APPENDIX S

Request for Attorney General's Opinion Pertaining to Income Earned By Funds Invested in the GeFONSI

MEMORANDUM

State of Alaska

Department of Revenue
Office of the Commissioner

TO: Bruce Botelho
Attorney General

THRU: Jim Ayers
Chief of Staff

FROM: Wilson L. Condon
Commissioner

DATE: April 22, 1998

TELEPHONE : 465-2300

FAX NUMBER: 465-2389

SUBJECT: Opinion Request Regarding the Income of the General Fund and Other Non-Segregated Investments "Fund" (the GeFONSI)

1. Overview

The Treasury Division in our Department (Treasury) and the Division of Finance in the Department of Administration (Finance) need your opinion and advice on several matters relating to a November 24, 1997 request from Molly McCammon, Executive Director of the Exxon Valdez Oil Spill Trustee Council. (Appendix 1)

Since 1992, portions of the Exxon Valdez Oil Spill Trust (EVOS Trust) have been invested in a commingled asset pool managed by the Treasury Division; this pool is commonly known as the *General Investment Fund.*[1] The settlement documents governing the Trust require the State to credit the Trust with "*all interest accrued*" by the Trust. During the four-year period July 1993 through July 1997 the State (acting through Treasury and Finance) did not credit the Trust with the *actual interest* or *actual income* earned by the *General Investment Fund.* Instead the State credited the EVOS Trust and other similar funds with a *proxy measure* of *actual income* – the weekly auction rate for the 180-day Treasury Bill. The Trustee Council has requested Treasury to credit the EVOS Trust with its proportionate share of the *actual income* earned by the General Investment Fund over the four-year period July 1993 through June 1997. (See Executive Director McCammon's November 24, 1997 request - included as Appendix 1).

Must we credit the EVOS Trust with *actual income* as the Trustee Council requests? If yes, how do we determine *actual income*? Are the terms *actual income* and *all interest accrued* synonymous? Must we make similar adjustments for any of the other funds that were invested in the General Investment Fund over the four year period pertinent to Trustee Council's request?

[1] As explained in some detail later in this document, only the money from the EVOS Trust expressly distributed to the State of Alaska for expenditure is invested in this pool. At this time, the State of Alaska does not manage any other *joint funds* for the Trustee Council.

The facts surrounding this request are complex, and I have attempted to lay out those facts in detail. Nevertheless, I believe the answers to this request are relatively straight-forward. I hope the member of your staff assigned to answer this request will talk with us before he or she invests a great deal of time on the matter.

2. The GeFONSI (a.k.a. the General Investment Fund), the Legal General Fund, and the Operating General Fund.

It may be helpful to begin with a very brief description of the three different entities: (1) the *GeFONSI; (2)* the *legal general fund;* and (3) the *operating general fund.*

The GeFONSI is the name we now use for the pooled state assets that have commonly been known as the General Investment Fund. The General Investment Fund is, however, not a fund at all in the vocabulary of proper governmental accounting. In governmental accounting a fund is:

> [a] fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations. [2]

The full name of the state asset pool historically called the General Investment Fund is: The General Fund and Other Non-Segregated Investments "Fund".

The word "Fund" is set off in quotation marks because, as explained briefly above, this entity is not strictly speaking a fund. The shorthand name for this creature is: The *GeFONSI.*

Treasury and Finance established the GeFONSI well over a decade ago to invest a wide range of state funds committed to the care and custody of the Department of Revenue. Investing these funds in a single pool achieves significant savings in management and administrative costs. As well, because the times when these various funds draw down their balances differ, Treasury can invest the pooled funds with a significantly longer time horizon than if it were investing each of the funds separately. As a consequence, Treasury can increase the return on these funds over the long term by investing them in a commingled pool.

Over the past several years the GeFONSI has quite consistently held about $1 billion in state assets. About two thirds of that amount has constituted the *legal general fund.* In turn, about one half of the *legal general fund* - 1/3 of the GeFONSI – is the *operating general fund.* The *operating general fund* is the unrestricted general fund that is used to pay the bills pertinent to the state's general fund budget.

The other half of the *legal general fund* consists of 39 *subfunds* that the legislature has created as "funds within the general fund." Prominent examples include the following:

---

[2] National Council on Governmental Accounting, *Statement 1: Governmental Accounting and Financial Reporting Principles* (Chicago: Municipal Finance Officers Association of the United States and Canada, 1979), P. 2.

