: Fiscal Notes and Analysis from Depts. of Administration and Revenue
- Item 3: Letter from Department of Commerce and Economic Development, July 18, 1988 and Backup Information
- Item 4: Position Paper from the Department of Administration
- Item 5: Letter from Department of Administration to Rep. Gruenberg, March 20, 1989

Item 2

FISCAL NOTE

REQUEST:

Revision Date: _____ Agency Affected: Administration
 Title: An Act relating to state warrants BRU: Finance
and providing for an effective date
 Sponsor: _____ Components: _____
 Requestor: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES		59.8	24.9	24.9	24.9	24.9
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		59.8	24.9	24.9	24.9	24.9
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND		59.8	24.9	24.9	24.9	24.9
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME		1	1	1	1	1
TEMPORARY		1				

ANALYSIS: (Attach a separate page if necessary)

See attached

Prepared By: Keith Busch, Director *Keith Busch* Phone: 465-2240
 Division: Finance Date: _____

Approved by Commissioner: John M. Andrews *[Signature]* Date: 3/7/89
 Agency: Department of Administration

Distribution (by preparer):
 Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

CONTINUATION of FISCAL NOTE ANALYSIS

For Bill/Resolution No. HB 186

This bill would grant holder in due course rights to Alaska financial institutions with respect to State warrants. As a result, the State would be compelled to redeem State warrants if an Alaska financial institution cashes the warrant in good faith and without knowledge of a stop payment notice regarding that warrant. Currently, warrants are not considered to be negotiable instruments and the State is not required to redeem them.

Because warrants would be subject to holder in due course rights, notice of stop payments must be immediate. In order to accommodate this, it would be necessary to implement program changes in the payroll system to eliminate the delay on stop payments between the payroll system and the accounting system. These changes would require the support of one nonpermanent Programmer/Analyst IV position for a period of seven months. This would be a one-time cost of \$34.9. — OK

In addition, the support of an additional permanent part-time Accounting Technician III position would be necessary to provide tighter monitoring and control of stop pay items. This position would act as the liaison between the State's clearing bank and the Division of Finance and the Department of Revenue, Treasury Division. Responsibilities would include coordinating all State warrant stop payments (currently about 2,000 are placed annually), advising the clearing bank of stop pay items, and researching and resolving differences. This would be an annual cost of \$24.9. It is assumed that the State's clearing bank would be responsible for notifying other Alaska financial institutions of stop payments placed on State warrants. However, should it be necessary for the Division of Finance to perform this function a full-time Accounting Technician III position at an annual cost of \$49.8 would be required.

33 FINANCE DEPT
Accountant that ?
FAV 19,800

FISCAL NOTE

REQUEST:

Revision Date: _____ Agency Affected: _____
 Title: An Act relating to state
warrants and providing for an effective date. BRU: _____
 Sponsor: _____ Components: _____
 Requestor: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES		59.8	24.9	24.9	24.9	24.9
TRAVEL						
CONTRACTUAL		19.8	19.8	19.8	19.8	19.8
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		79.6	44.7	44.7	44.7	44.7

CAPITAL						
---------	--	--	--	--	--	--

REVENUE						
---------	--	--	--	--	--	--

FUNDING: (Thousands of Dollars)

GENERAL FUND		79.6	44.7	44.7	44.7	44.7
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME		1	1	1	1	1
TEMPORARY		1				

ANALYSIS : (Attach a separate page if necessary)

Prepared by: Keith Busch, Director Phone: 465-2240
 Division: Finance Date: _____

Approved by Commissioner: John M. Andrews Date: _____
 Agency: Department of Administration

- Distribution (by preparer):
- Legislative Finance
 - Legislative Sponsor
 - Requestor
 - Office of Management and Budget
 - Impacted Agency(ies)

CONTINUATION of FISCAL NOTE ANALYSIS

For Bill/Resolution No. HB 186

This bill would grant holder in due course rights to Alaska financial institutions with respect to State warrants. As a result, the state would be compelled to redeem state warrants if an Alaska financial institution cashes the warrant in good faith and without knowledge of a stop payment notice regarding that warrant. Currently warrants are not considered to be negotiable instruments and the state is not required to redeem them.

Because warrants would be subject to holder in due course rights, notice of stop payments must be immediate. In order to accommodate this, it would be necessary to implement program changes in the payroll system to eliminate the delay on stop payments between the payroll system and the accounting system. These changes would require the support of one non-permanent Programmer/Analyst IV position for a period of seven months. This would be a one-time cost of \$34.9

In addition, the support of an additional permanent part-time Accounting Technician III position would be necessary to provide tighter monitoring and control of stop pay items. This position would act as the liaison between the State's clearing bank and the Division of Finance and the Department of Revenue, Treasury Division. Responsibilities would include coordinating all state warrant stop payments (currently about 2,000 are placed annually), advising the clearing bank of stop pay items, and researching and resolving differences. This would be an annual cost of \$24.9 in personal services.

After discussion with the Department of Revenue, Treasury Division, and Key Bank it was determined that the State would be responsible for notifying all Alaska financial institutions of stop pay items. This would involve the daily transmission of stop pay information to 33 financial institutions. This would be done by fax at a minimum cost of \$2.30 per transmission per business day for an annual cost of \$19,734.00 in contractual services/communications. ($\$2.30 \text{ per transmission} \times 33 \text{ financial institutions} \times 260 \text{ business days annually} = \$19,734.00$.)

FISCAL NOTE

REQUEST:

Revision Date: _____ Agency Affected: Department of Revenue
 Title: State Warrants BRU: Treasury
 Sponsor: Gruenberg Components: _____
 Requestor: House State Affairs

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: attach a separate page for analysis.

