

HOUSE FINANCE COMMITTEE
November 5, 2009
9:02 a.m.

9:02:14 AM

CALL TO ORDER

Co-Chair Hawker called the House Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Representative Mike Hawker, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Bill Thomas, Jr., Vice-Chair
Representative Allan Austerman
Representative Reggie Joule
Representative Mike Kelly
Representative Woodie Salmon
Representative Harry Crawford

MEMBERS ABSENT

Representative Anna Fairclough
Representative Les Gara

ALSO PRESENT

Representative Mike Doogan; Representative Nancy Dahlstrom; Representative Paul Seaton; Representative Scott Kawasaki; Senator Joe Thomas; David Teal, Director, Legislative Finance; James Armstrong, Staff, Co-Chair Stoltze; Amanda Ryder, Fiscal Analyst, Legislative Affairs, Legislative Finance; Annette Kreitzer, Commissioner, Department of Administration; Jim Calvin, McDowell Group, Juneau; Attorney General, Dan Sullivan, Department of Law; Kevin Brooks, Deputy Commissioner, Department of Administration.

PRESENT VIA TELECONFERENCE

Representative David Guttenberg

SUMMARY

^Workshops: Legislative Finance Division; Alaska Geographic Differential Study; Department of Law

9:02:28 AM

Co-Chair Hawker observed that due to the impact of the world oil market the state's finances have evolved from \$1 billion annual deficits to multi-billion dollar surpluses, which has

impacted the way the Legislative Finance Division summarizes and reports to the legislature.

[9:06:15 AM](#)

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE, provided members with a handout entitled, House Finance Committee Work Session - November 5, 2009 (copy on file). Mr. Teal began with a brief update of the current fiscal situation. He summarized page 1 of the handout, the FY 2010 General Fund Revenue - Fiscal Sensitivity. He noted that the information is on the Legislative Finance Division's website, which is updated with each official forecast change. The slide shows the spring forecast.

Mr. Teal stated that the final figures for FY 2009 are not yet known. The certified annual financial report will not be out for another four weeks. At the end of session the Statutory Budget Reserve (SBR) draw was anticipated to be approximately \$950 million. No funds were taken from the Constitutional Budget Reserve (CBR) because of the way the appropriation bill was structured. The total of \$1 million in the SBR must be used before the CBR comes into play. The current estimate is for a draw of something less than \$500 million.

Co-Chair Hawker pointed out that the discussion referred to FY 2009, not FY 2010.

Co-Chair Stoltze recalled when oil price charts were less than \$36 per barrel. Mr. Teal stated that there was no reason to show higher prices back then. Co-Chair Stoltze related that even at \$36 dollars there was a bigger surplus, which heightens the issue of production today.

Mr. Teal explained the lines on the sensitivity chart. The Y axis is money in billions; oil price is on the X axis. The horizontal line just above \$3 billion is the FY 2010 budget. The line that sweeps upward from left to right is revenue at various oil prices. That line crosses at the \$3.05 billion. The break even oil price required is \$57. The official forecast is for \$58.29, which yields a small surplus of about \$150 million.

Co-Chair Hawker noted that the chart refers to FY 2010. He thought the average for FY 2010 so far was over \$70. Mr. Teal agreed that the amount was about \$70 with volume about 4 percent, which is not unusual due to winter production increases. Volume does not appear to be a major factor; however, price is. The projected price is about \$58.29, and the actual price is about \$70 year to date; at this rate the surplus for FY 2010 would be \$1.4 billion; at \$75 the surplus would be \$2 billion.

[9:12:35 AM](#)

Mr. Teal turned to issues that would have an impact on future budgets. He noted that education was not forward funded last year. The amount to forward fund education is \$1.1 billion, which would cut into the surplus. Another factor is that Alaska has had two years of low capital budgets due to vetoes and veto threats, which may require the capital budget to be "beefed up" through a supplemental appropriation. He concluded that it would not be difficult to spend the 1.4 billion surplus.

Vice-Chair Thomas reported that the Executive Director of the Alaska Association of School Boards pointed out the lack of forward funding for education.

Mr. Teal explained that the budget includes a reference to Article 9, Section 17(b) of the constitution:

(b) If the amount available for appropriation for a fiscal year is less than the amount appropriated for the previous fiscal year, an appropriation may be made from the budget reserve fund. However, the amount appropriated from the fund under this subsection may not exceed the amount necessary, when added to other funds available for appropriation, to provide for total appropriations equal to the amount of appropriations made in the previous calendar year for the previous fiscal year.

