

JOINT
HOUSE FINANCE COMMITTEE
SENATE FINANCE COMMITTEE
January 16, 2008
1:11 p.m.

CALL TO ORDER

Co-Chair Chenault called the Joint House and Senate Finance Committee meeting to order at [1:11:01 PM](#).

HOUSE MEMBERS PRESENT

Representative Mike Chenault, Co-Chair
Representative Kevin Meyer, Co-Chair
Representative Bill Stoltze, Vice-Chair
Representative Harry Crawford
Representative Les Gara
Representative Mike Hawker
Representative Reggie Joule
Representative Mike Kelly
Representative Mary Nelson
Representative Bill Thomas Jr.

SENATE MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Charlie Huggins, Vice-Chair
Senator Fred Dyson
Senator Kim Elton
Senator Donald Olson
Senator Joe Thomas

MEMBERS ABSENT

Representative Richard Foster
Senator Bert Stedman, Co-Chair

ALSO PRESENT

Representative Anna Fairclough; Representative Bob Buch; Governor Bill Sheffield; Karen Rehfeld, Director, Office of Management and Budget, Office of the Governor; Joan Brown, Chief Budget Analyst, Office of Management and Budget; John Boucher, Senior Economist, Office of Management and Budget; Craig Campbell, Adjutant General, Commissioner, Department of Military & Veterans Affairs; Jack Kreinheder, Chief Analyst, Office of Management and Budget.

SUMMARY

FY 2009 Budget Overview and Policy Discussion
Office of Budget and Management

Co-Chair Chenault convened the Joint House and Senate Finance Committee meeting in order to review Governor Palin's FY09 budget proposal overview and policy discussion provided by the Office of Management and Budget.

Co-Chair Chenault reminded all listeners that the documents referred to in the meeting are posted on the Legislative Finance Website at www.legfin.state.ak.us/Finance/FinanceDocuments.

KAREN REHFELD, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, provided members with a handout of the presentation (Copy on File). She noted that the Governor, in preparation for the first 90-day session, had asked the Office of Management and Budget (OMB) and state agencies for a reasonable and responsible spending plan for 2009 based on key priority areas: resource development, education, transportation, and public health and safety. The Governor hoped an early release of a comprehensive budget plan would help facilitate the budget process.

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Ms. Rehfeld began with an overview of the Governor's two-year savings proposal. Throughout the special session on the oil tax legislation, the focus was on savings and where the State should invest or save the Alaska's Clear and Equitable Share (ACES) surplus. The intent language in the ACES legislation highlighted key areas for savings, reflected in the chart in Slide 3. The Governor used that intent language to develop an on-line survey participated in by over 11,000 Alaskans. The estimate of the surplus over two years is \$4.6 billion: \$3 billion from FY08 and \$1.6 from FY09. The chart highlights the Governor's proposal to transfer \$2.4 from the Earnings Reserve Account into the principal of the Permanent Fund, \$2.6 billion to the Public Education Fund, \$1 billion for the Alaska Transportation Fund, \$450 million into the Teacher Retirement System (TRS), \$379 to the Constitutional Budget Reserve (CBR), and \$250 million for energy programs.

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Ms. Rehfeld identified the two-year savings plan as the heart of future policy discussions.

The Governor proposed the transfer of the deposit of the Earnings Reserve into the principal of the Permanent Fund when she took office last year. That bill is still before the Legislature. The Governor will be proposing amendments to the legislation and ask for consideration of the transfer.

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Ms. Rehfeld turned to Slide 5, which estimates by fiscal year the surplus the Governor wants to put in various components of her savings plan. The nearly \$2.6 billion total in the Public Education Fund comes from the FY08 surplus of \$1.6 billion added to the \$1 billion FY09 surplus. Similarly, the Transportation Fund totals \$1 billion (\$500 million from each of FY08 and FY09); the Teacher Retirement System (TRS) Unfunded Liability Deposit of \$450 million is from the FY08 surplus; \$379 million to the Constitutional Budget Reserve is the \$224 million FY08 surplus added to \$155 million from FY09; and finally a \$250 million surplus from FY08 will go into the Energy Fund.