Prepared By: Milt Barker MB
 Division: Treasury

Phone: 465-2350
 Date: 3-8-89

Approved by Commissioner: Milton B. Barker for
 Agency: Department of Revenue

Date: 3-8-89

Distribution (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

STATE OF ALASKA

DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT

OFFICE OF THE COMMISSIONER

Item 3
STEVE COWPER, GOVERNOR

7TH FLOOR FRONTIER BLDG.
3601 C STREET, SUITE 722
ANCHORAGE, ALASKA 99503-5934
PHONE: (907) 562-728

July 18, 1988

Banking

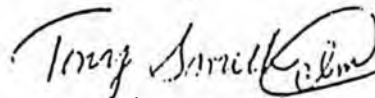
Mr. Robert P. Gray, President
National Bank of Alaska
Box 10060
Anchorage, Alaska 99510-0600

Dear Bob:

John Williams and I have met with Hugh Malone and Milt Barker on the state warrant issue. It seems like the best answer is some change in AS 37.10.078 so there is an opportunity for reasonable banking procedures to be applied to the cashing of warrants over \$5,000 without impacting the state's investments and deposits. I enclose the legislative listing provided by Jeff Bush.

My suggestion would be a reasonable regulation. Please think about it.

Cordially,



J. Anthony Smith
Commissioner

JAS/dm
0272Z

enclosure

cc; Hugh Malone, Commissioner, Department of Revenue
John Williams, Deputy Commissioner, DCED
Milt Barker, Department of Revenue
Jeff Bush, Assistant Attorney General

no official position



National Bank of Alaska

CORPORATE HEADQUARTERS • BOX 100600 • ANCHORAGE, ALASKA 99510-0600

ROBERT P. GRAY
PRESIDENT

August 5, 1988

Mr. J. Anthony Smith
Commissioner
Department of Commerce & Economic Development
3601 C Street
Anchorage, Alaska 99503-5934

Re: Your letter of July 18, 1988

Dear Tony:

Thank you for your attention to the problem that has been presented to you concerning the cashing or negotiating of State Warrants.

Upon reflection, I do not feel the size of the warrant is the issue here; rather, the issue is the rights under a holder in due course. Perhaps if I detail what I perceive is the actual situation we will be able to agree that the problem can be easily resolved without causing the State unnecessary burdens.

I can give you the conclusion first - if the State of Alaska agrees to comply with the Holder in Due Course doctrine and other general principles of the UCC as applies to negotiable instruments, then there is no problem as far as NBA is concerned. The continued insistence by the AG's office that warrants are not negotiable items is not, in my opinion, sensible, and certainly does not coincide with everyday business practices.

It is useful to restate what the Holder in Due Course doctrine states. (I realize you are familiar with it, but some to whom you may discuss this matter may not be.) In laymans terms an entity (individual, corporate or whatever) becomes a holder in due course of a negotiable instrument when he/she or it:

Mr. J. Anthony Smith
August 5, 1988
Page 2

1. Receives the instrument for value
2. Receives the instrument in good faith
3. Has no notice of any defect in the instrument or in the title of the person or entity negotiating it.

A holder in due course has a valid, enforceable claim against the maker of the instrument. In the case of a State Warrant, the maker is, of course, the State of Alaska.

In the case of a bank becoming a holder in due course, #1 above would always apply, #2 would apply unless the bank were involved in some sort of conspiracy against the State and #3 is the main issue. Here's where the important distinctions come:

1. If the bank negotiates the item and it is determined that any of the endorsements are forged, the bank is not a holder in due course (defect in title.)
2. If the item is stale dated the bank is not a holder in due course. (The bank has a notice of defect by examining the instrument.) Generally, for these purposes, to clearly protect the Holder in Due Course status, an item should be negotiated within 30 days of the issue date.
3. If the check is altered the bank is not a holder in due course (defect in the instrument.)

Then what are the banks and the State arguing about?

If a bank accepts a State Warrant, with no forgeries and negotiates it, we want to be paid without exception. The fairness of this is clear -- we have no way of determining that there is a potential for dishonor of the item. How can we fairly be asked, and actually forced as per your enclosure, to cash State Warrants under any other circumstances?

Mr. J. Anthony Smith
August 5, 1988
Page 3

The problem we have with the Univentures check is exactly to the point. NBA cashed the check for the payee -- no one disputes that fact. The State dishonored it. We contacted the State for payment and it refused. Even though no replacement warrant had been issued. We had no way to know the check would be dishonored. We should be paid.

The reason we're making such a big deal about this is the potential exposure is limited only by the dollar amount of the check. When you think about it, the State's position is exactly analogous to the bank's when we issue a cashier's check. How do we protect ourselves?

When someone claims they lost a cashier's check that they purchased, we usually invoke a 30 day waiting period, we require an indemnity agreement to be signed and, we sometimes require a bond to be posted. And, of course, we are careful when we issue cashier's checks.

As a final point, in relation to your letter to me, whether the State calls its instruments checks or warrants, or how it funds these items is a completely independent matter from whether or not the State abides by the Holder in Due Course doctrine.

I would appreciate your opinion of my suggestions -- that the State observe the Holder in Due Course doctrine and the UCC, as adopted by the State.

Thank you for your attention to this matter.

Sincerely,

Robert P. Gray
President

RPG:sl

1989 LEGISLATIVE PROPOSAL REQUESTS
DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT

DIVISION/AGENCY: Banking, Securities & Corporations

SUBJECT OF PROPOSED LEGISLATION:

State Warrants: Amendment to AS 45.03.302, holder in due ^{case} cause.

SUMMARY OF PROPOSAL: What does the proposal do; why is it needed; how many incidents have occurred which necessitate the change; has similar legislation been drafted/introduced in the past, and if so, what happened to it? (Attach copy of previous drafts, additional background information if necessary.)

Proposal would make state warrants subject to the Uniform Commercial Code's Holder in Due Course Doctrine for Alaska financial institutions, similar to checks. According to an Attorney General's opinion, current law holds that state warrants are not negotiable instruments. Financial institutions have had problems with the state dishonoring warrants when the institution had no prior knowledge that there was a potential for dishonoring the item. (see attached)

WHO SUPPORTS/OPPOSES THE PROPOSED LEGISLATION: Which interest groups, constituencies, or other departments are affected, and in what way?

