



ATTORNEY GENERAL AUDIT FOLLOW-UP: STATE AGENCY BILLING

EXECUTIVE OFFICES AND CRIMINAL JUSTICE APPROPRIATIONS SUBCOMMITTEE
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ISSUE BRIEF

SUMMARY

In June 2015, the Office of the Legislative Auditor General (OLAG) completed two audits of the Office of the Attorney General (OAG), a performance review and a budget review. The Legislative Audit Subcommittee tasked the Executive Offices and Criminal Justice (EOCJ) Appropriations Subcommittee with assessing the budget review, determining which recommendations from the auditors should be implemented, and taking action to ensure the implementation of those recommendations.

As detailed in the accompanying PowerPoint presentation, there are six key recommendations from the auditors, with input from the Legislative Fiscal Analyst (LFA), which would require subcommittee action:

1. Address concerns with billing of state agencies for legal services.
2. Clarify accounting for the Attorney General Litigation Fund.
3. Require reporting on three other off-budget funds.
4. Require reporting of all funding requests for new attorneys.
5. Reassess accounting practices and data tracking in two areas.
6. Categorize settlement payments more clearly.

This issue brief provides additional detail for item number one, as there are multiple options for consideration and most options would require statutory change.

ISSUE

The Attorney General acts as the legal counsel for state agencies. This work is largely housed in the State Agency Counsel division, but is also categorized in other divisions in the Civil, Criminal Prosecution, and Child Protection programs. Some of these assistant attorneys general are housed within the state agencies they represent and some divide their time across multiple agencies. The OAG collects approximately \$17.3 million annually in dedicated credits from billing state agencies. The office's primary funding source, however, is direct General Fund appropriations; some portion of General Fund appropriations provide for legal services to agencies without charge and at the OAG's discretion, and another portion covers other legal services to the State. For FY 2016, the OAG expects to bill agencies a total of \$17.7 million in dedicated credits, which agencies pay from a variety of funding sources. In FY 2016, agencies will pay \$5.9 million from federal funds, \$3.2 million from the General Fund, and \$8.5 million from restricted revenue sources.

As the legislative budget review showed, the OAG as a whole does not systematically track hours of service provided. Payment arrangements are agreed to on an individual basis between each agency and the OAG. **This system lacks transparency and consistency, which:**

1. Limits the ability of the Legislature to manage the amount of state funds spent on legal services;
2. Likely causes some agencies to be over-billed and others to be under-billed; and
3. Puts federal funds used by agencies to procure legal services at risk, due to federal requirements regarding documentation of services provided.

Additionally, the OLAG found that the use of dedicated credits by the OAG is not consistent with statute.

Based on their findings, the OLAG offered three options to improve the accounting of the OAG's billing of state agencies:

1. Establish state agency services as an Internal Service Fund (ISF) and allow the OAG to collect dedicated credits (as other ISFs do).
2. Establish state agency services as a Cost Allocation Plan (CAP), add statutory language requiring detailed accounting, and appropriate revenue as transfers.
3. Create a new line item for state agency services without any other changes, add statutory language requiring detailed accounting, and appropriate revenue as transfers.

Both the OLAG and LFA recommend converting the current billing system into an Internal Service Fund. An ISF would provide the most detailed accounting and would be consistent with how other state-wide services are delivered, such as technology services and human resource management. Other options could provide a similar level of accountability, but they would have to include additional controls. Any new system will require significant time and resources to implement and each new system involves important trade-offs for consideration. An in-depth explanation and comparison of billing options follows.

What OAG revenue should be converted to a new system?

The OAG currently receives General Fund and dedicated credit appropriations to provide services to state agencies. The Legislature could decide to convert all funding for agency services to one of the new system options and then appropriate the General Fund amount to agencies, in the interest of greater transparency or giving more control to agencies. On the other hand, maintaining the General Fund appropriation would give the OAG capacity and discretion to identify agency needs that are in the State's interest, without regard for the agency's ability to pay for those services. General Fund could also be used to pay for services that are considered "unallowable" when billing federal funds. **The OLAG and LFA recommend retaining the mix of General Fund and dedicated credit appropriations for state agency services.** As such, only the dedicated credit portion of OAG revenue would be converted to the new billing system.