Ms. Rehfeld described education (Slide 6) as a clear priority for the Governor. She emphasized that the goal is to provide a stable and predictable source of funding for Alaska's K-12 education. The savings plan builds on the work of the Joint Legislative Education Funding Task Force, which is before the Legislature. She referred to proposed amendments that the Governor would like to offer, specifically in the Base Student Allocation (BSA) and in pupil transportation.

Ms. Rehfeld moved on to Slide 7 and the goal of the Administration to create diverse and flexible funding streams to meet Alaska's transportation requirements and avoid tripling the gas tax. She emphasized the importance of a transportation infrastructure to Alaska's economy. The Governor has introduced a bill that would create an Alaska state transportation fund with a market payout of approximately \$50 million a year. The fund could grow over time with additional deposits. To generate an equivalent amount of revenue through the gas tax, the State would have to increase the per gallon tax from 8 cents to roughly 25 cents.

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Ms. Rehfeld described the Governor's proposed deposit of \$450 million to the Teachers Retirement System (TRS) (Slide 8), reflected in the FY09 budget as a \$46 million savings. She referred to a current unfunded liability in excess of \$8 billion: approximately \$3 billion in TRS and \$5.5 in the Public Employees Retirement System (PERS). The deposit would give Alaska immediate savings. Several things would have to happen in order for that savings to occur. Senate Bill 125, still pending before the Legislature, would make the rates (22 percent for PERS and 12.56 percent for TRS) permanent. This will provide fiscal predictability for retirement costs to municipalities and school districts. The bill would also convert PERS to a cost share system.

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Ms. Rehfeld addressed the Constitutional Budget Reserve (CBR) (Slide 9). This primary emergency reserve fund was created by the voters in 1990 to insulate the State from price swings like the ones that devastated Alaska's economy in the mid 1980s. She said about \$7 billion has been deposited in the CBR and the Legislature has drawn out approximately \$5.2 billion. She emphasized the Governor's commitment to paying back these withdrawals, including a current year deposit of \$50 million. The \$379 million deposit referred to in the slide was recently completed.

Co-Chair Chenault pointed out that current law requires the settlement money be deposited into the CBR account. Ms. Rehfeld concurred, saying there would be further discussions about the appropriation language for the CBR as the Governor's Office and Legislature work on the bills together.

Ms. Rehfeld referenced Slide 10, goals for energy programs. The Governor is proposing that \$250 million from the FY08 surplus be used as the funding source for the Renewable Energy Fund, which will be used for energy projects. She referred to the Governor's recent speech covering the appointment of an energy coordinator, the funding to match Denali Commission funds for conservation, and working with the Alaska Housing Finance Corporation on weatherization programs. The Administration acknowledges that affordable, reliable energy is critical to the State's economic well being.

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Senator Hoffman commented on the \$2.4 billion the Administration proposes to put into the Permanent Fund and asked if those dollars were needed to bridge the gap between now and the first gas. Ms. Rehfeld believed they could make the transfer from The Earnings Reserve Account into the Permanent Fund.

Senator Hoffman further asked if there is a cash-flow chart showing how this gets accomplished. Ms. Rehfeld answered that the cash-flow chart could be provided. She said there are several assumptions that need to be made in order to transition to first gas.

Senator Hoffman agreed the Legislature should be as conservative as possible in order to assure the people of Alaska that if the money is locked away the State won't be faced with drastic reductions in the operating or capital budgets, or forced to enact an income or sales tax. He questioned if the Administration proposes tripling the gas tax if it is unable to put \$1 billion into the Alaska Transportation Fund.

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Ms. Rehfeld thought it unlikely that the Governor would increase the gas tax that dramatically. She believed the Governor's preference, if the Legislature is not amenable to the transportation fund, would be the CBR. The Governor is not interested in increasing the gas tax.

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Senator Hoffman's voiced a question regarding the \$2.6 billion earmarked for the Education Fund. He wondered if this was a long-term savings plan or if the Administration believed there would be withdrawals in the near future. He wanted to know if the State plans on carrying forward a three year surplus in the Education Fund. Ms. Rehfeld said the \$2.6 billion would pay for the three year education funding plan before the Legislature.