Mr. Teal related that the FY 2011 forecast is generally held until the Governor's budget is released on December 15 and that no information has been received from the Office of Budget and Management (OMB) in regards to the FY 2011 budget approach, but that a continuing conservative approach is expected.

[9:15:28 AM](#)

Co-Chair Hawker mentioned that the Governor invited the House leadership to a meeting; they received similar information of a limited formula growth picture. Not counting on Federal Medical Assistance Percentages (FMAP) reverting back to the pre-stimulus rate, the Governor's office is looking at a 40 million growth in formula programs, which is inconsistent with the trend that was established in past years. Ongoing actuarial valuations include an increase in the retirement system contributions. Co-Chair Hawker expected a continuation of the same level of operations from the Governor's office.

Mr. Teal observed that FMAP was \$75 million in 2010, which was paid with federal stimulus money by reducing the match rate. When and if the state reverts to the regular match in

2011 it will cost \$75 million in general funds (GF). There is also a \$100 increase in the base student allocation education rate, as well as some differentials and intensive needs items scheduled to go into effect, which would amount to another \$50 million increase. Mr. Teal concluded that there would be a minimum increase in the FY 2011 budget of \$125 million.

[9:17:51 AM](#)

Co-Chair Hawker agreed with the Governor that the federal government would continue the beneficial FMAP rates due to the overwhelming demand placed on the federal system by several states; however, if that does not happen a plan is in place to make an adjustment.

Representative Austerman asked for the FY 2011 dollar amount expected for FMAP. Mr. Teal replied that FMAP would cost \$75 million and K-12 education would be a little over \$50 million. Co-Chair Hawker thought the Governor said it would be \$69 million. Mr. Teal suggested that Medicaid may increase by \$40 million. He concluded that there may be a total increase by as much as \$200 million. He agreed that FMAP was very "iffy". Alaska, unlike other states, is not in dire straits because it does not rely on income tax or sales tax. He anticipated that Congress will feel extreme pressure from other states. He thought there might also be a second round of stimulus money because of huge state deficits.

[9:21:28 AM](#)

Mr. Teal turned to the fiscal summary format. Changes in the state's fiscal situation have driven the alteration to the summary. Drivers include changes in the fiscal situation, how money is used, and attitudes about how and what should be shown. He observed the simplicity of the FY 2005 Summary of Appropriations. He noted that a little over \$400 million was put into the Public Education Fund in FY 2005 due to a spike in oil prices. By FY 2007, general funds had jumped to \$3.5 billion. The division discovered complications with how to deal with large supplemental and other appropriations that cross fiscal years as well as with the definition of savings. For instance, does putting money aside in one year and spending it the next amount to "savings".

Co-Chair Hawker pointed out that savings still need to be "appropriated" in order to be transferred to savings. Appropriations do not therefore equate to spending. He maintained that "moving money from one savings account to another is not spending, even though we still have to appropriate it."

Mr. Teal observed that by FY 2008 a savings category was added to the fiscal summary as a result of legislative

action that deposited funds into the Public Education Fund and the Alaska Housing Finance Corporation (AHFC) subsidiary account, created the Capital Income Fund, and deposited funds into the Constitutional Budget Reserve Fund (CBR), which resulted in billions of dollars that had been appropriated but not spent. He concluded that \$4 billion was set aside in addition to funds that went into the CBR. He recalled concerns that the fiscal summary did not reflect what it should.

[9:25:56 AM](#)

Co-Chair Hawker noted that the fiscal summary is not an accounting document and is not part of the state's formal reporting system; it is a working tool for the legislature that attempts to summarize the budget on one page. Mr. Teal pointed out the difficulty of summarizing the budget on one page. The Legislative Finance Division (LFD) recognized the deficiencies and revamped the fiscal summary, which was presented to the Governor in FY 2009. As a result changes made to the fiscal summary by LFD their summary no longer tracked with that of the governor's Office of Management and Budget (OMB). He explained that the new format by LFD added agency operations, which he felt most people identified with when thinking of the "budget". He added that better accounting for supplemental appropriations were included due to large surpluses. Savings were separated out. These changes allowed a better vision of cash flow. He pointed to line 45 of page 3, which showed that there was a pre-savings deficit of \$950 million in FY 2009. Post savings there was a surplus of \$104 million since \$1,052.6 million was pulled from the Public Education Fund.

[9:29:57 AM](#)

REPRESENTATIVE MIKE DOOGAN asked if it takes an additional appropriation to spend money moved to a separate savings account. Mr. Teal replied that it does not take an additional appropriation in all cases. He explained that the Public Education Fund allows money to be withdrawn according to the K-12 formula without appropriation. Money is appropriated to the fund, but the funds flow out without appropriation. The rest of the savings accounts require an appropriation for any withdrawals. In response to a question by Representative Doogan, Mr. Teal explained that the fiscal summary shows the funding transfer to K-12 Education on line 11.