First proposed by National Bank of Alaska

ESTIMATED FISCAL IMPACT:

Capital: 0
Operating: 0

PRECEDENTS IN ALASKA OR OTHER STATES:

WHICH LEGISLATORS WOULD BE INTERESTED IN THE PROPOSAL, PRO AND CON:

OPTIONS THAT THE GOVERNOR SHOULD CONSIDER:

DIVISION/AGENCY DIRECTOR: William F. Hager

DATE: 8/22/88

COMMISSIONER: William F. Hager

DATE: 8/22/88

DEPARTMENTAL PRIORITY: 3

GOVERNOR'S OFFICE RECOMMENDATION:

MEMORANDUM

State of Alaska

TO: Hugh Malone, Commissioner
Department of Revenue

DATE: August 22, 1988

FILE NO:

TELEPHONE NO:

THRU:

SUBJECT: Proposed Legislation on
State Warrants

FROM:


J. Anthony Smith, Commissioner
Department of Commerce and Economic
Development

In June, I met with Milt Barker, Assistant Attorney General Jeff Bush, and members of my staff, to discuss a possible solution to a problem raised by National Bank of Alaska (NBA) regarding the treatment of state warrants after the state has issued a stop pay notice. As you may know, in January 1987, Jeff issued an informal AG's opinion to the effect that state warrants are generally not negotiable instruments, and therefore, a holder in due course has no recourse against the state if the state has issued a stop pay notice on a particular warrant. This legal doctrine makes warrants different than normal checks.

NBA has asked us to consider sponsoring legislation to make warrants subject to the Uniform Commercial Code's holder in due course doctrine, similar to checks. According to NBA, the federal government treats its warrants as negotiable instruments. After numerous discussions with Bob Gray, NBA's president, we believe we may have reached a compromise that will protect the state from incurring substantial additional risks while granting Alaskan financial institutions the benefits of the doctrine. We, therefore, plan to include in the legislative package of the Department of Commerce and Economic Development a proposal to amend AS 45.03.302, which defines a holder in due course, to include holders of state warrants, but only when the holder is an Alaska financial institution or a branch of a national bank, if the branch is located in Alaska.

As you know, the AG's office and Milt are concerned about protecting the state from warrants cashed after the state issues a stop pay notice. The holder in due course doctrine provides that the holder of a check normally can recover from the issuer even if the issuer has attempted to stop payment on the check. The only exception is that a holder may not recover if he had notice that the check was not negotiable, or that a stop payment notice was out, prior to cashing it. Thus, in order to protect the state, we will have to modify the state contract with Keybank to require the bank, to notify all Alaska institutions within a certain, preferably short, period of time of any stop payment notices issued by the state. We believe this would be relatively simple for Keybank, given the sophis-

Commissioner Hugh Malone

- 2 -

August 22, 1988

tication of today's communications between the shrinking number of institutions and the relatively few stop pay notices issued by the state.

In light of your department's interest in this issue in the past, your comments on this proposal would be welcome.

JAS/LW/pal/C.52
082288b

DEPARTMENT OF ADMINISTRATION
POSITION PAPER

Division: Finance Bill Number: HB 186

Bill Title: An act relating to state warrants; and providing for an effective date

House Bill 186, "An act relating to state warrants; and providing for an effective date", will amend AS 45.03.104(b) to include state warrants making all state warrants a negotiable instrument. It will also repeal AS 43.05.170 which would grant holder in due course rights to Alaska financial institutions with respect to state warrants. As a result, the state would be compelled to redeem any state warrant that an Alaska financial institution cashes in good faith without knowledge of a stop payment notice regarding the warrant.

This bill raises several areas of concern regarding the potential costs and risks to the state. The first concern is the liability placed on the state each time a stop payment is processed against a state warrant.

Historically, state and city governmental agencies have been authorized to issue warrants for disbursement of funds and this method of disbursement is commonly used by many states including Texas, California and Washington. The State of Alaska has been issuing warrants since pre-statehood. As warrants are payable on acceptance by the State, their issuance allows the State to provide good management of public funds and prevent funds from being disbursed without a valid appropriation.

As a part of managing public funds, it is the State's responsibility to ensure monies are properly disbursed. At times this necessitates a stop payment be placed on a previously issued warrant. Stop payments are generally requested for one of three reasons:

- The warrant was issued in error. In these cases funds may be overspent if the warrant is allowed to redeem.
- The payee has notified the state of nonreceipt of a warrant and the warrant has not been redeemed.
- The payee has notified the state of nonreceipt of a warrant and the warrant has been redeemed. In these cases fraud is most likely involved and the stop payment request becomes a nonissue.

During FY 88 approximately 2,000 stop payments were placed on state warrants amounting to over \$4,800,000. If state warrants are considered to be negotiable instruments, each of these stop payments becomes a potential liability to the state. Should a financial institution cash a warrant in good faith without prior knowledge of a stop payment and then be unable to recover funds on the stop pay warrant from the payee, it will be necessary for the issuing agency to either reimburse the funds from it's existing budget or request a supplemental appropriation. In these instances the state would be obligated to reimburse financial institutions for unrecoverable stop pay items, which in turn could force the state into the illegal over expenditure of appropriations (AS 37.05.170).

The actual dollar amount that would be expended for unrecoverable stop payments is undeterminable. Although a stop payment notification system between the state and the financial institutions would be implemented, there could be as much as a 24-hour delay between the time the stop payment is placed in the state's accounting system and the banks are notified. During the first ten months of calendar year 1988, 156 warrants with stop payments were cashed by the payee and presented to the state for redemption. These warrants totaled \$156,506. Of the 156 warrants cashed with stop payments, 17.8 percent were cashed within one day of the date of issue. Therefore, it can be concluded that the state may have to absorb 17.8 percent of its stop pays at the very minimum and undoubtedly a great deal more if the financial institution cannot readily collect from the payee of a sizable warrant.

The second area of concern is the direct impact on the Division of Finance. It is a responsibility of the Division of Finance to maintain a reconciliation system for all state issued warrants. The following provides a brief overview of this reconciliation process:

Warrant Reconciliation:

Warrant reconciliation includes the monitoring and control of all warrant issues, warrant redemptions, stop payments, cancels and staledates. Warrant reconciliation is provided for all eleven types of state issued warrants.