Senator Hoffman asked if the Administration intended in 2010 to start withdrawing from that fund until it was depleted or if there were level it should be maintained at for the long term.

Ms. Rehfeld thought it would be important to maintain and forward funds each year. While building the FY10 and FY11 budgets, the State should plan ahead in order to keep replenishing the Fund into future years. She defended the idea of "forward funding" education.

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Co-Chair Meyer followed up on Senator Hoffman's remarks. Regarding locking up the Permanent Fund earnings, he voiced concern that it would be many years until Alaska gets gas revenue, making an obvious gap. More discussion will be needed as well as cash flow analysis to show the viability of putting this money into the Permanent Fund.

Regarding the Public Education Fund Co-Chair Meyer asserted the House came up with the idea two years ago with the intent of prefunding education one year in advance, not three. He suggested that instead of the \$2.6 billion that is being proposed, the State aggressively invest the additional \$1.6 billion and put it in a CBR sub-account for a good return.

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Ms. Rehfeld agreed it was important to openly discuss where to put the funds. Co-Chair Meyer stated his intention to clarify and consolidate Alaska's many funds, hoping for bigger return. He thought the transportation fund, energy fund, and others were good ideas, but that the State could

reach the same goal by taking the money out of the CBR, which he believed the public sees as a savings account. Ms. Rehfeld agreed that the situation is complex.

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Representative Crawford, referring to Slide 8, asked for an explanation of the "immediate FY09 savings of \$46 million" by contributing \$450 million to the TRS. Ms. Rehfeld said because TRS is a general fund program the immediate return would be greater. Representative Crawford understood the reason and wanted to know why the State wouldn't do the same thing with PERS. Ms. Rehfeld responded that the Governor chose to put the surplus in TRS, understanding that the Legislature may choose to put it into PERS.

Representative Crawford asked how the Administration envisions the energy fund working, whether as an endowment or loan fund. Ms. Rehfeld said it would be a fund that could be used as grants or loans with an advisory panel looking at projects. She stated the Governor's interest in working on HB 152 or similar legislation to work out the details.

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Co-Chair Chenault wondered if there was an actuarial statement.

JACK KRIENHEADER, ANALYST, OFFICE OF MANAGEMENT AND BUDGET, OFFICE OF GOVERNOR said there had been verbal discussions with the actuary.

Representative Gara did not see opportunity for people not born with it in the budget. He referred to an early education task force charged with developing an education plan for 3-5 year olds. Forty other states have such a plan, but Alaska does not. Children who receive early education succeed in greater numbers. He questioned the Administration's priorities regarding early education.

Ms. Rehfeld agreed that early learning is foundational for later success. She acknowledged the Administration had not increased the funding for the Best Beginnings group although there is an amount in the operating budget. The Governor did hold the Best Beginnings Summit in December and is developing a state-wide plan for early learning programs.

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Representative Gara said the group has been around for a long time and have made recommendations, but have not acted. He asked if any early learning classrooms would be opened under the budget as written. Ms. Rehfeld answered that the

State does not fund early learning classrooms although some school districts fund them through their K-12 budgets.

Representative Gara suggested increased funding for Head Start instead of continuing to cut the program. Ms. Rehfeld agreed Head Start has been flat-funded for some time. The Best Beginnings group is working on this. She said the Governor's priorities are increases for K-12. Representative Gara reiterated his concerns regarding early education.

Senator Huggins asked for a copy of budget guidelines in order to get more understanding of the Governor's priorities as well as the goals and constraints of the budget.

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Ms. Rehfeld answered the Governor's priorities have been very clear. Senator Huggins said they were not clear to him.

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Representative Hawker questioned the use of the word "savings" used by the Administration. As an accountant, he interprets what he sees in the budget as deferred spending and also as a lateral transfer of money that has already been saved, the Permanent Fund money. Ms. Rehfeld said that Alaska has the opportunity because of a surplus to "set aside" money, knowing the State will have to access these funds in the future for priority areas. The Administration views putting money into the CBR as putting it into a savings account.