What is an Internal Service Fund?

An Internal Service Fund (ISF) agency provides services to agencies across the State. These services are ones needed by most agencies that can be provided in a more cost-effective manner through centralization. The Department of Technology Services, Division of Fleet Operations, and Department of Human Resource Management are examples of current ISFs in Utah. These agencies set rates for services and bill other agencies on a cost reimbursement basis, according to the amount and level of service provided. Billing agencies, rather than having a direct appropriation, allows the ISF agency to access other funding sources such as federal funds and restricted revenue sources. This system also provides greater transparency as to the amount and level of service each agency receives and provides greater consistency in what agencies pay.

Each year, ISF agencies appear before a rate committee to propose any changes to their rates. ISF agencies, like other agencies that charge fees, are required to establish rates that are “reasonable, fair, and reflect the cost of services provided” ([UCA 63J-1-504\(2\)](#)). There is some flexibility for expenditures to be above or below revenue, but the aim of an ISF is not to maximize profits. After the rate committee makes its recommendation, the Governor also makes a recommendation. The Legislature then reviews the rates in an appropriations subcommittee meeting – for the OAG, EOCJ would evaluate the rates. Rates are then reviewed and approved by the full Legislature in the fee bill during each General Session.

ISF agencies provide services based on an agency’s demand for those services. Agencies are appropriated funds to cover ISF expenses – including increases each year based on rate increases – but are not obligated to expend those funds on ISF services. Because agencies pay only for services rendered and have the ability to request services at will, ISF agencies do not have a guaranteed revenue stream. Collections can vary from appropriations and over different years. In recession years when agencies receive less funding, ISF agencies generally do not experience rate decreases but could experience decreased demand for services, possibly resulting in the need to reduce FTEs.

Agencies can also choose to spend more funds on ISF services if they have unspent funds or can re-prioritize expenses; for example, an agency might make additional payments to the Department of Technology Services (DTS) in a particular year if they choose to update their website. The ISF agency has discretion to prioritize among agency requests, but it cannot identify projects of interest to the State without funding from an agency.

ISF agencies may only hire new FTEs or contract employees with legislative approval during the annual appropriations process ([UCA 63J-1-410\(3\)](#)). If an ISF agency begins providing a new service or product, it may hire contract employees during the interim and then report on the new contractors to the appropriate appropriations subcommittee for review ([UCA 63J-1-410\(4\)](#)). This regulation provides strong legislative control over staff increases, but limits flexibility to meet increased demand in the time between General Sessions. One means to address this lack of flexibility is to include intent language in an appropriations act that gives an ISF agency authority to hire up to a certain number of new FTEs during the year under certain conditions. The Division of Facilities Construction and Management (DFCM) usually requests such intent language.

To balance revenue variation, ISF agencies can hold additional funds left at the end of the fiscal year as “retained earnings” ([UCA 63J-1-601\(2\)](#)). There are different state and federal regulations governing retained earnings, but ISF agencies do not need to request authority from the Legislature to carry forward those funds, as agencies do with nonlapsing balances. ISF agencies may also have negative operating results at the end of a fiscal year. For the acquisition of capital assets, ISF agencies have authority to borrow available cash from the General Fund and special revenue funds, with legislative approval ([UCA 63J-1-410\(8\)\(d\)](#)).

In the case of the OAG, the office would set rates for legal services, potentially with several tiers based on the expertise level of a given attorney. The OAG would then track hours of service and bill agencies accordingly. Current infrastructure would make this process difficult, but such documentation should be facilitated by the implementation of a new electronic case management system that was funded in the 2015 General Session.

An ISF would partly address an issue raised by the auditors, that compensation increases for the OAG granted by the Legislature are not always fully realized under the current state agency billing system.

Historically when the Legislature increases compensation for employees at ISF agencies, ISF rates are adjusted accordingly and additional funds are appropriated to state agencies. With an ISF, compensation increases for the OAG could be accounted for in increased rates, but total revenue collections would still not be guaranteed.