State Warrants:

There are currently eleven different types of state warrants. The Division of Finance is directly responsible for the stock control for seven of the warrant types, Payroll, AKSAS, Longevity Bonus, Permanent Fund, Refundable Credit, Handwrite, Field Warrant and Post Secondary, which includes releasing stock for print, ordering or assisting in the ordering of new stock, verifying the print process, releasing the warrants for distribution and performing physical

inventory of stock on hand. The other three warrant types, Welfare, Court Warrants and Medical Assistance are maintained and printed by the issuing agency.

Warrant Issues:

Each warrant issue must be recorded in the accounting system as a warrant outstanding. General warrants are recorded when a request for a warrant is entered into the accounting system. All other types of warrants are external to the accounting system and issue data is recorded through a daily subsystem interface process. All warrant issue data is verified against warrant issue logs to ensure the accounting system is in sync with the actual warrants issued. The state issued approximately 1,835,943 warrants during FY 88 for a total of \$3,080,068,968.

Redemptions:

Warrants are presented for redemption by the State's clearing bank, Key Bank, on a daily basis. Redemption data is passed from Key Bank to the accounting system via bulk data transfer. This data is then matched against the warrants outstanding file. Any errors are researched and the Treasury Division is notified of items that should be returned to the bank, such as warrants cashed for an incorrect amount or stop pay items. Other types of errors, such as issue data, are manually corrected in the accounting system.

Stop Payments:

At times, warrants are issued but not received by the payee or warrants are issued in error. In these instances the issuing agency will request a stop payment be placed on the warrant. A stop payment may only be placed if the physical warrant is not in the state's possession. Warrants in the state's possession are canceled as explained in the following paragraph. For each stop payment, a Warrant Status Change form is completed by the issuing agency and a stop payment transaction entered into the accounting system. This information is then forwarded to the Division of Finance where it is verified and the transaction is authorized for processing. Approximately 1,753 stop payments were placed in FY 88 for a total dollar amount of \$4,813,123. This does not include stop payments placed on payroll warrants. Payroll procedures do not allow for the accumulation of stop payment detail separately from payroll warrant cancels and cancel/reissues. Stop payments for other warrant types ranged from \$3.50 to \$1,532,325.63. Attached are several charts detailing stop payment volume by warrant type, dollar amount and monthly activity.

Cancels:

Warrant issued in error are canceled in the accounting system. To cancel a warrant, the issuing agency must have the physical warrant in hand. The issuing agency then enters a cancel transaction into the accounting system and forwards the physical warrant to the Division of Finance for verification and authorization of the transaction. 21,167 warrants were canceled in FY 88 totaling \$25,663,429.

Staledates:

According to AS 37.05.180 warrants issued and not redeemed within two years of the date of issue are considered to be staledated and no longer redeemable. Each month during a warrant purge process these warrants are identified and listed on a hardcopy report. Using this report, a transaction is entered into the accounting system for each warrant to record the warrant as a staledated item. 3,587 warrants were staledated during FY 88 totaling \$597,510.

Attached is a breakdown by warrant type of total counts and dollar amounts for warrant issues, stop payments, cancels and staledates during FY 88.

The volume of data managed in the warrant reconciliation process is tremendous. The implementation of the bill relating to the negotiability of state warrants would only further increase this workload. To reduce the potential liability each stop payment creates, it would be necessary to enforce stricter control over stop payment transactions. At best it would be necessary to notify the state's clearing bank immediately of each stop payment at the time it is entered into the accounting system. This would require daily contact with the bank for the transmitting of stop payment data (most likely by fax). It is possible that the state would be responsible for also notifying other Alaska financial institutions of stop pay items. In addition, there would be an increase in research, inquiries and legal battles. We cannot provide the increased services with existing staff while at the same time continuing to provide adequate control over state-issued warrants. Additional support of a part time Accounting Technician III position, at an annual cost of \$24.9, would be required.

As a part of the above need to provide the bank with immediate stop payment data, it would also be necessary to implement program changes in the State's payroll system. Currently, stop payments on payroll warrants are input into the payroll system and then passed to the accounting system on the following day. To ensure the state's clearing bank is notified of all stop payments timely, it will be necessary to reverse this process and eliminate the one day lag prior to the stop payment placed in the accounting system. To program and implement the changes needed in the payroll system, the

support of one non-permanent Programmer/Analyst IV position for a period of seven months would be required. This will be an estimated one-time cost of \$34.9.

The Department of Administration does not support this bill and recommends it not be passed. If the banking industry has been harmed it may be less expensive to the state to remedy that harm rather than increase state operating costs and potential exposure for checks cashed that have had stop payments placed against them. The Department of Revenue supports the Department of Administration's position on this bill.

APPROVED:

Director: Keith Busch

Signature: Keith Busch Date: 3/10/89

Commissioner: John M. Andrews

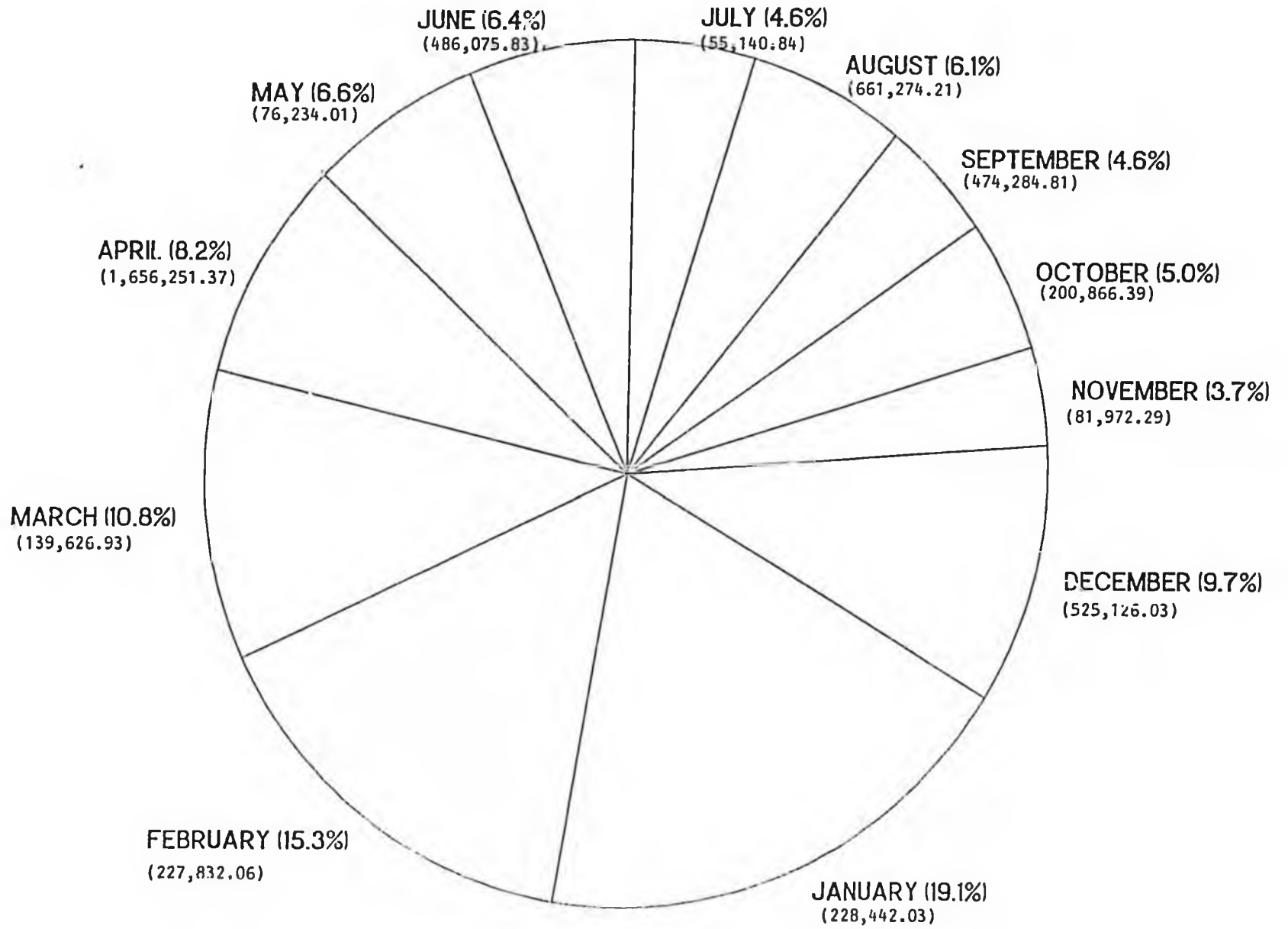
Signature: J.M.A. Date: 3/13/89

For further information call Dean Gottehrer at 465-2200

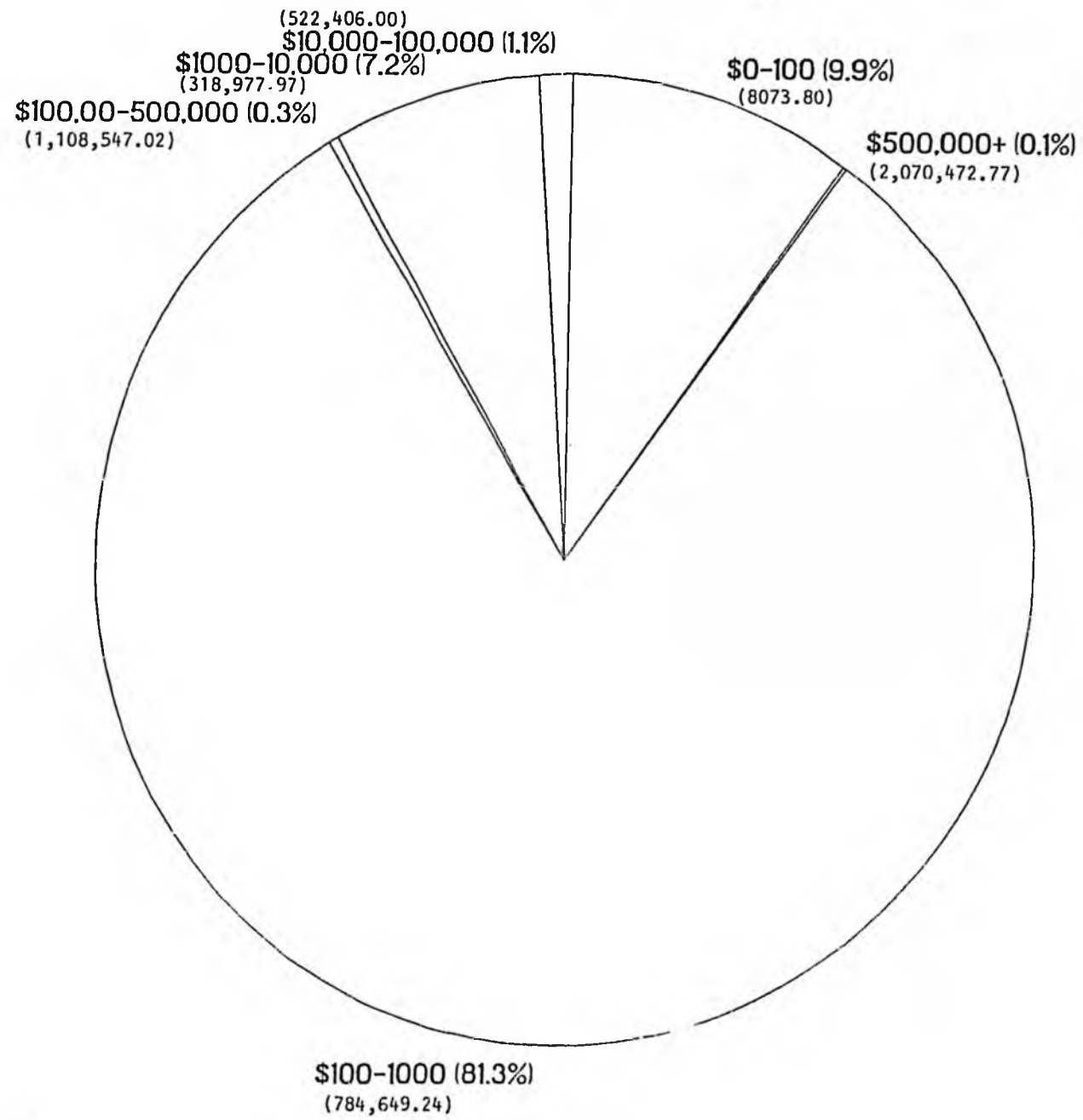
WARRANT RECONCILIATION DATA - FY 88

WARRANT CLASS	WARRANT ISSUES		STOP PAYMENTS		CANCELS		STALE DATED	
	COUNT	AMOUNT	COUNT	AMOUNT	COUNT	AMOUNT	COUNT	AMOUNT
PAYROLL	409,875	418,665,891	not avail	not availabl	1,349	1,393,204	107	55,191
AKSAS	402,150	2,071,933,989	412	2,480,461	4,134	8,637,998	1,375	136,929
LONGEVITY BONUS	202,381	50,322,869	164	41,000	796	183,000	125	29,250
WELFARE	197,112	73,861,567	248	114,289	2,433	871,844	328	91,482
PERMANENT FUND	527,205	362,334,626	800	543,179	6,306	4,250,740	705	248,014
FIELD WARRANT	30,620	not available	52	11,206	377	70,192	224	25,235
COURT WARRANT	32,665	1,061,834	19	1,481	502	23,489	694	9,474
POST SECONDARY	31,384	71,087,670	53	108,030	5,033	9,989,174	0	0
MEDICAL ASSISTANCE	2,433	6,563,821	3	1,052	43	231,062	0	0