Representative Hawker, continuing to address the concept of set-asides, expressed "serious concerns" about the Legislature getting away from the foundations of Alaska's Constitution. He referred to Article 9, Finance and Taxation, Section 7, known as the Prohibition Against Dedicated Funds, which states: "The proceeds of any state tax or license shall not be dedicated to any special purpose." He questioned how the Administration reconciles their whole proposal with the intent of the drafters of the Constitution.

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Ms. Rehfeld said the Legislature does have the power to appropriate from dedicated funds. Representative Hawker and Ms. Rehfeld debated the intent of the drafters of the Constitution regarding dedicated and designated funds and the Governor's intent in the Administration's approach to the budget.

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Senator Dyson agreed with comments made by Representative Hawker. He added for the record that he did not agree that government-controlled early childhood education is the best policy.

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Senator Elton thanked Representative Hawker for his comments and stated that he shares Representative Hawker's concerns. He added that the Legislature knows the intent of the drafters of the Constitution. The Legislature has come up with a political and artful solution that gets around that intent.

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Representative Nelson spoke to early learning programs and lowering the compulsory school age. She asked that parents who would like their younger children to go to an early learning program have a state-funded program to send them to.

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Ms. Rehfeld continued with the budget plan presentation beginning with Slide 11. The total budget of \$8.3 billion includes and savings investments of \$1.9 billion, but does not include the Permanent Fund. The general fund represents 53% of the total budget, federal funds 31% and other funds 16%.

Slide 12 provided a snapshot comparison of FY08 changes. She noted the different percentages.

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Ms. Rehfeld pointed out that Slide 13 breaks out the various components of the budget. The first component is the agency operations non-formula portion totaling \$1.7 billion. She highlighted increases including agency and university bargaining increases, public safety and protection, workforce development, court system, Alaska Marine Highway, elections, ACES implementation and resource development and protection.

She noted the \$105 million built into the general fund budget for supplementals, new legislation and potential operating amendments.

The K-12 component (Slide 16) of approximately \$1 billion represents the proposed increase to the BSA and the amount proposed by the Governor for FY09. The Governor has requested that student transportation costs be reconsidered.

Ms. Rehfeld addressed the formula programs in the \$656 million (Slide 17), pointing to increases to the Medicaid/Proshare program, the Department of Health and Social Services (DHSS), the National Guard benefits and the Alaska Military Youth Academy.

Slide 18 outlined the direct deposit into the Public Employees Retirement System / Teachers Retirement System (PERS/TRS) programs. A deposit of \$408.8 million in FY09 includes \$246 million to PERS, retaining an employer rate of 22%; \$162.4 million to TRS, retaining the 12.56% rate. Ms. Rehfeld delineated what would need to happen for this funding amount to be used in FY09.

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Representative Hawker made a clarification regarding the Joint Task Force on Education, which recommended that the transportation numbers be recalculated this year. He appreciated the place holder to the DHSS budget for review of provider rates and services. He hoped that process, which will take a couple of years, will reinforce the foundations of sustainable government.

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Senator Elton referenced various slides and asked if agency-specific increases had been included in the overall 4% increase in the general fund. Ms. Rehfeld replied that they had been included.

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Senator Hoffman referenced the Governor's State of the Budget presentation on January 15, 2008, particularly programs and expansions she had highlighted. Ms. Rehfeld stated that she had not yet reviewed Legislative Finance's overview of the budget in detail.

Senator Hoffman addressed the "bottom line" increases in the Governor's budget as compared to that of the Legislative Finance Division. He asked how the differences could be reconciled. Ms. Rehfeld responded that generally the two divisions work closely in preparing the proposals. She could not speak to those differences at this time. Senator Hoffman stated that the numbers should be reconciled before the legislative process can begin. He stated concerns about the obligation to the general fund.

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Representative Gara, referencing Slide 12, pointed out the authorization to spend 4.5% and asked if state spending

would actually be increased by 8%. He stated that "other funds" are largely state funds. Ms. Rehfeld agreed.