An ISF requires detailed accounting and precisely identifies what services are provided and billed. Consultants that the OLAG spoke with for their audit and individuals at the Division of Finance have noted that certain services that the OAG might want to bill agencies for would be considered “unallowable” charges under federal rules. Under another system, such as a CAP, the OAG might be more able to bill for these charges because there is less transparency. However, the OLAG and LFA recommend that only federally allowable charges be billed to agencies and that unallowable charges be covered by direct General Fund appropriations to the OAG. This recommendation holds for all of the billing systems discussed, as one of the aims of instituting a new billing system is to reduce the risk of losing federal funds.

One item for consideration is that of flexibility in hiring new FTEs and contract employees to meet the needs of the State. Currently, if agency demand exceeds OAG capacity and an agency has available funds to pay the salary of a new attorney, the OAG will hire an FTE on a time-limited contract. If that attorney is needed on an ongoing basis, the agency or the OAG will make an ongoing funding request in the next General Session. This practice limits legislative oversight of staff increases, but provides the OAG and state agencies flexibility to meet unanticipated needs in a time-effective manner. The tighter staffing controls applied to ISFs could end this practice. However, given the ability for an ISF agency to hire contractors when it “begins a new service or introduces a new product,” it could be argued that new contracted attorneys could still be hired depending on the service needed ([UCA 63J-1-410\(4\)](#)). This question merits legal review in advance of implementing an ISF at the OAG. Additionally, the OAG could request intent language that provides authority to hire up to a certain number of FTEs under certain conditions.

The collection of agency billings as dedicated credits should be addressed. The legislative auditors recommended reclassifying state agency billings as transfers, which would solve the issue of complying with statute. If an ISF is implemented, however, it would be more consistent to allow collection of dedicated credits by the OAG, as other ISFs do. It is possible that the OAG’s status as an ISF would supersede the Budgetary Procedures Act, which prohibits the collection of dedicated credits by the OAG, or a change in statute might be necessary ([UCA 63J-2-102\(2\)\(b\)](#)). Again, this question should undergo a legal review to determine what statutory clean-up is required.

A last point is that the federal government already considers legal services provided to state agencies as an ISF. The Division of Finance is required to submit information to this effect to the federal government, but the current lack of documentation means that the division cannot provide the required detail on the form.

Internal Service Fund	
Pros	Cons
1. Agencies, and Legislature through appropriations, would have more control over how OAG services are distributed.	1. Reduced autonomy for OAG to decide service distribution and ability to prioritize based on the State’s interest.
2. Would require detailed record-keeping of billable hours by agency and greater accountability for service level delivered.	2. Significant effort would be required to make the change, leading to time and resources spent by OAG and agencies.
3. Improved transparency and consistency.	3. Legislature controls appropriations to agencies, but agencies could redirect funds to obtain more services without legislative oversight.

4. Consistent rates charged across agencies; could have different rates for tiers of attorneys, based on experience, etc.	4. Service level would be based on agencies' ability to pay.
5. Agencies would only pay for services they received.	5. OAG would need legislative approval for new hires, including contractors, depending on how new statute was written/implemented.
6. Treats similar interagency services the same, such as DTS, Fleet, etc.	6. Total revenue collections would not be known, as is currently the case.
7. Ability to charge all sources of finance (General Fund, federal funds, restricted accounts, etc.)	7. Compensation increases could be built into rates, but unknown total collections would still limit full implementation.
8. Improved accounting for federal funds; reduced likelihood of potential loss of funds.	
9. Flexibility for agencies to request more services, if internal resources can be made available and OAG has capacity.	
10. Greater legislative oversight of staff increases.	

What is a Cost Allocation Plan?

A Cost Allocation Plan (CAP) operates similarly to an ISF, in that it distributes costs to agencies based on a formula and can access non-state funding sources. CAPs, in general, require less specificity in accounting. They can be implemented in a number of ways, with corresponding variable levels of accountability. The OLAG recommended that if the Legislature chooses to implement a CAP for OAG state agency services, that additional requirements for detailed reporting be included in statute. The office also recommended appropriating OAG revenue as transfers rather than dedicated credits, to be consistent with current statute.

To operate as a CAP, an agency determines its total costs of operation and the percentage of service that is provided to each agency, and then divides total costs by those percentages and bills agencies accordingly. The CAP must document services provided to determine the percentage distribution, but the distribution and billing amount is determined prospectively at the start of the fiscal year rather than on a cost reimbursement basis, as with an ISF. Adjustments to expected service distribution are only made in the next fiscal year. Adjustments due to over- or under-billing of agencies based on actual service provided are also accomplished in the next fiscal year, through credits or additional charges as needed.