[9:32:30 AM](#)

Co-Chair Hawker put forth that it would be misleading to leave out the education funds coming from savings since they amount to more than a billion dollars in agency operations. He pointed out that money comes out of savings and flows

into agency operations in line 11. He explained that there would have been a positive number going into the fund had the legislature taken funds from the CBR to replenish the Public Education Fund, which would have resulted in a net zero and a negative number in the CBR. Both transactions would have occurred under the savings line. Any surplus would have flowed back into the CBR.

[9:34:03 AM](#)

Mr. Teal summarized that the most important factors in a fiscal or appropriation summary are:

- amount,
- flavor (federal funds, general funds or other funds),
- location (agency operations, fund caps, debt service, or the capital budget),
- timing (fiscal year in which an appropriation becomes effective), and
- purpose.

Mr. Teal observed that the amount is generally known. Flavor refers to the category or group such as federal funds, general funds or other funds. The flavor of funds is complicated by transfers between funds and the need to account for duplicated funding sources because once a fund is capitalized (funds are put into a fund) the same funds cannot be counted on the way out or they will be double counted. Duplicated funds are hard to track and are always categorized as "other funds". The focus of the House and Senate Finance Committee co-chairs has been to reduce "other funds" or at least explain and identify when they are "general funds". The funds are counted on the way in, which make them hard to count on the way out where they are really spent.

Mr. Teal continued to explain that location refers to agency operations, fund caps, debt service, or the capital budget. Funds are created and then spent, creating an accounting problem on the way out. Timing refers to the fiscal year in which an appropriation becomes effective and is not a problem. The purpose does not cause problems. Flavor and location create the greatest problems; the biggest areas of concern are reappropriations, fund transfers, and fund categorization.

[9:38:18 AM](#)

Mr. Teal reviewed the history and difficulties of reappropriations. He noted that reappropriations have not always been accounted for since they are net zero transactions. In 2000, the division began recording

appropriations from operating to operating reappropriations, and operating to capital appropriations. Capital to capital appropriations remained a problem since there is no record of old capital projects that have been reappropriated or the substitute project. This year (2009), the reappropriations will be entered in the capital tracking system (TPS reports). The new project side of reappropriations will be recorded, which will allow digital searches. Non-legislative reappropriations will be eliminated, but legislative reappropriations will remain with a slight change in the process. Legislative reappropriations allow funds to stay in the district in which they were originally appropriated. Guidelines for legislative reappropriations and repeals were outlined on pages 4(a-c); LFD began implementation of these guidelines for legislative repeals and reappropriations in 2009.

Mr. Teal highlighted his three main recommendations: moving money in a current fiscal year should be done in the supplemental bill, operating carry-forward and other operating reappropriation should appear in the operating bill (so that operating subcommittees can see the full story), and the governor's capital projects should be terminated without tying the money to a new project. The legislature would review all new projects on an equal footing, so that they compete equally with all other capital projects. Reappropriations might not need to be examined, which would be a major change.

[9:42:41 AM](#)

Co-Chair Hawker recalled last year's reappropriation process, which he found excruciating and enlightening. The process demonstrated that the division was not tracking the oil and gas appropriations and reappropriations as well as they should. He observed that there was not sufficient time to make the change in guidelines during the past session.

[9:44:44 AM](#)

Mr. Teal observed that OMB has the guidelines but have not yet committed to following them. The new guidelines would require OMB to turn in a list of "dead projects" instead of a list of money they would like to reappropriate. He explained that if OMB turns in a list of \$50 million in projects that are going to be administratively terminated, \$50 million would be recorded in the fiscal summary as new revenue and the capital projects to replace them would compete with all other capital projects as new money. He concluded that there would be a net zero if the entire \$50 million is spent.

In response to a question by Representative Doogan, Mr. Teal explained that the funds would show as revenue in the year

the project is terminated. Funds terminated on July 1, 2010 would be available for FY 2011; funds terminated on June 30, 2010 could be spent in the supplemental bill. Tracking would not be difficult. The effective date of the appropriation does not pose a problem. He reiterated that the terminated projects would be recorded as "new" capital funds.

[9:49:18 AM](#)

Co-Chair Hawker explained that the intent is to handle projects that have been sitting on the books for as much as 20 years.

Mr. Teal addressed page 9, line 4, which showed terminated capital projects.