Representative Gara commented on rates that have been frozen which negatively impacted vulnerable populations, particularly foster care reimbursement. Ms. Rehfeld responded that all the rates were being determined. Representative Hawker emphasized that the \$24.4 million was based on testimony today. The number is a placeholder and will be developed in the on-going budget process. It is a matter of timing and commitment to a long-term plan. He reiterated his full endorsement of the process underway.

Representative Gara stressed the shortage of foster families in Alaska and emphasized the foster family reimbursement rate has not been raised in five years. The compensation rate for personal care attendants has also not risen, making it difficult to hire individuals for home health care for elderly and disabled citizens.

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Co-Chair Meyer referenced Slide 12, noting the increased use of other funds. He expressed concern about whether those funds would be placed into the capital budget or operating budget. Ms. Rehfeld responded that the page represents the entire spending plan.

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Ms. Rehfeld proceeded to Slide 19, the Capital Budget of \$1.4 billion. The Federal Funds represent 58% or \$792 million; the General Funds represent 27% or \$372 million and other funds total \$206 million or 15%. She wanted to make clear that this is an unduplicated number. Slide 20 highlights the different funding sources of the general fund of \$372.3 million. The most significant difference from 2008 is the Governor's proposal of a 50% increase in revenue sharing. The Governor believes communities should be able to use this for their own priorities. Ms. Rehfeld highlighted DOT/PF federal highway match, the water and wastewater program, a major renovation of the McLaughlin Youth Center, and renovation of the Palmer Office Building.

Ms. Rehfeld used Slide 21 to highlight areas of other funds, particularly use of the Alaska Student Loan Corporation's third and final return of capital, estimated to be about \$60 million in bond proceeds that can be used for specific capital projects. A high priority for these funds is maintenance and upgrade of existing buildings.

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Ms. Rehfeld continued with Slides 22 and 23, highlighting the Alaska Capital Income Fund which is expected to have an available balance of \$277 million. The Administration has identified some projects to be funded with this money, including about \$100 million for school construction and major maintenance projects. It also includes about \$40 million for the University of Alaska deferred maintenance list and \$10 million to match energy projects with Denali Commission and through the Alaska Energy Authority.

Ms. Rehfeld referenced Slide 24, federal funds that come into Alaska. The Department of Transportation and Public Facilities is still the largest recipients of federal funds for roads and aviation, at \$515.6 million. Turning to Slide 25, she said Administration is proposing legislation requesting authorization to go to the voters for General Obligation (GO) Bonds. The first GO bond is for \$140 million for transportation, including \$120 for Department of Transportation projects, \$10 million for the Port of Anchorage, and \$8.9 million to the Department of Natural Resources for an access road to South Denali State Park. The other GO Bond for \$100 million is for the State Crime Lab. There has been discussion about GO Bonds. The current cost to borrow is low which helps keep spending down while utilizing bonds for infrastructure projects the State couldn't do otherwise. Ms. Rehfeld expects further discussion on GO bonds, as they require voter approval.

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Ms. Rehfeld then discussed debt retirement fund caps and other funding sources talked about earlier. The Alaska Housing Finance Corporation (AHFC) dividend, for example, is \$68.5 million. The Administration proposes spending about \$48 million of that in the capital budget; \$11.8 million will go to the Debt Retirement Fund Capitalization. In addition, the Administration proposes the Americans with Disabilities Act (ADA) dividend, which is \$23 million, go into the Debt Retirement Fund Capitalization. Finally, the Post Secondary Education Dividend at \$4.1 million would be used in the operating budget.

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Co-Chair Meyer stated concern over using capital budget monies as the State has a surplus of general funds. He liked the idea of bonding, but was concerned about the items proposed for bonding, specifically the Port of Anchorage project. He viewed this as basic infrastructure that should not be dependent on advocacy. Ms. Rehfeld agreed more discussion would be necessary and that the Governor was aware of the issue.