CAPs are not widely used in the State, but some agencies use them internally. The Division of Finance operates a somewhat similar system, known as the State-Wide Cost Allocation Plan (SWCAP). Because the use of CAPs is limited, details about the hiring of FTEs and contract employees, what services may be included in CAP billing, how the level of service provided will be evaluated, how services provided will be tracked, and other aspects would need to be considered and included in statute or rule.

Comparing a CAP to an ISF, there are a number of trade-offs. As with an ISF, agencies receive appropriations to cover the costs of a CAP, but unlike with an ISF, agencies must remit that amount to the CAP. CAPs therefore have guaranteed revenue streams: in addition to easier internal budgeting, any compensation increases granted by the Legislature could always be fully implemented. With an ISF, agencies only pay for services they request and as a result they have significant control over service level and distribution. With a CAP, in contrast, it is the CAP agency that exercises the most control over the level and distribution of services.

With a CAP, as compared to an ISF, the Legislature has greater control over the total amount of state funds expended on services, since it determines the total allocation to the CAP. Setting a total appropriation for CAP services prevents any increase in staff not authorized by the Legislature, but also reduces flexibility for the CAP to provide unanticipated, needed services between General Sessions. If there are new needs from a certain agency, the CAP agency can modify service distribution but some reduction in service will accrue to other agencies. Further, although the Legislature authorizes the CAP's service distribution by appropriating CAP funding to agencies, there is limited accountability for whether the expected level of service is actually provided.

The auditors determined, through discussions with consultants, that at least several other states operate their OAG services as CAPs and that CAPs provide sufficient documentation from the perspective of the federal government. The consultants were not aware of any states that use an ISF for attorney general services. As noted in the ISF section, a CAP could facilitate billing federal funds for some "unallowable" services, but LFA recommends only billing for allowable services regardless of the billing system chosen, to operate in compliance with federal law and reduce the risk of losing federal funding.

Cost Allocation Plan and Reporting Requirements	
Pros	Cons
1. Would require detailed record-keeping of billable hours by agency and greater accountability, but less so than with an ISF.	1. Similar to an ISF in many ways, may not be worth creating a unique system separate from the typical practice of ISFs.
2. Total amount of legal services provided could be fully controlled by the Legislature, including controlling expansion of OAG staff.	2. Significant effort would be required to make the change, leading to time and resources spent by OAG and agencies.
3. More autonomy for OAG to prioritize agency needs than with an ISF.	3. Cap on resource level would prevent OAG from expanding services and staff for legitimate needs.
4. Improved transparency and consistency.	4. Less control by agencies and the Legislature over service level and distribution than with an ISF.
5. Consistent rates charged across agencies; could account for different rates for tiers of attorneys, based on experience, etc.	6. Adjustments to reflect actual service delivered must be made at the end of each year.
6. Can charge all sources of finance (General Fund, federal funds, restricted accounts, etc.)	
7. Improved accounting for federal funds; reduced likelihood of potential loss of funds.	
8. Guaranteed revenue stream for OAG internal budgeting.	
9. Compensation increases for the OAG could be consistently implemented.	

What are other billing options?

New line item (absent other changes) and statutory requirements for reporting. Both the ISF and CAP options would require a new line item to track state agency billings through the new system. This option would involve creating a new line item and appropriating funds to that line item as transfers rather than dedicated credits as the only budgetary changes. If the Legislature chooses this option, the OLAG and LFA recommend requiring detailed accounting and reporting on the level of an ISF to achieve the preferred

level of accountability for legislative and federal purposes. This option would be simpler to implement than an ISF or CAP and provide some additional clarity in accounting. Whether transparency and consistency sufficiently improved would depend on the language and implementation of the reporting requirements entered into statute.