REFUNDABLE CREDIT	0	0	1	100	194	12,726	29	1,935
HANDWRITE	118	24,236,701	1	1,532,325	0	0	0	0
TOTAL	1,835,943	3,080,068,968	1,753	4,813,123	21,167	25,663,429	3,587	597,510

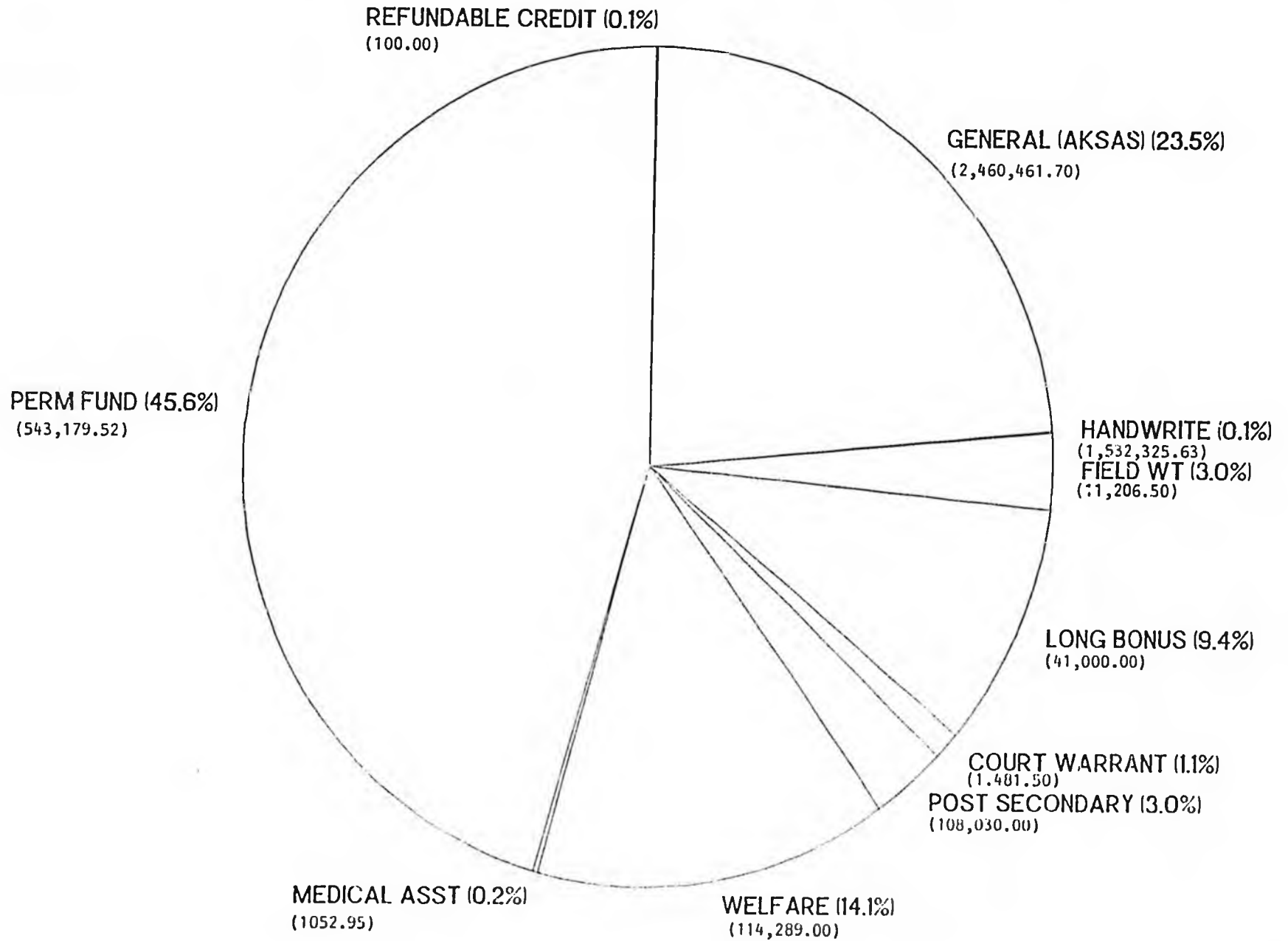
FY 88 STOP PAYMENTS - BY MONTH



FY 88 STOP PAYMENTS - BY DOLLAR AMOUNT



FY 88 STOP PAYMENTS - BY WARRANT CLASS



STATE OF ALASKA

DEPARTMENT OF ADMINISTRATION

DIVISION OF FINANCE

Item 5

P.O. BOX C
JUNEAU, ALASKA 99811-0204
PHONE: (907) 465-2240

March 20, 1989

The Honorable Max Gruenberg
Alaska State Representative
P.O. Box V
Juneau, AK 99811-3100

Dear Representative Gruenberg:

I have reviewed your request for an alternative to House Bill 186 which would provide some assurance to the banking industry that the State would honor its warrants, and at the same time minimize the administrative costs. I believe the following proposal is consistent with the concept of fairness to the private sector, minimizing increased operating costs to the State, and providing continued collection participation by the banking industry.