[9:51:12 AM](#)

JAMES ARMSTRONG, STAFF, CO-CHAIR STOLTZE, discussed the reappropriation guidelines on page 4 (b) and asked if it would be a separate entity on the district summary. Mr. Teal offered to discuss the issue later in the presentation and indicated that the division needed legislative directive.

Mr. Teal emphasized that it would be less confusing if the governor submitted his reappropriation items in the way the legislature wants to see them in the legislation but acknowledged that the division could correctly account for them if they were received before the budget closeouts occur. Co-Chair Hawker noted the open communication between the Legislative Finance Division and the Office of Management and Budget.

Mr. Teal observed that the greatest effect will be in the supplemental and operating legislation. He suggested that the four finance co-chairmen request OMB to implement the guidelines as soon as they are comfortable with them.

[9:56:28 AM](#)

Co-Chair Hawker expressed support for the work done by the Legislative Finance Division and stressed that the intent is to achieve consistency and an understandable product. Mr. Teal added that it is a matter of simplicity and allowing reappropriation projects to compete with new projects.

[9:57:38 AM](#)

AT EASE

[10:06:35 AM](#)

RECONVENED

Mr. Teal spoke to structure, which is an agency with an appropriation and allocation. Fund capitalizations (fund caps) are treated as a pseudo agency. Savings are put in a separate category because they are not expenditures; this is true of many of the fund caps. He pointed to page 3, which

showed the pre-savings cash-flow or deficit at -\$950 million; this changed to a surplus post savings. The intent is to eliminate confusion by renaming fund caps as transfers. Each fund capitalization results in duplications as funds are counted on the way in and on the way out. The way out is where the money is really spent and where it needs to be accounted.

[10:09:56 AM](#)

Mr. Teal provided an example of a fund capitalization. A \$300 million capital budget that includes \$30 million in spending to the Capital Income Fund would show a reduction of \$30 million plus a \$30 million of other expense in the capital budget. In the new system the funds would show as a transfer and be counted on the way out (where they are being spent). The capital budget would show \$30 million in general funds (rather than "other" funds). Under the current system, the funds going into the Capital Income Fund were general funds, but they were categorized as "other funds" when they were spent since general funds cannot be duplicated.

[10:13:56 AM](#)

Co-Chair Hawker stressed the need for simplification, understandability, and truth in budgeting. Mr. Teal added that it is simply a different way of presenting the material in an improved format.

[10:16:05 AM](#)

In response to a question by Representative Salmon, Mr. Teal explained that the new legislative guidelines for reappropriations affect the administration. Legislative reappropriations for each representative remain the same.

[10:18:09 AM](#)

Mr. Teal gave a further example of a fund capitalization. He observed that \$20 million in general funds is appropriated to the Debt Retirement Fund for 2003 series B bonds; another appropriation is made from the Debt Retirement Fund for the State Bond Committee to pay the debt service. He suggested that a single appropriation could be made from the general fund to the State Bond Committee. There would be one direct appropriation without fund capitalization or duplication.

Co-Chair Hawker pointed out that there could be some issues with accounting problems surrounding debt compliance but felt that technical problems can be solved. Mr. Teal agreed.

Mr. Teal spoke to the pseudo agency "transfers", which are not added in to any reports. He reviewed page 5b. Agency budgets for statewide transfers do not change. Non-additive

fund transfers are excluded from the sum of the appropriations so that the transfers can be accounted where the expenditure occurs rather than as a fund capitalization. This will allow the elimination of duplicated codes, as seen on page 6a and 6b. Page 6c demonstrates the duplicated codes that would remain. There would be a major improvement in simplicity, categorization of funds (general, federal or other), and location of reporting where the money was spent.

[10:22:05 AM](#)

Mr. Teal emphasized that general funds that are spent will show as general funds. He maintained that nothing is changing in the terms of what is being spent. The system is set up and the division is ready for implementation.

Co-Chair Hawker recalled the complication of past budgets that tried to explain the connection between various funds. Mr. Teal interjected that the current fiscal summary is confusing and can be made far more useful with these changes. He noted that OMB's initial reaction was positive. He expressed the hope that OMB would implement the new system.

[10:25:44 AM](#)

Co-Chair Hawker acknowledged that there could be some transition issues but expressed the desire to work with OMB for clarification.

Mr. Teal referred to page 7a, which shows current fund capitalization and noted that page 7b shows that the Disaster Relief Fund would be the sole remaining fund capitalization. He noted that money flows out of the Disaster Relief Fund without further appropriation so there would be no duplication.

Mr. Teal reviewed page 8, savings. There are designated, undesignated savings and transfers.

[10:28:32 AM](#)

Mr. Teal discussed fund categories and stressed that the intent is to provide better budget information. Fund categories are general, federal, or other. In 2005, there was \$1 billion in other funds in a \$2.3 general fund budget. Other funds are currently \$1.25 billion; the general fund budget up to \$2.4 billion.