New Line Item and Reporting Requirements	
Pros	Cons
1. Some improvement in transparency.	1. Improvements in accounting of billable hours by agency and documentation of level of service provided would depend on how new reporting requirements are written and implemented.
2. Relatively simple, compared to other fixes; business practice would remain largely unchanged.	2. Limited improvement in risk of loss of federal funds.
3. Can charge all sources of finance (General Fund, federal funds, restricted accounts, etc.).	3. No improvement in ensuring compensation increases are realized.
4. Would require fewer additional resources from OAG and agencies than ISF or CAP options.	4. Limited improvement in legislative oversight of service level and distribution.
5. Retains current flexibility to increase temporary staff with demand and available funding from agencies.	5. No improvement in legislative oversight of OAG staff increases.

Direct General Fund appropriation for all state agency services. This approach would be the simplest and provide the greatest discretion for the OAG. It would allow the Legislature to have oversight of total funds spent on legal services, but there would be less oversight of the level and distribution of service provided to agencies, with corresponding limited accountability for the OAG. It would, however, provide the OAG with a known budget and simplify compensation increases provided by the Legislature. Most importantly, federal funds and restricted revenue sources that agencies use to pay for legal services could not be accessed under this model. The amount of service would have to be reduced or the Legislature would have to appropriate additional General Fund to the OAG. For FY 2016, this would be about \$14.4 million.

Direct General Fund Appropriation to OAG	
Pros	Cons
1. Simple, transparent.	1. OAG would not be able to tap into non-General Fund sources, causing a reduction in available funds (about \$14 million); could require additional General Fund appropriations.
2. Total amount of legal services provided could be fully controlled by the Legislature, including controlling expansion of OAG staff.	2. Agencies have limited input on needed service levels.
3. OAG has complete discretion to decide agency service levels and distribution.	3. No flexibility to provide additional needed services.
4. Compensation increases would be fully realized, but full burden would be borne by state funds.	4. Legislature has limited oversight of service level and distribution across agencies.

Status Quo. Retaining the current system, which is not transparent or consistent, would not solve the concerns of limited legislative oversight, inequitable billing of agencies, and the risk of losing federal funds.

At a minimum, the OLAG and LFA recommend the new line item option, with appropriations as transfers and new reporting requirements.

Status Quo	
Pros	Cons
1. Flexibility for OAG to create arrangements on a case-by-case basis.	1. Lack of transparency and legislative oversight.
2. Agencies can request services as needed, if they can find additional funds; OAG can then hire temporary personnel.	2. Lack of consistency. Some agencies are likely over-billed; others are likely under-billed.
3. Can charge all sources of finance (General Fund, federal funds, restricted accounts, etc.).	3. OAG can hire new temporary personnel based on agency demand without legislative oversight.
4. Combination of both agency and OAG deciding service levels.	4. Limited and inconsistent tracking of level of service provided to agencies.
5. Would not require additional resources.	5. Could lead to federal review and loss of federal funds.
	6. Compensation increases are not fully realized.

Recommendation

The OLAG and LFA both recommend an ISF as the preferred solution for addressing concerns related to the OAG’s billing of state agencies for legal services. Legal services are delivered and can be billed in a manner similar to the current ISF system that is in place with other agencies. An ISF would provide the most detailed tracking and accountability as compared to the other options, while facilitating some discretion for the OAG by retaining partial direct General Fund appropriations. The ISF can be developed in conjunction with the implementation of the OAG’s new electronic case management system, ensuring the needed functionality is included and enabling detailed tracking at the level recommended in the audit. If the Legislature chooses another option, ISF-like accounting requirements should be included in the new statutory language to attain the desired improvements in transparency and consistency. Further, the OLAG and LFA recommend continuing the practice of appropriating some General Fund to the OAG for state agency services, to preserve discretion for the OAG in identifying agency needs that are in the State’s interest and to cover expenses that cannot be billed to federal funds.

Timeline for Implementation

1. January 2016-June 2016 – Collect baseline of agency needs by tracking attorney workload, in spreadsheets or by other informal means. Outline needs from the case management system and work with vendor to implement. Begin to determine ISF rates.
2. July 2016-June 2017 – Track attorney workload using the case management system. Determine needed accounting structures and ISF rates that will cover costs.
3. September 2016 – Present proposed rates at rate committee hearing.
4. 2017 General Session – Include rates in fee bill.
5. July 2017 – Begin operation as an ISF for state agency services.