Railbelt Energy Fund
Oil and Hazardous Substance Release Prevention and Response Fund
Power Cost Equalization and Rural Electric Capitalization Fund

The *legal general fund* – which as I just explained includes both the operating general fund and all the other sub funds created inside the general fund – is the state general fund for legal and accounting purposes; it is the general fund you will find presented in the state's Comprehensive Annual Financial Report.

The final one third of the GeFONSI consists of the assets of 83 funds that break down into the following categories:

- Special Revenue Funds
  (example- Fish and Game Fund)
- Enterprise Funds
  (example – Commercial Fish Revolving Loan Fund)
- Internal Service Funds
  (example – Information Services Fund)
- Trust and Agency Funds
  (example – Exxon Valdez Settlement Fund)
- Treasury Funds
- Component Unit Funds

The description of this series of Russian dolls nesting one inside the other may be confusing. The graphical representation on the next page depicts how these funds fit together. In addition, Appendix 2 to this request is a detailed table reflecting information about all the various funds invested in the GeFONSI.

The GeFONSI

GeFONSI (General Investment Fund)

General Fund Group
(also referred to as the "legal" general fund)

Includes 39 “subfunds” of the General Investment Fund that are considered legally part of the State general fund but have been segregated for various purposes by statue. Some examples include:

- General Fund (operating)
- Storage Tank Assistance Fund
- Debt Service Fund
- Power Cost Equalization Fund
- Alaska Marine Highway Fund

General Fund
(also referred to as the "operating" general fund)

One fund within the General Fund Group. Most State receipts and disbursements pass through this fund.

Holds and invests the cash of approximately 122 State funds that is not required to be held separately. These funds are broken down into the following groupings:

- **General Fund Group**
- **Special Revenue Funds**
- **Capital Project Funds**
- **Enterprise Funds**
- **Internal Service Funds**
- **Trust & Agency Funds**
  (the EVOS fund is in this group)
- **Treasury Funds**
- **Component Units**

The area inside the blue line (orange, yellow and white areas) represents the GeFONSI (General Fund and Other Non-Segregated Investments).

The area inside the green line (yellow and white areas) represent the "legal" general fund.

The area in white represents the "operating" general fund.

3. Exxon Valdez Oil Settlement Fund

As part of the restitution for damages caused when the Exxon Valdez hit Bligh Reef on March 24, 1989, Exxon will pay $900 million to the state and federal governments in a civil settlement agreement (United States of America v. Exxon Corporation, Civil Action No. A91-082CIV and State of Alaska v.Exxon Corporation, Civil Action No. A91-083CIV).

The settlement agreement sets out Exxon's payment schedule:

Amount	**Date Due**
$90,000,000	December 16, 1991
150,000,000*	December 1, 1992
100,000,000	September 1, 1993
70,000,000	September 1, 1994
70,000,000	September 1, 1995
70,000,000	September 1, 1996
70,000,000	September 1, 1997
70,000,000	September 1, 1998
70,000,000	September 1, 1999
70,000,000	September 1, 2000
$70,000,000	September 1, 2001

* Less certain of Exxon's expenditures

Pursuant to the settlement agreement, this fund is under the continuing jurisdiction of the United States District Court for Alaska (Judge Holland) and is directly managed by the Exxon Valdez Trustee Council (three state and three federal representatives). The funds are invested under the supervision of the federal courts in the Court Registry Investment System (CRIS), and held in the Federal Reserve Bank in Texas. The funds kept by CRIS are held in two separate accounts, the liquidity account and the reserve account. The liquidity account, which is invested in 100-day securities, contained $54,930,666 at the end of 1997. The restorative reserve account, invested in strip securities laddered over six years, had a value of $52,375,454 at the end of 1997. The Trust has been required to pay the federal courts a sliding-scale management fee (ten percent of the interest accrued by the Trust for the first five years reduced by 2.5 percent each five years thereafter) and a service fee of 2½ basis points for any securities purchased for the Trust.

The Exxon Valdez Trustee Council is responsible for the deciding how to spend this money and for overseeing expenditure of the money in the Fund. Each time the Trustee Council requests a payment from the CRIS for expenditure by a State agency, the money flows into a State fund called the Exxon Valdez Settlement Fund, the subject of this opinion request.