[10:31:33 AM](#)

Mr. Teal explained that other funds do not get the same scrutiny that general funds receive. He asserted that other funds are often really are general funds, as seen in the

transfers. The Permanent Fund is the only fund created by the Alaska State Constitution that is separate from the General Fund. Many have argued that there are only two categories of funds: federal and general. The Department of Law and the Division of Legislative Audit agree with this interpretation. However, the finance chairmen have instructed finance sub-committees to look at other funds.

Mr. Teal maintained that other funds do count. The lack of scrutiny of other funds is one of the big drivers in the funding categorization process initiated by the co-chairs. All four co-chairs have expressed a desire to straighten out the issue of other funds and to categorize where the money really belongs. The level of discretion that the legislature has in spending money creates the basis for categorization. General funds are discretionary.

[10:36:00 AM](#)

Mr. Teal continued that the categorization is not an arbitrary decision on the part of LFD. Rules apply to the categorization of funds. The official name for general funds is "unrestricted general funds". When the legislature designates a use for an appropriation the funds are no longer unrestricted. He concluded that everything that has a designation does not have to be categorized as other; it could be categorized as restricted (or designated) general funds. The division chose to call these funds designated general funds since "restricted" has a different meaning in accounting terminology.

[10:38:36 AM](#)

Mr. Teal analyzed the fiscal summary on page 9. The summary shows little change in the unrestricted general fund line; the change occurs between other funds and designated general funds. There was a \$700 million move from other funds to designated general fund.

Co-Chair Hawker elaborated that the \$700 million coming out of other funds is state money that can be spent in any way with legislative approval and support of the governor. He spoke of the practice of taking funds "off budget".

Co-Chair Hawker observed that the Senate Finance Committee has taken a different approach and expressed the desire to come to an agreement for clarity.

[10:42:34 AM](#)

Mr. Teal observed that the Senate utilizes a category designated as "flex funds", which are any funds that spend like general funds.

[10:45:11 AM](#)

Mr. Teal stated that all four co-chairs understand the impact and have expressed support for the new process.

Representative Austerman asked what percentage of other funds can be redirected to the new designations. Mr. Teal noted that \$750 million is being redirected. The remaining other funds would be approximately \$500 million, and are trust funds and bond funds that do not have discretion.

Mr. Teal explained that the same thing happened with the capital appropriations. The general fund portion would go from \$173 million to \$266 million. He emphasized that the capital portion is still being worked on and that there will not be as large a jump as the summary on page 9 shows.

[10:47:15 AM](#)

Mr. Teal observed that the general fund budget in FY 2011 appears to increase by \$750 million, but pointed out that this would disappear once the FY 2010 budget is presented in the same manner.

Co-Chair Hawker emphasized the importance of acceptance by both sides of the political aisle. Governor Parnell expressed strong receptivity, and is concerned about bad politics and poor presentation of the governor's budget.

Representative Kelly advised that the changes be made to previous budgets for better comparison.

[10:51:10 AM](#)

Mr. Teal spoke to participation by OMB and acknowledged the difficulty of converting during preparation of the budget. He stated that LFD can make the conversion and stressed that it is important that the budget be converted before it goes into finance operating subcommittees.

Mr. Teal elaborated that conversions of past budgets would be time consuming and that LFD would work on the process next interim. He thought budget comparisons older than 10 years would be irrelevant.

[10:54:49 AM](#)

Mr. Teal continued to discuss the fund code book and the necessary of rewriting the codes.

Representative Austerman commented that a list regarding certain acronyms would be helpful to understand the proposed classification.

Mr. Teal concluded that the transfers are at the bottom of the fiscal summary and are excluded from the totals. The Permanent Fund remains a separate category. He noted that page 10 shows the impact agency by agency.

[10:58:19 AM](#) AT EASE
[11:09:19 AM](#) RECONVENED

Co-Chair Hawker referred to page 11a, and noted that OMB was involved in discussions regarding fund codes. Mr. Teal interjected that the intent is to improve reporting through reclassifying fund codes. He discussed page 11a. The column "Current Group" refers to the current classification. He clarified that RLF is used for Revolving Loan Fund. There are federal revolving loan funds and general fund revolving loan funds. The intent is to have subgroups that can cross the main group to report on all revolving loan funds. Notes are used to explain why a particular fund group was categorized. There is also a column called "eliminate". Most of the items identified for elimination were slid to the back of the spreadsheet. The statute column references the need for statutory change for the reclassification to occur. Column P is structure and subcommittee. An "x" usually means that the item has been moved to transfers. An "s" indicates that the subcommittee needs to address the item. The methodology used was to list codes in a group and then identify anything that moved to the group.

