

Betsy,

This is to follow up on our conversations about a draft bill that would clarify and expand the State's authority to audit certain public and private entities. My advice, if the decision is to proceed with legislation, is that the Committee consider:

1. Naming the *public* entities that the draft bill identifies as "instrumentalities"; and
2. Requiring State agencies to include audit language in their contract and grant agreements with the *private* entities identified in the draft bill.

Audits of public entities.

Current law directs the State Auditor of Accounts to perform or contract for financial and governmental audits of State agencies and State government generally. Section 1 of the draft bill would direct the State Auditor to audit "instrumentalit[ies]" as well. Section 2 would require these "instrumentalities" to make their records available to the State Auditor for audit purposes.

The Legislature has created several entities as public instrumentalities. For example, the Vermont Economic Development Authority was created by the Legislature as "a body corporate and politic and a public instrumentality of the state." 10 V.S.A. § 213(a). Other examples of entities that the Legislature created as bodies corporate and politic and as public instrumentalities include:

- the Vermont Housing and Conservation Board, 10 V.S.A. § 311
- the Vermont Housing Finance Agency, 10 V.S.A § 611
- the Vermont Educational and Health Buildings Finance Agency, 10 V.S.A § 3852
- the Vermont Veterans Home, 20 V.S.A § 1712
- the Vermont Municipal Bond Bank, 24 V.S.A § 4571

The Legislature created the Vermont State Colleges as "a public corporation" and designated the corporation as "an instrumentality of the State." 16 V.S.A § 2171(a) and (c). Likewise, it created the Vermont Student Assistance Corporation as "a nonprofit public corporation" and designated it as an "instrumentality." 16 V.S.A §§ 2821, 2823, 2826. The Legislature created the Vermont State Housing Authority as a "a public body corporate and politic", but did not designate it as an "instrumentality." 24 V.S.A § 4005(b).

The Legislature has the authority to impose audit requirements on all of these public entities and in some instances it has done so specifically. For example, under current law the State Auditor "may at any time examine the accounts and books of the [Vermont Economic

Development] Authority.” 10 V.S.A. § 217(c). Current law provides that VSAC’s books must “be audited annually by an independent public accounting firm.” 16 V.S.A § 2835.

In summary, “instrumentality” is a term that has been used frequently but not always consistently in the statutes. It is not defined by statute and is subject to interpretation. It may capture or miss entities that the Committee may want to exclude or include from the reach of audit legislation.

Therefore, if the decision is to proceed with legislation, my recommendation is that the Committee refer to the affected instrumentalities by name and not refer to them generally as “instrumentalities.” Also, the Committee may want to indicate whether any new audit language is intended to replace or add to existing audit language. This would help to avoid future arguments about legislative intent.

Audits of private entities.

Section 5 of the draft bill would authorize the State Auditor to “examine the accounts and books” of “public or private nonprofit agencies” that the Department of Mental Health and DAIL commissioners designate as “community mental health agencies.” This audit authority would apply to “matters relating to” the work that these agencies perform “on behalf of the State.”

My understanding is that most or all of these community agencies are private nonprofit corporations -- not public entities -- and that the services they perform are reimbursed pursuant to contract or grant agreements with DMH, DAIL and perhaps other State agencies. Agency of Administration Bulletins provide that State agencies must include standard terms in their contracts and grants. See Bulletin 3.5 (contracts) and Bulletin 5 (grants). One of the standard terms obligates contractors and grantees to keep books and records and to make them available to the State for audit purposes. See Contracts/Grants Attachment C at para. 10 (records available for audit). Therefore, it is likely that the State Auditor and other representatives of the State already have the legal authority, pursuant to contracts or grants, to audit the relevant records of community agencies.

Here are the links to Bulletin 3.5, Bulletin 5 and Attachment C:

<http://aoa.vermont.gov/bulletins/3point5> ;

http://aoa.vermont.gov/sites/aoa/files/Bulletins/Bulletin_5_eff12-26-14.pdf;

http://bqs.vermont.gov/sites/bqs/files/pdfs/purchasing/Multi-Use%20ATTACHMENT%20C_Contracts_Grants_UGrev_9-1-15.pdf

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Be aware that the standard audit language was omitted from a pharmacy benefit manager contract a few years ago, and that caused some concern. However, that omission was sanctioned by a statute that has since been amended. *See* 18 V.S.A. § 9472(c) prior to amendment by 2013, No. 144 (Adj. Sess.), § 12. The norm is that State contracts are reviewed by the Agency of Administration and by the Attorney General's Office for compliance with the requirements of Bulletin 3.5, including the audit language requirement. Grant agreements are not reviewed by the AG's Office; however, as noted above, Bulletin 5 requires State agencies to include the standard audit language in grants as well as contracts.

If the Committee concludes that something more than the current Bulletins and practices are needed to assure audit access to the books and records of the designated mental health agencies, the bill could be drafted to require State agencies to include audit language in their community mental health agency contracts and grants. This would continue the State's current practice of designating and working with entities – including private entities – willing to accept the standard audit language. And, it would avoid questions that might be raised if the Legislature granted the State Auditor a unilateral authority to inspect the books and records of these private entities.

Section 6 of the draft bill would authorize the State Auditor to “examine the accounts and books of VITL.” VITL has been the subject of much legislation that raises questions about its legal structure. However, it is registered with the Secretary of State as a domestic nonprofit corporation – a private entity – and should be treated accordingly. Therefore, my recommendation is that the Committee treat it like the designated mental health agencies. If the Committee concludes that something more than the current Bulletins and practices are needed to assure audit access to VITL's books, legislation could be drafted that would require State agencies to include audit language in their contracts and grants with VITL.

Please let me know if you or the Committee have related questions.

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