Through December 1997, a total of $333,395,650 has been requested from CRIS by the Trustee Council. Of that amount, $172,791,328 went through the State fund that is the subject of this opinion request. The balance of $160,604,322 went to various agencies of the United States Government for expenditure.

4. Which of the Funds Invested in the GeFONSI Keep Their Earnings?

a. Attorney General's Opinions and Memoranda of Advice

Currently, Treasury credits 40 of the 128 funds investing assets in the GeFONSI with a share of the *income* earned by the GeFONSI. Fourteen other funds received similar credits at some time between July 1986 and December 1997.

On at least three separate occasions the Office of Attorney General has expressed its opinion in relation to the authority of Treasury to credit the *income* earned by investing the assets of these funds back to the funds themselves. In a 1982 formal opinion, your office concluded that the federally imposed requirement that the state credit the Fish and Game Fund with "interest earned upon the money in the fund" did not violate the dedicated fund prohibition set forth in Article IX, section 7 of the Alaska Constitution. 1982 Op. Attorney General No. 13 (Nov. 30). In 1985, in an informal opinion, your office similarly concluded that a state law requiring that Treasury credit the "income from investment of money in the [power development revolving loan] fund" to that fund did not violate the dedicated fund prohibition. See Memorandum from Susan D. Cox, Assistant Attorney General to Mary A. Nordale, Commissioner of Revenue, July 19, 1985, A.G. File No. 366-171-85.

Finally, you advised our department in 1984 that when state agencies receive money *in trust*, Treasury generally has the authority to invest the trust property and the obligation to credit the income realized from that property back to the trust. See Memorandum from Jonathan B. Rubini, Assistant Attorney General, to Milton Barker, Deputy Commissioner of Revenue and Richard I. Peques, Director of Administrative Services, Department of Law, September 10, 1984, A.G. File No. 366-103-85.

b. Memoranda of Understanding between Treasury and Finance together with attached schedules.

The legal opinions described above formed the basis for a series of seven Memoranda of Understanding (MOUs) between Treasury and Finance spelling out the specific provisions by which Treasury has credited investment earnings to various funds invested in the GeFONSI. The effective dates on this series of MOUs were:

July 1, 1986
July 1, 1988
July 1, 1990
April 1, 1991
September 1, 1992
July 1, 1993
July 1, 1997

A set of these MOUs is included as Appendix 3.

The list of funds to which Treasury was obligated to credit a share of the GeFONSI income has been specified in schedules attached to each of the MOUs. For the July 1, 1986 MOU, the pertinent schedule was Attachment A. For the subsequent MOUs, the schedule was Attachment C. Treasury and Finance amended these schedules from time to time without altering the underlying MOU. Appendix 4 to this memorandum is a table summarizing the Attachment A and Attachment C MOU schedule and showing, by date, the funds to which Treasury was obligated to credit a share of the income earned by that fund's investments in the GeFONSI.

5. How do you Determine the Income a Fund Earns?

a. The July 1986 through June 1993 MOU procedures.

All five versions of the Treasury – Finance MOUs covering the July 1986 through June 1993 period specified both a means for calculating GeFONSI *income* or *earnings* and a means for allocating that *income* to the various funds with assets invested in the GeFONSI. First, it is important to remember that over the entire period – 1986 to the present – Treasury has invested the GeFONSI in fixed income instruments.

The five MOUs covering July 1986 through June 1993 provided that the monthly income to be distributed to the pertinent funds was the sum of the following:

1. Interest accrued during the month;

2. Monthly amortization of premiums; (Where Treasury had purchased a fixed-income instrument at a premium, that premium was to be amortized over the time period from the purchase of the instrument until the maturity date of the instrument. For example, assuming today's interest rate is 8%, a U.S. Treasury Bond with a par value of $100,000 maturing in five years with a coupon rate of 10% would sell for $108,113. The premium of $8,113 would result from the fact that prevailing interest rates today would be lower than when the United States issued the bond. Under the procedures specified in the MOUs, if Treasury purchased this bond today, the premium of $8,113 would be amortized each month over the remaining life of the bond.)

Monthly accretion of discounts; (Where Treasury had purchased a fixed income instrument at a discount, that discount was to be accreted over the time period from the purchase of the instrument until the maturity date of the instrument. For example, a U.S. Treasury Bond with a par value of $100,000 maturing in five years with a coupon rate of 10% would sell for about $92,642 today assuming the current market interest rate is 12%. The discount of $7,358 results from the fact that prevailing interest rates today would be higher than when the United States issued the bond. Under the procedures specified in the MOUs, if Treasury purchased this bond today, the $7,358 would be accreted each month over the remaining life of the bond.)