Alternate Proposal

The State of Alaska will indemnify an Alaska financial institution who, unknowing, accepts a State warrant under ten thousand dollars which has been voided or which has had a stop payment placed upon it based upon the following procedures:

- A) The State will continue to operate the warrant redemption process. We will notify a financial institution in accordance with Uniform Commercial Code (UCC) when a warrant with a stop payment has been submitted for redemption, and will return the warrant to the financial institution through our warrant redemption and clearing bank.
- B) The financial institution will be responsible for taking all reasonable steps to collect returned warrants from customers. If after taking reasonable steps, they are unable to recover such funds, and the warrant is under ten thousand dollars, the financial institution may submit the warrant to the Department of Administration for indemnification. Reasonable steps includes the financial institution's attempt to collect funds from clients' accounts, or through personal contact, the balance due, if that person has insufficient funds and resides in the state.
- C) If the Department of Administration is satisfied the financial institution has taken reasonable collection actions, the department will pay to the institution the value of the warrant if sufficient funds exist or from a

March 20, 1989

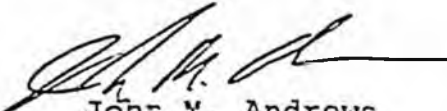
supplemental appropriation. The disbursement will be charged against the originating authorization if sufficient authorization exists. If insufficient authorization exists, a supplemental appropriation will be submitted to the legislature through the budget process. Upon approval of the legislature and Governor, appropriated funds would be paid to the financial institution.

- D) For warrants in excess of ten thousand dollars the financial institution will have the option of calling the State for verification that no stop payment has been placed on a warrant prior to cashing it. There will be available a current listing of stop payments in the Division of Finance. If the financial institution calls and are informed the warrant is valid, and a subsequent stop payment is placed, the State will honor the warrant if there is a sufficient appropriation balance. If insufficient authorization exists, a supplemental appropriation will be submitted to the legislature through the budget process. If the financial institution does not call or calls and are informed the warrant is not valid, subsequent redemption of the warrant will be rejected, and the warrant will be returned to the financial institution.

In addition we are presently studying the possibility of putting a listing of stop payments on the State's computer network so that financial institutions can access that information directly.

This proposal has several advantages over the proposed bill. First, State warrants will not become negotiable instruments subject to holder in due course. The issue of being required to overspending an appropriation is addressed. There would be no increased administrative cost, and we estimate that the cost of indemnification for stop payments would be about the same under this proposal as under the proposed bill.

Sincerely,



John M. Andrews
Commissioner

JMA/KB/tln
8/3D4/031622-9
cc: Division of Finance
Department of Administration

Position Paper
House Bill 186

House Bill 186, "An act relating to state warrants; and providing for an effective date, will amend AS 45.03.104(b) to include state warrants making all state warrants a negotiable instrument. It will also repeal AS 43.05.170 which would grant holder in due course rights to Alaska financial institutions with respect to state warrants. As a result, the state would be compelled to redeem any state warrant that an Alaska financial institution cashes in good faith and without knowledge of a stop payment notice regarding the warrant.

This bill raises several areas of concern regarding the potential costs and risks to the state. The first concern is the liability placed on the state each time a stop payment is processed against a state warrant.

Stop payments are generally requested for one of three reasons:

- The warrant was issued in error. In these cases funds may be overspent if the warrant is allowed to redeem.
- The payee has notified the state of non receipt of a warrant and the warrant has not been redeemed.
- The payee has notified the state of non-receipt of a warrant and the warrant has been redeemed. In these cases fraud is most likely involved and the stop payment request becomes a non-issue.

During FY 88 approximately 2,000 stop payments were placed on state warrants amounting to over \$4,800,000 in state funds. If state warrants are considered to be a negotiable instrument, each of these stop payments becomes a potential liability to the state. Should a financial institution be unable to recover funds for a stop pay warrant from the payee, it will be necessary for the issuing agency to either reimburse the funds from their existing budget or request a supplemental appropriation. The state would be obligated to reimburse financial institutions for unrecoverable stop pay items, which in turn could force the state into the illegal over expenditure of appropriations.

The actual dollar amount that would be expended for unrecoverable stop payments is undeterminable. Although a stop payment notification system between the state and the financial institutions would be implemented, there could be as much as a 24 hour delay between the time the stop payment is placed in the state's accounting system and the banks are notified. During the first ten months of calendar year 1988, 156 warrants with stop payments were cashed by the payee and presented to the state for redemption. These warrants totaled \$156,506. Of the 156 warrants cashed with stop payments, 17.8 percent were cashed within one day of the date of issue. Therefore, it can be concluded that the state may have to absorb 17.8 percent of its stop pays at the very minimum and undoubtedly a great deal more if the

financial institution cannot readily collect from the payee of the warrant.

The second area of concern is the direct impact on the Division of Finance. It is a responsibility of the Division of Finance to maintain a reconciliation system for all state issued warrants. The following provides a brief overview of this reconciliation process:

Warrant Reconciliation:

Warrant reconciliation includes the monitoring and control of all warrant issues, warrant redemptions, stop payments, cancels and staledates. Warrant reconciliation is provided for all eleven types of state issued warrants.

State Warrants:

There are currently eleven different types of state warrants. The Division of Finance is directly responsible for the stock control for seven of the warrant types, Payroll, AKSAS, Longevity Bonus, Permanent Fund, Refundable Credit, Handwrite, Field Warrant and Post Secondary, which includes releasing stock for print, ordering or assisting in the ordering of new stock, verifying the print process, releasing the warrants for distribution and performing physical inventory of stock on hand. The other three warrant types, Welfare, Court Warrants and Medical Assistance are maintained and printed by the issuing agency.