[11:13:45 AM](#)

In response to a question by Representative Crawford, Mr. Teal explained that a code has not been created for the Statutory Budget Reserve (SBR), since it has never been used. He estimated that \$500 million would have to be drawn from the SBR and that a code would be created. Co-Chair Hawker added that funds from the SBR require a legislative majority and signature by the governor. Mr. Teal acknowledged that other codes would have to be added.

[11:15:58 AM](#)

Mr. Teal discussed codes for federal receipts. Funds must be federal to receive a federal designation. Lines 18 to 29 of page 11a are existing federal codes without modification. New federal codes were created for the Election, Clean Water and Drinking Water funds.

[11:18:58 AM](#)

Mr. Teal illustrated how the Alaska Clean Water Revolving Loan Fund was reclassified from "other" to "federal". He stressed the difficulty of categorizing the fund, which appears to be composed of state and federal funds. The fund was capitalized with federal funds (\$10 million). The state

fulfills its required federal match through the sale of bonds (\$2 million). A portion of the money leaves the fund as an appropriation for administrative costs (\$1 million), and a portion is used for loans (also without appropriation). A trace of the funds shows that the money in the fund can be used for three purposes: making loans, administrative costs, and to pay debt service. Money is taken from the fund to pay off the bonds that were issued (\$2 million). He concluded that the state funds cancel and the federal funds remain (\$9 million after a \$1 million reduction in administrative costs) and therefore the fund is capitalized with federal funds and can be designated as federal. He concluded that there were no great changes in federal receipts.

[11:23:14 AM](#)

Mr. Teal turned to unrestricted general fund as shown on page 11a, which are state revenues with no statutory destination. Three codes remained as general funds. The Constitutional Budget Reserve Fund (CBR) was moved to this category. Appropriations from the CBR are open-ended. General funds are appropriated and if the revenue is insufficient then the CBR is used to "backfill". He explained that the CBR is not appropriated by a fund code or amount; it is used to backfill a general fund appropriation. Under the new system any funds spent from the CBR will show as general funds. Management fees are taken out of the CBR by a three-quarter vote, which creates a liability from the CBR and must be swept back from the general fund to restore the CBR. He suggested that a logical conclusion may be that management fees should be appropriated directly from the general fund. This item was flagged with an "s" since the subcommittee may want to consider the issue.

[11:26:37 AM](#)

Mr. Teal informed that the Investment Loss Trust Fund was also designated for subcommittee review, since it is simply revenue. There was never any fund source available other than strictly, unrestricted general fund cash, similar to Alaska Housing Finance Corporation (AHFC) dividends or the Alaska Municipal Bond Bank or the Alaska Industrial Development and Export Authority dividends. Codes and where dividends are spent can be tracked, but the "bottom line is those dividends can be spent for anything you want and should be classified as unrestricted general funds".

[11:27:47 AM](#)

Mr. Teal turned to miscellaneous earnings, which will need to be split between general funds and other bonds that are not general obligation bonds.

Mr. Teal observed that most of the changes occurred as other funds were reclassified to designated general funds as shown on page 11b. Sub-groups were used. The first list refers to revolving loan funds. He pointed out that the loans themselves are not appropriated. Only the administrative costs are appropriated. The administrative costs could be paid as a dividend from the revolving loan fund to the general fund. However, most revolving loan fund statutes allow for payment of statutory costs. Co-Chair Hawker reiterated that it is a choice of the legislature and governor how funds are spent.

[11:29:11 AM](#)

Mr. Teal referred to the Commercial Fishing Revolving Loan Fund on line 58, which has an "x" and "s" under the note column. He explained that the legislature appropriated \$1.3 million from the fund for costs other than administration, since the fund has sufficient capitalization to pull money from it. These funds have been used to pay for non-administrative costs in the Department of Fish and Game. He observed that the change to general fund designation would eliminate this need, since funds were taken from the revolving loan fund to protect general funds. He suggested the subcommittee may want to look at this item since it is being used outside of its current statutory designation. The Bulk Fuel Bridge Loan Fund was flagged for legislative review because it has a zero interest rate; therefore, paying for administrative costs from the loan reduces the funds available.

[11:31:36 AM](#)

In response to a question by Representative Crawford, Mr. Teal explained that the School Fund, Fishermen's Fund and Public Trust Fund are dedicated funds that were previously designated as other. There are several ways a fund can be dedicated: through the Alaska State Constitution, in federal law, or grandfathered in because they pre-existed the constitution. These three funds were grandfathered in because they pre-existed; however, a grandfathered fund does not have to be a dedicated fund. The legislature has the ability to change the use of the fund at anytime for any purpose. Representative Hawker emphasized legislative discretion over the spending of the fund source.