3. Any gains or losses realized during the month as a consequence of selling any of the fixed income instruments in the portfolio. (Gains or losses were the difference between [1] the sales price and [2] the purchase price minus amortization of premiums or accretion of

discounts as appropriate. Unrealized gains and loses were not distributed to the participating funds.)

The MOUs covering July 1986 through June 1993 provided that Treasury distribute the GeFONSI monthly income, calculated as specified above, in pro rata shares to the various funds' month-end cash balances in the GeFONSI.

b. The July 1993 through June 1997 MOU procedures.

Apparently in late 1993 or early 1994 Treasury discovered it had failed to credit the funds entitled to receive a share of the *income* from the GeFONSI for the five-year period July 1988 through June 1993 with their respective shares of the net gains realized on the sale of bonds in the GeFONSI portfolio. (The correction of this mistake is discussed briefly in Section 6(a) below.) The discovery of this mistake prompted an examination of the GeFONSI income determination and distribution policies.

In February 1994, Treasury apparently proposed new terms for the governing MOU effective back to July 1, 1993; Finance, in turn agreed to the proposed terms. Instead of calculating and distributing the *actual income* of the GeFONSI each month, Treasury proposed using the weekly auction rate for the 180-day Treasury Bill applied to the *daily* balance in each pertinent fund to determine the amount of each funds' GeFONSI income credit. The MOU reflecting these new terms was executed by the Commissioner of Revenue on February 9, 1994 and by the Commissioner of Administration on February 15. We are informed by the Trustee Council that when then Trustee Council Executive Director, Jim Ayers, learned of this change, he met with then Commissioner Rexwinkel to express concerns about the change. According to the Trustee Council, Rexwinkel told Executive Director Ayers that the Trustee Council's views would not be considered by the Department of Revenue.

I have included as Appendix 5 a February 8, 1994 memorandum from Mark W. Prussing, the Comptroller in Treasury, to the Commissioner of Revenue justifying these new procedures.

Treasury and Finance used the 180-day Treasury Bill income proxy for distributing GeFONSI income for the four-year period July 1, 1993 through June 30, 1997. The EVOS Trust challenges the legality of this practice. From our department's records, we cannot determine if the Department of Law provided advice to Treasury or Finance with respect to these procedures.

c. The July 1997 and thereafter MOU procedures.

For the period prior to July 1, 1996, Generally Accepted Accounting Principles (GAAP), promulgated by the Governmental Accounting Standards Board (GASB), provided that periodic *income* for invested government funds should be determined in the manner described in section 5(a) above – the same method prescribed in the MOU for determining the GeFONSI's income distribution from July 1, 1986 through June 30, 1993. That is, investment earnings are comprised of dividends or interest (including accruals), plus or minus net realized capital gains or losses. The earnings exclude unrealized capital gains and losses.[3]

As a consequence of many factors – among them the 1994 Orange County bankruptcy – GASB changed the rules for determining the periodic income of invested governmental funds. Effective July 1, 1997, the new rule, GASB No. 31, requires that governmental bodies determine the income for invested governmental funds by *marking-to-market*. This means that in order to comply with GAAP, governmental bodies must now determine periodic income by measuring the difference in the fair market value of the invested assets from the beginning to the end of the pertinent period. Thus, *income* as defined by GASB No. 31 now includes unrealized capital gains and losses.

For the one-year period July 1, 1996 through June 30, 1997 governmental bodies had the option under GASB standards of determining and reporting *income* for invested governmental funds using the old procedures described in section 5(a) above (excluding unrealized capital gains and losses) or the new *marked-to-market* procedures (includes unrealized capital gains and losses). The State of Alaska used the new *marked-to-market* procedure beginning July 1, 1996 for most purposes including its Comprehensive Annual Financial Report.

The new *marked-to-market* procedures were also adopted by Treasury and Finance for determining and distributing GeFONSI income effective July 1, 1997 – one year after the State adopted these procedures for general accounting purposes. This change is reflected in the last of the MOUs in Appendix 3 to this request.

d. What would these different procedures for determining income mean for the EVOS Trust?