Warrant Issues:

Each warrant issue must be recorded in the accounting system as a warrant outstanding. General warrants are recorded when a request for a warrant is entered into the accounting system. All other types of warrants are external to the accounting system and issue data is recorded through a daily subsystem interface process. All warrant issue data is verified against warrant issue logs to ensure the accounting system is in sync with the actual warrants issued. The state issued approximately 1,835,943 warrants during FY 88 for a total of \$3,080,068,968.

Redemptions:

Warrants are presented for redemption by the State's clearing bank, Key Bank, on a daily basis. Redemption data is passed from Key Bank to the accounting system via bulk data transfer. This data is then matched against the warrants outstanding file. Any errors are researched and the Treasury Division is notified of items that should be returned to the bank, such as warrants cashed for an incorrect amount or stop pay items. Other types of errors, such as issue data, are manually corrected in the accounting system.

Stop Payments:

At times warrants are issued but not received by the payee. In these instances the issuing agency will request a stop payment

be placed on the warrant. A stop payment may only be placed if the physical warrant is not in the state's possession. Warrants in the state's possession are canceled as explained in the following paragraph. For each stop payment, a Warrant Status Change form is completed by the issuing agency and a stop payment transaction entered into the accounting system. This information is then forwarded to the Division of Finance where it is verified and the transaction is authorized for processing. Approximately 1,753 stop payments were placed in FY 88 for a total dollar amount of \$4,813,123. This does not include stop payments placed on payroll warrants. Payroll procedures do not allow for the accumulation of stop payment detail separately from payroll warrant cancels and cancel/reissues. Stop payments for other warrant types ranged from \$3.50 to \$1,532,325.63. Attached are several charts detailing stop payment volume by warrant type, dollar amount and monthly activity.

Cancels:

Warrant issued in error are canceled in the accounting system. In order to cancel a warrant the issuing agency must have the physical warrant in hand. The issuing agency then enters a cancel transaction into the accounting system and forwards the physical warrant to the Division of Finance for verification and authorization of the transaction. 21,167 warrants were canceled in FY 88 totaling \$25,663,429.

Staledates:

According to AS 37.05.180 warrants issued and not redeemed within two years of the date of issue are considered to be staledated and no longer redeemable. Each month during a warrant purge process these warrants are identified and listed on a hardcopy report. Using this report, a transaction is entered into the accounting system for each warrant to record the warrant as a staledated item. 3,587 warrants were staledated during FY 88 totalling \$597,510.

Attached is a breakdown by warrant type of total counts and dollar amounts for warrant issues, stop payments, cancels and staledates during FY 88.

The volume of data managed in the warrant reconciliation process is tremendous. The implementation of the bill relating to the negotiability of state warrants would only further increase the workload in this area. To reduce the potential liability each stop payment creates, it would be necessary to enforce stricter control over stop payment transactions. At best it would be necessary to notify the state's clearing bank immediately of each stop payment at the time it is entered into the accounting system. This would require daily contact with the bank for the transmitting of stop payment data (most likely by fax). It is possible that the state would be responsible for also notifying other Alaska financial institutions of stop pay items. In addition, there would be an increase in research, inquiries and legal battles. We cannot provide the increased services with existing staff while at the same time continuing to provide adequate control over state issued warrants. Additional support of a

part time Accounting Technician III position, at an annual cost of \$24.9, would be required.

As a part of the above need to provide the bank with immediate stop payment data, it would also be necessary to implement program changes in the State's payroll system. Currently, stop payments on payroll warrants are input into the payroll system and then passed to the accounting system on the following day. In order to ensure the state's clearing bank is notified of all stop payments timely, it will be necessary to reverse this process and eliminate the one day lag prior to the stop payment placed in the accounting system. To program and implement the changes needed in the payroll system, the support of one non-permanent Programmer/Analyst IV position for a period of seven months would be required. This will be an estimated one-time cost of \$34.9.

The Department of Administration does not support this bill and recommends it not be passed. If the banking industry has been harmed it may be less expensive to the state to remedy that harm rather than increase state operating costs and potential exposure for check cashed that have had stop payments placed against them.

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Mark T. Handley

Attorney at Law

Judiciary Committee

ALASKA HOUSE OF REPRESENTATIVES

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Alaska State Legislature



House of Representatives House Judiciary Committee

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February 28, 1989

MEMORANDUM

TO: Representative Red Boucher
Chair, House State Affairs Committee

FROM: Max Gruenberg *MG*

RE: HB 186, "An Act relating to state warrants; and
providing for an effective date."

I would appreciate it if you would schedule a hearing for HB 186 as soon as possible.

HB 186 will make state warrants the legal equivalent of checks under the Uniform Commercial Code. I introduced the bill at the request of the banking community.

Thank you.

1 IN THE HOUSE

BY GRUENBERG

2

HOUSE BILL NO. 186

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to state warrants; and providing for
7 an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 45.03.104(b) is amended to read:

10 (b) A writing which complies with the requirements of this
11 section is

12 (1) a "draft" ("bill of exchange") if it is an order;

13 (2) a "check" if it is

14 (A) a draft drawn on a bank or a state warrant, and

15 (B) payable on demand;

16 (3) a "certificate of deposit" if it is an acknowledgment
17 by a bank of receipt of money with an engagement to repay it;

18 (4) a "note" if it is a promise other than a certificate of
19 deposit.

20 * Sec. 2. AS 43.05.170 is repealed.

21 * Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

↑ ?

CONCERNS



*

→ elimin agency spend of 'wctoo'
Appropriation ✓ ?

WORST PUBLIC POLICY



→ B of N - state does redemption
↑ of costs - not by stop
pmt -

→ tighten up manage policy
not by Agency ?



→ PF → should get PF check &
WILLIAM WARRON, -

→ stop interest working ?

→ put on line ?

→ appear Act. At OWN BANK ?

2.7 & check

CONFUSION (15+)

20d
schedule?

Decide what STATE DOES

→ centralize location to notify?
NO

→ How about within?
set up BANK ACCOUNT?

→ continue to be own Broker -
+ r of payor BANK

because
wage

→ have to ref.

→ NO. 109106 restored
US NON-REGULATED

→ feels the risk shouldn't FAIL hold
ON PAYOR

→ BRUNBERG suggestion

→ WCS COMPANY

→ 5,000 limit - stop in od by check

★
sol of cos?
→