[11:34:07 AM](#)

Mr. Teal observed that the Special Vehicle Rental Receipts need to be split to differentiate between boats and snowmobiles in response to federal regulations (boats are dedicated, snowmobiles are not).

Co-Chair Stoltze expressed the concern proper tracking occurs so that the rights of snowmobile users can be protected. Co-Chair Hawker and Mr. Teal assured him that proper tracking can and would be done.

[11:37:29 AM](#)

Mr. Teal expressed that the intent is not to get rid of fund codes but to correctly categorize the existing codes.

In response to a previous question by Representative Crawford, Mr. Teal explained that the Public School Trust Fund gets a certain percentage of the revenues derived from the payment of cigarette taxes, fees and penalties in licensing. The restriction on use is constitutionally dedicated to rehabilitation, construction, repair, insurance, and cost of school facilities. Approximately \$25 million a year goes into the fund. The Public School Trust Fund is the balance of the Public School Permanent Fund on July 1978 plus one-half of one percent of receipts derived from the management of state land. These funds may not be appropriated for purpose other than the state public school program. Mr. Teal noted that there are also three statutes setting up school construction funds that are duplicates.

[11:40:14 AM](#)

Co-Chair Stoltze asked whether there was still a code for the school tax. Mr. Teal explained that once the use or source of a dedicated fund is broken, funds cannot be returned as dedicated.

Mr. Teal compared the University of Alaska to the Alaska Marine Highway System, which sells tickets and provides a service. An argument can also be made that the university is more like AHFC and other state corporations, which were left in the other category. He observed that it did not really matter which category was used, since a designated general fund code cannot be used outside the program that designates the income. Mr. Teal continued that one way to view designated general funds is that while the legislature can they should not break the designation.

[11:43:23 AM](#)

Mr. Teal observed problems with the uninsurance employment tax related, which flows to the federal government without appropriation. Co-Chair Hawker agreed that there were hundreds of millions unaccounted for in the appropriations in terms of the uninsurance employment tax.

Mr. Teal spoke to receipts support services and asserted that the code needs to be split into three pieces: non-regulated fees that are unrelated to the cost of running the

program, regulated fees that are unrelated to the cost of running the program, and regulatory fees equal to the cost of running the program. Co-Chair Hawker commented that LFD would lead the subcommittee through the discussion.

[11:45:29 AM](#)

Mr. Armstrong asked what happens if the House and Senate give an appropriation different designations. Mr. Teal observed that items could be rectified in conference committee, but hoped that the classification system would not be political. Co-Chair Hawker suggested that hours have been spent on the discussion.

Representative Kelly thought fund code changes made sense but cautioned that agencies need to be assisted. Co-Chair Hawker agreed.

[11:48:58 AM](#)

Mr. Teal addressed the Permanent Fund - page 12 (a-e), which is a reclassification of a billion and a half dollars to general fund since the Earnings Reserve Account is available for legislative appropriation. The \$1.5 billion in the Earnings Reserve Account are dividends that now count as general fund expenditures, and inflation proofing, which is also a general fund expenditure. He added that \$7 million of the permanent fund corporate receipts are used for agency operations in the departments of law, revenue, and natural resources. These expenditures will now show up as general funds, which means there is no real reason to use the Earnings Reserve Account instead of general funds. He observed that permanent fund corporate receipts are being used to support an agency that did not generate the receipts. Alaska Statutes 37.05.145 prohibits this practice.

[11:52:48 AM](#)

Mr. Teal reviewed the subgroups that remain in the other category on 11d: dedicated funds (federal or forced by the US Constitution), trust funds (retirement), bond funds (AHFC), and corporate receipts.

[11:54:50 AM](#)

Vice-Chair Thomas clarified comments regarding halibut IFQ's. He noted that fishers have lost over 54 to 55 percent of their halibut IFQ's, which equates to \$20 million a year in Southeast Alaska's economy. Ninety percent of the IFQ's are owned by residents of SE Alaska, most of them rural.

[11:57:38 AM](#)

AT EASE

[1:09:58 PM](#)

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Co-Chair Hawker observed that there was confusion in the previous budget cycle regarding university funding because the budget submitted by the governor was not in line with the proposals of the Board of Regents. The intent of the Board of Regents is to work with the Office of the Governor to bring forth a budget to the legislature. The Board of Regents will establish a three-member liaison team to enable better communication with the legislature.