The following table reflects alternative income calculations for the EVOS Trust assets invested in the GeFONSI for the four year time period during which Treasury and Finance employed the 180-day Treasury Bill procedure for determining and distributing GeFONSI *income*. The "T-Bill Rate" column in the table reflects the month-by-month breakdown of the $4,169,783.43 actually credited to the EVOS Trust under the 180-day Treasury Bill procedure.

The "Daily Income Factor" column reflects the month-by-month breakdown of the $4,756,937.28 that would result from using the *marked-to-market* procedure now required under GASB standards. As you can see, this procedure for determining *income* would require that Treasury transfer an additional $587,153.85 to the EVOS Trust Fund.

The "GAAP Income" column reflects the month-by-month breakdown of the $4,559,500.01 that would result from using the Generally Accepted Accounting Principles for determining *income* for invested governmental funds promulgated by the GASB. The "GAAP Income" procedure would require the transfer of an additional $389,716.58 to the EVOS Trust Fund. Notice that for the period July 1996 through June 1997 the "Daily Income Factor" amounts are

[3] GAAP required that investments be recorded a the lower of cost or market at the reporting date. Therefore, if the market value of the overall portfolio was materially less than the cost value, an unrealized loss might in fact be recognized.

the same as the "GAAP Income" amounts as a consequence of Finance having adopted the changes in the GASB standards described above.[4]

[4] The staff of the EVOS Trust has raised three objections with respect to the information reflected on the next page:

a. Use of month-end balances to calculate projected "actual income" shares under the old GAAP procedures.

For the calculation of income shares under both the 180-day *T-Bill rate* and the *daily income factor*, the table reflects calculations in which the earnings rate (weekly for the T-Bill rate and daily for the daily income factor) was multiplied times the daily balance. The GAAP income share for the period prior to July 1, 1996 was derived by multiplying the GAAP monthly income rate times the funds' month-end balance. We could easily recalculate the income share under the GAAP income procedures for the period prior to July 1, 1996 using either the daily balances or the average monthly balance together with the monthly GAAP income rate; we could only derive a daily GAAP income rate for the period prior to July 1, 1996 at a very high cost. We strongly believe it would waste scarce resources to undertake that task. Further, we believe the earnings share derived using daily GAAP earnings applied to a daily fund balance would not be materially different from the amount calculated using month-end balances and a monthly earnings rate. Finally, the method we used in calculating GAAP income is the same method that was used to credit earnings for the Constitutional Budget Reserve Fund following the Hickel v Halford litigation in 1993 and 1994; this method of calculating actual earnings was expressly sanctioned by the Legislative Auditor. See Audit Control Number 04-4495-94.

b. The GAAP Income column in the table may not correctly reflect the adjustment required in July 1996 when the GAAP procedures changed.

They may be correct. This is an item we need to discuss if the Attorney General concludes Treasury should have used actual earnings.

c. Since GAAP procedures did not recognize unrealized gains and losses prior ro July 1996, the negative income for July 1994 reflected in the GAAP Income column must be erroneous.

In July 1994 the Treasury Division reconstituted its fixed income portfolio in a manner that required recognizing all of the then-pending unrealized gains and losses in the portfolio. Because interest rates had just recently spiked up as a consequence of the Federal Reserve actions, the sum of the unrealized gains and losses were necessarily a net loss. This action, while it reflects negative earnings for July 1994, did not affect the net earnings over time for the EVOS Trust.