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Co-Chair Meyer expressed concern over the previous year's vetoes, which affected the capital budget. He viewed the capital budget as a means of creating private sector jobs. Ms. Rehfeld agreed the Administration would like to avoid vetoes this year. She proposed continuing communication and pointed out that the Governor has been clear since the vetoes about her priorities and responsibilities to the State. After the vetoes were announced, the public was largely in support of the vetoes but tended not to like their particular project being vetoed.

Representative Hawker agreed with Representative Meyer's concerns about having a dialogue. His district lost \$6 million worth of critical, life-safety improvements because of the vetoes.

Representative Gara asked why he did not see in the increase in state funding the \$408 million to pay down the PERS/TRS debt. Ms. Rehfeld answered that the general fund does include that money. Representative Gara continued the line of questioning.

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Ms. Rehfeld said the overview presented is just a snapshot that cannot explain all the changes.

Representative Gara commiserated with other legislators who had not gotten their projects funded the previous year and said the problem was not only a lack of communication with the Governor but across party lines.

Representative Thomas said that his district also lost a total of \$11.2 million for water, sewer and safety projects the previous year. He wanted to see more emphasis on communities other than Anchorage and Mat-Su.

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Senator Hoffman talked about transparency in budgeting which could help citizens better understand how the budget works. He pointed out that saving and then utilizing savings as spending distorts how much is being spent.

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Senator Thomas agreed with Senator Hoffman's concerns. He asked about the deferred maintenance total and whether there was a plan to approach that. Ms. Rehfeld answered that the deferred maintenance list totals about \$1.2 billion in requests. The budget allocates based on square footage and intends to provide this maintenance on an annual, ongoing

basis, which will be challenging because of all the pressures on the budget.

Senator Thomas wondered if the new energy coordinator would be able to coordinate the activities of the various agencies that deal with energy. Ms. Rehfeld agreed with the necessity of a coordinator.

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Representative Joule, in reference to the capital budget, described erosion issues in his district and wondered if the budget process takes into account these communities. Ms. Rehfeld replied that the Administration has been dealing with climate change and specifically erosion. Senator Stevens came to Alaska to meet regarding the role of various agencies in the efforts to address these challenges. She described coordination of agencies and resources as the current challenge.

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Vice-Chair Stoltze referred to the erosion issue as well and expressed frustrations about the time lapse in response. Ms. Rehfeld said the subcabinet group has been working on those issues.

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Co-Chair Meyer asked for clarification regarding the Governor's position on federal earmarks. Ms. Rehfeld suggested that the State has to be more of a partner with the federal government, offering support in the form of a match, which will further requests for earmarks.

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Senator Elton reiterated previously voiced concerns about deferred maintenance. He also wondered how the Governor's office sets priorities. He suggested that if the State is setting aside funds for important problems, perhaps deferred maintenance ought to be ahead of a transportation endowment that builds new things requiring further maintenance.

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Representative Gara voiced concerns about public safety and child protection. He referred to a recent case involving the murder of a foster child. The State is short about 32 social workers and yet the budget recommends only six. The State Troopers are also having a problem attracting and retaining workers because the salaries are not competitive.

Ms. Rehfeld addressed the issue of the State's ability to attract and adequately pay these positions. She agreed that social workers are needed and said that the Administration is doing everything it can. The DOA has been working to become a more attractive employer. Representative Gara restated his frustration and urged action. Ms. Rehfeld believed there would be legislation addressing the issues of salary and compensation.

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Co-Chair Chenault asked about operating costs that had been put into the capital budget the previous year. He requested a charting of the funding differences between the two budgets. He hoped the budget of the Legislative Finance and the Governor's budget could be reconciled.

Co-Chair Chenault referenced the proposed supplemental budget funding. Ms. Rehfeld pointed out that the supplemental bill was due to the Legislature on January 28th. The placeholder is \$108 million for supplementals not including the tax credit which amounts to an additional \$125 million. She hoped that the numbers submitted would be real.

Co-Chair Chenault reiterated the need for transparency regarding where dollars are taken from and where they will actually be spent. He hoped that the process will move forward quickly.

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ADJOURNMENT

The meeting was adjourned at 3:27 PM