State of Arizona Accounting Manual

INTRODUCTION

Article IX, Section 5 of the Constitution of the State of Arizona states that, except in certain conditions relating to warfare, the aggregate amount of debt contracted or entered into by the State shall never exceed three hundred and fifty thousand dollars ($350,000).

This amount, originally established in 1912, might, without further explanation, seem insufficient to manage the affairs of a state with an annual monetary throughput measured in the tens of billions of dollars. It is the purpose of this section of SAAM to provide the needed explanation.

First, "debt," according to an opinion of the Attorney General of the State of Arizona, means the "borrowing of money evidenced by some paper." Debt, therefore, refers to the borrowing of money, not the mere acquisition of goods or services; the paper is an agreement having the characteristics a promissory note, not simply those of an invoice or statement. So, liabilities incurred as accounts payable in the normal course of business are not included in the calculation of debt.

Second, "debt," as intended by the constitutional provision, refers to a debt secured by the full faith and credit of the Government of the State of Arizona. If a is debt is secured or collateralized only by the property, real or personal, used as collateral and, in the event of default, the only financial consequence to the State is the loss, by way of repossession, of the possession and/or use of the collateral, then there is no impairment of or claim against the full faith and credit of the State of Arizona. More simply put, when the State has no financial liability beyond the loss of the collateralized asset, the amount owed is not debt subject to the constitutional limitation.

Third, there are means of financing operations, construction and activities other than traditional general debt obligations.

- Revenue bonds are debt instruments secured by specific income sources of the securer; if the anticipated revenue does not materialize, the bondholder has no claim against other revenues or assets of the issuer.

- A privatized-lease-to-own (PLTO) contract is a public-private financing agreement that is essentially a sale-leaseback arrangement involving the purchase or construction of real property. If the lease payments are not made, the lessor loses its right to occupy the property; the lessor is entitled to no other damages.

- Certificates of participation (COPs) are financing arrangements under which a share of future specified revenues—such as rental income from particular buildings—are sold to investors. Should the revenues never materialize, the investors have no recourse against the State.

Fourth, and finally, most significant acquisitions made and contracts entered into by the State are subject to "fiscal-funding-out" provisions. These provisions mean that expenditures related to these contracts and acquisitions may not be made if adequate cash is not available to liquidate the debt or sufficient spending authority is not granted by the legislative appropriation process.

In spite of a number of processes, prohibitions and proscriptions that appear to shelter State Government as a whole from certain liabilities, the fact remains that the State pays its bills when due and is actually subject to statutory requirements to discharge its obligations on a timely basis.

Because the State Procurement Office has included fiscal-funding-out clauses and other protections in the terms and conditions of the contracts it awards, agencies are rarely in a position to violate the constitutional debt limitation. However, such violations might from to time occur: these are frequently related to equipment leases that contain provisions for damages beyond mere repossession in the event of early contract termination. Violations also occur when an agency enters into certain lease purchase contracts or installment purchase agreements, where the State's potential exposure extends beyond simple repossession.

It is important to realize that debts or liabilities required to be reported as such by Generally Accepted Accounting Principles might not be debts as contemplated by the constitutional debt limitation.

POLICY & PROCEDURES

1. If an agency does not have specific statutory authority to issue a debt instrument (i.e., a bond, COP, PLTO, etc.), it may not do so. If unsure, an agency should verify its authority with the Attorney General.

2. Agencies are not to enter into any agreement that:

2.1. Does not contain a provision that exempts the State from any liability (beyond recovery of any collateralized or leased property), should funds not be available or not have been appropriated to make scheduled payments (i.e., that do not contain a fiscal-funding-out clause).

2.2. Does not comply with the Arizona Procurement Code.

3. Before execution by an agency, any agreement involving periodic payments to finance the acquisition of assets must be submitted to in-house legal counsel or the Office of the Attorney General for review.