EVOS Trust Income – Three Approaches

	INCOME CALCULATION METHOD		
MONTH/YEAR	180-day T-BILL RATE	DAILY INCOME FACTOR (using marked-to-market methodology)	GAAP INCOME
Jul-93	38,501.80	40,311.52	51,251.30
Aug-93	31,719.47	42,752.66	27,714.58
Sep-93	21,068.68	24,215.99	18,419.05
Oct-93	19,029.53	18,045.67	21,644.41
Nov-93	28,561.46	22,629.53	18,826.97
Dec-93	16,817.37	19,297.71	23,357.47
Jan-94	22,397.52	37,410.04	24,985.65
Feb-94	19,088.73	(1,829.42)	19,094.74
Mar-94	20,753.91	6,475.43	17,657.35
Apr-94	18,714.04	7,487.86	14,379.64
May-94	15,877.83	10,752.29	8,184.78
Jun-94	17,707.22	18,656.93	32,596.28
Jul-94	52,823.32	61,925.14	(18,803.71)
Aug-94	48,450.45	41,631.55	32,435.84
Sep-94	40,408.26	17,631.62	25,548.43
Oct-94	44,290.74	38,222.59	75,183.64
Nov-94	63,286.12	20,253.59	44,396.26
Dec-94	67,496.28	53,101.50	58,012.96
Jan-95	89,340.74	141,075.93	108,402.97
Feb-95	100,713.64	195,213.53	114,128.83
Mar-95	104,569.98	113,308.52	101,655.90
Apr-95	95,432.42	132,688.16	95,732.78
May-95	92,595.32	216,654.52	106,798.66
Jun-95	80,612.82	95,135.18	79,572.63
Jul-95	76,424.12	51,853.66	79,329.04
Aug-95	68,770.81	89,879.47	75,587.30
Sep-95	59,944.75	69,901.24	61,735.51
Oct-95	133,486.41	189,017.68	209,179.12
Nov-95	154,119.18	277,400.54	170,687.91
Dec-95	143,916.96	226,538.61	168,816.30
Jan-96	134,300.31	228,241.74	177,405.58
Feb-96	122,348.26	151,775.24	138,244.52
Mar-96	132,468.91	1,922.02	161,304.73
Apr-96	126,549.66	70,017.78	151,207.56
May-96	136,731.89	83,949.31	158,921.43
Jun-96	145,501.15	208,498.66	171,010.31
Jul-96	128,195.45	61,993.18	61,993.18
Aug-96	106,079.47	91,341.86	91,341.86
Sep-96	110,890.29	158,529.04	158,529.04
Oct-96	181,597.93	323,646.33	323,646.33
Nov-96	162,806.05	242,537.62	242,537.62
Dec-96	153,991.02	72,007.37	72,007.37
Jan-97	147,934.03	154,081.90	154,081.90
Feb-97	125,136.65	99,320.38	99,320.38
Mar-97	131,456.84	33,814.24	33,814.24
Apr-97	122,110.70	185,818.89	185,818.89
May-97	114,954.25	151,787.56	151,787.56
Jun-97	99,810.69	160,014.92	160,014.92
TOTAL	**4,169,783.43**	**4,756,937.28**	**4,559,500.01**
	DIF greater than T-Bill by:	587,153.85	
		GAAP greater than T-Bill by:	389,716.58
		GAAP less than DIF by:	(197,437.27)

6. Other Pertinent Facts

a. The 1988 to 1993 failure to credit capital gains to funds invested with the GeFONSI.

As explained above, in late 1993 or early 1994 Treasury apparently discovered that they had failed to properly credit realized capital gains to funds invested with the GeFONSI. This discovery appears to have prompted the adoption of the 180-day Treasury Bill procedure selected in February 1994 retroactive to July 1, 1993.

Commissioner of Revenue Darrel Rexwinkel on June 30, 1994 - his last day in that office – notified the Department of Administration of the gains-crediting oversight. In that notice he recommended against retroactive credits to correct the mistakes. Administration Commissioner Robert Libbey rejected Rexwinkel's proposal, and Treasury made the required adjustments.

Appendix 6 contains the important documents pertinent to this episode.

b. The EVOS Trust – Treasury communication.

Appendix 7 contains all the pertinent correspondence between the EVOS Trust staff and Treasury relating to the set of transactions that is the subject of this opinion request.

7. Miscellaneous Thoughts on the Issues

a. Periodic "Income" is a term that does not have a definite single meaning.

Effective July 1, 1997, GASB procedures require that *periodic income* be determined by *marking-to-market.* For the first three years of the time period pertinent to this opinion request, July 1, 1993 through June 30, 1996, *income* under the GASB rules was defined using the principles set forth in section 5(a) above. For the fourth year, July 1, 1996 through June 30, 1997, either of the two definitions was acceptable under GASB rules.

Because generally accepted accounting principles allowed for discretion in reporting of investment income during part of this period, some state entity had to exercise the discretion to select between the allowed methodologies. I believe this discretion rested with the Division of Finance in the Department of Administration because of that division's overall responsibility for accounting for the State's finances. Obviously, there is also a limit on Finance's discretion to define *income.* Did Finance exceed that limit when it acceded to Treasury's request to use the 180-day Treasury Bill Rate as a proxy for *actual income*?

If using the 180-day Treasury Bill Rate as a proxy for *actual income* fell outside of Finance's band of discretion, then it seems to me it might make sense to correct that error by defining *income* with reference to the choices Finance made with respect to the State's Comprehensive Annual Financial Report – the old GASB rule for the period July 1, 1993 through June 30, 1996 and the new GASB 31 rule for July 1, 1996 and thereafter. Using those choices for the definition of *income* would result in EVOS Trust income in the amounts set forth in the "GAAP Income" column on page 9.

b. The special status of trusts.

It is certainly possible that you will conclude that when a trust is involved the State must credit the trust with some measure of actual income – not an income proxy. If you reach that conclusion, then would a different rule apply where the pertinent fund is not a trust?

c. All the funds invested with the GeFONSI during the July 1, 1993 through June 30, 1997 got a good deal.

My staff strongly urges that I point out that, without pooling, most of the pertinent funds invested in the GeFONSI would not have earned as much as the 180-day Treasury Bill Rate. When considered by themselves, investments for almost all of these funds – including the EVOS Trust – would have a very short time horizon. As such, most of these funds, had they been managed separately, would have been invested in 90-day Treasuries at a lower, so-called risk-free rate. Since the EVOS Trust would not have earned even the 180-day Treasury Bill Rate without the help of Treasury's GeFONSI, my staff argues, the EVOS Trust should not be entitled to any income in excess of that rate. This argument is similar to the contentions currently being made to the United States Supreme Court in the recently argued Phillips case, a challenge to the use of the income from the pooling of lawyers' small trust accounts to support legal services through the Interest on Lawyers' Trust Accounts (IOLTA) program. In the IOLTA dispute, the proponents of the IOLTA program contend that small, individually managed lawyers' trust accounts would likely earn little or nothing. Therefore, the IOLTA income is simply "found money", and the beneficiaries of those trust accounts have no expectations of or property right to the income earned from the IOLTA pools. Here, of course, in contrast to the facts in the IOLTA dispute, the EVOS Trust and the other pertinent funds received a substantial proportion of the income attributable to the benefits of pooling. Furthermore, the MOU guaranteed the 180-day Treasury Rate each day even if the GeFONSI earned less (it often did) or suffered a loss (it did from time to time).

Contrast these arrangements with the arrangements, described in section 3 above, provided by the federal courts with respect to the investment of the bulk of the EVOS Trust. Most of the federally invested money will earn less than the GeFONSI 180-day Treasury Bill Rate. The management fee that would have been charged by the federal courts (10% of the interest earned) in almost equal to the additional amount over the 180-day Treasury Bill Rate that the EVOS Trust is requesting here. And Treasury charges no management fee for the EVOS Trust money invested in the GeFONSI.

d. The logistics of computing and crediting income calculated in a different way.

If you conclude that Treasury should not have used the 180-day Treasury Bill Rate for the pertinent four year period, we hope you will confer with us to establish a set of procedures that will permit us to make a legally sufficient set of adjustments without an unnecessary commitment of scarce staff resources. In particular, we would like to discuss the information set forth in the table on the next page.

Summary of Data Availability and Income Determination Methods

FY	Actual Paid Under MOU (T-Bill): Balances Used	Actual Paid Under MOU (T-Bill): Rates Used	Data Available (theoretical)[5]: Balances	Data Available (theoretical)[5]: Rates	Rate Applied for Original Re-calc (Daily Factor): Balances Used	Rate Applied for Original Re-calc (Daily Factor): Rates	Rate Applied for Most Recent Re-calc (GAAP Income): Balances Used	Rate Applied for Most Recent Re-calc (GAAP Income): Rates	GAAP Requirement for State CAFR Presentation
93	Month end Balance	Pro rata share of GeFONSI earnings[6]							
94	Daily Balance	180-Day T-Bill[7]	Daily Balance	GeFONSI Mark to Market Daily Rate[8]	Daily Balance	GeFONSI Estimated Mark to Market[9]	Month end balance[10]	No GAAP Rate of Return[11]	LCM[12]
95	Daily Balance	180-Day T-Bill[7]	Daily Balance	GeFONSI Mark to Market Daily Rate[8]	Daily Balance	GeFONSI Mark to Market	Month end balance[10]	No GAAP Rate of Return[11]	LCM
96	Daily Balance	180-Day T-Bill[7]	Daily Balance	GeFONSI Mark to Market Daily Rate[8]	Daily Balance	GeFONSI Mark to Market	Month end balance[10]	No GAAP Rate of Return[11]	LCM
97	Daily Balance	180-Day T-Bill[7]	Daily Balance	GeFONSI Mark to Market Daily Rate[8]	Daily Balance	GeFONSI Mark to Market	Daily Balance	No GAAP Rate of Return[11]	LCM, but the State implemented GASB No. 31 early which presents invested assets at fair (market) value
98	Daily Balance	GeFONSI Mark to Market Daily Rate	Daily Balance	GeFONSI Mark to Market Daily Rate	N/A	N/A	N/A	N/A	Fair (market) value

[5] Data availability is based on hindsight without consideration for the cost benefit of the resources required to obtain the data.
[6] Per MOU dated October 2, 1992 effective September 1, 1992. Earnings are defined as realized gains or losses, accrued income [refers to interest rather than income since the later term includes capital appreciation/depreciation], amortization of premiums, and accretion of discounts.
[7] Specifically, the rate was derived from the Bond Yield Equivalent resulting from the weekly 180-day Treasury Bill auction for the previous week.
[8] Treasury *could* have obtained the daily income factor from the custodian bank at any time (if it had been requested). Note that the GeFONSI was not daily priced during FY 1994.
[9] Since the GeFONSI was not daily priced during FY 1994, the *estimated* daily income factor is derived from themonthly rate divided by the number of days in the month. This methodology was used for the re-calculation because the custodian bank could not readily re-calculate a daily rate as records needed for the re-calculation either have been destroyed or archived.
[10] Daily balances are available for FY 1994-96; however, daily GAAP income is not available. GAAP income excludes investment income on certain assets specific to the General Fund (such as mortgages), CFAB, and those pledged on behalf of AHFC.
[11] No GAAP rate of return is calculated or available. GAAP income, for purposes of this recalculation, is determined as follows:

$$\frac{\text{EVOS Month end Balance}}{\text{GeFONSI Month end Balance}} \times \text{GAAP Income for the Month}$$

[12] Lower of cost or market. Invested assets are reported at cost unless the market value is materially less at fiscal year end.

e. Interest and income – Are they terms of art with respect to GeFONSI distribution?

Some of the funds currently receiving a proportionate share of the *total return* from theGeFONSI are governed by statutes that specifically authorize them to receive *interest earned,* (e.g. the Fish and Game Fund). Are we authorized to distribute a share of the GeGONSI's total return (interest and capital gains) to these funds?

Similarly, Molly McCammon states in her November 24, 1997 letter to me that the Settlement Trust is entitled to "all interest accrued" by the Trust (Appendix 1). Since much of the income at issue here reflects capital gains and losses (both realized and unrealized), does that make any difference?

From a practical perspective we very much hope that you conclude that the term "interest", for purposes of this request, be read broadly enough to include capital gains and losses. Administratively, it will be very difficult to credit some of these funds with "income" that includes capital gains and losses and others with "income" that does not include capital gains and losses.

cc: Mark Boyer, Commissioner, Department of Administration (w/o attachments)
Ross A. Kinney, Deputy Commissioner, Department of Revenue (w/o attachments)
Molly McCammon, Executive Director, Exxon Valdez Oil Spill Trust (with attachments)
David Essary, Director, Division of Finance, Department of Administration (with attachments)
Betty Martin, Comptroller , Treasury Division, Department of Revenue (with attachments)

Appendices

1. November 24, 1997 letter from Molly McCammon, Executive Director, Exxon Valdez Oil Spill Trust, to Wilson L. Condon, Commissioner of Revenue.

2. Table Reflecting Attributes of Funds Invested in the GeFONSI.

3. Set of Treasury – Finance MOU's (1986-1997) without attached schedules.

4. Schedule of Category 1 Funds Reflected in Attachments "A" and "C" to the Treasury – Finance MOU's.

5. Memo to Darrel J. Rexwinkel, Commissioner of Revenue from Mark W. Prussing, Comptroller, Treasury Division, Subject: General Investment Fund Interest Distrubution dated February 8, 1994.

6. Memoranda and Correspondence Relating to the 1994 Corrections for Failure to Allocate GeFONSI gains for Fiscal years 1989-1993.
7. Memoranda and Correspondence relating to the Investment of Portions of the EVOS Trust in the GeFONSI.