[1:17:39 PM](#)

Senator Joe Thomas and Mr. Teal reviewed the Senate Finance Committee's workshop with the university (10/14/09 and 10/15/09). Senator Thomas felt that the meeting was beneficial. Mr. Teal concurred and added that there was honest discussion. The university considers itself to be an important priority and maintains that there is a rigorous process of evaluating campus needs. The Board of Regents indicated that they felt the legislature should approve its request [without change]. He stressed that the Board of Regents needs to understand that the legislature deals with the university's budget as submitted by the governor. It is not a reduction of the university's budget if the governor's submission is fully funded (instead of the budget presented by the Board of Regents in their Redbook.) Mr. Teal acknowledged that the university monitors a statewide program but disagreed that it is uniquely special. He observed that Senator Johnny Ellis agreed with this assessment and pointed out that the legislature has the statewide prospective and must balance the priorities of all agencies including the university.

[1:23:08 PM](#)

Mr. Teal reported that the university was not going to submit a large capital budget as they had in the past. The university intends to submit a request including one building and some deferred maintenance needs. He noted that Senator Ellis felt that the university's capital budget request was a demand and that they would not accept funding outside of their request. He recalled that Senator Ellis suggested that the university should rethink their capital budget strategy.

[1:24:59 PM](#)

Mr. Teal observed that there was also a brief discussion of future general fund requirements. He noted that Senator Stedman raised the point that in the past five years the university's unrestricted general fund portion has increased from 42 to 46 percent. The Board of Regents reported that the intent was to reduce this amount and that they would turn this ratio around. However, discussions with university

budget staff indicated that they are not likely to reduce their general fund amount.

Mr. Teal continued to relate the conversations at the meeting involving fixed costs. The desire of Senator Stedman was for the Legislative Finance Division and the University of Alaska to agree on the presentation of fixed costs or base budget. He assumed that the Redbook procedures would continue as they have in the past.

[1:27:02 PM](#)

Mr. Teal noted that the topic of a public building fund was not brought up during the workshop, but that he had discussions regarding the creation of a fund with Kit Duke, Associate Vice President of building facilities. He observed that the Public Building Fund has seven buildings and eighty million dollars of deferred maintenance. The university has 400 buildings and \$800 million in deferred maintenance. The university has a huge problem with deferred maintenance.

Co-Chair Hawker added that the governor has made it clear that he is contemplating a mechanism to address the backlog of deferred maintenance. He agreed that the meeting with the university was honest and blunt. He suggested elevating university funding as a priority of the entire House Finance Committee.

[1:31:26 PM](#)

Co-Chair Stoltze recalled being offended by the university's attitude about the capital budget. He stressed the inappropriateness of politics in the process. Co-Chair Hawker suggested that the proposed liaison team would help improve communication.

Representative Joule suggested that the legislature not ignore past work on deferred maintenance, which identified a billion dollars of deferred maintenance throughout the state, not just in the university system. He wanted to refocus efforts to determine the deferred cost of new buildings or laws.

[1:37:41 PM](#)

Representative Kelly commented that he came away from the university meetings with a hopeful attitude. Mr. Teal indicated that progress was made even if there was no agreement. He recalled disagreements in the previous year regarding maintenance costs for the new science building. A [university] public building fund would solve such problems. Representative Kelly reiterated that he was hopeful.

[1:41:25 PM](#)

Mr. Teal defined the proposed fiscal note system. The administration prepares the fiscal note, which is electronically stored. The division is working to streamline the process. Fiscal notes would be reported as a data transaction in the budget system in order to track versions of the legislation and the associated costs.

Co-Chair Hawker observed that fiscal notes are funded through the adoption by the conference committee on the operating budget. The process would allow electronic transfer of information.

[1:44:48 PM](#)

Mr. Teal gave an update on capital projects procedure. Legislative reappropriations are going to require full backup. The list of contacts will need to be updated on any project that was submitted in the previous year. Group emails will be available. The exchange of data should improve and be more streamlined.

[1:46:41 PM](#)

Mr. Armstrong suggested that reappropriations be segregated out in the reporting process as seen on page 4b of the handout, so that the funds do not count against a legislator's district if they are transferred to another district. He gave a hypothetical example. Mr. Teal thought it would be easy to do. Co-Chair Hawker agreed.

Vice-Chair Thomas observed that previously approved capital projects were recently funded with economic stimulus funds. He expressed concern that these projects are not double charged. He also brought up frustrations surrounding projects that are delayed by a failure to obtain necessary permits. He suggested project requests indicate if a permit is needed and if so if it is on hand. Co-Chair Stoltze agreed.

[1:50:23 PM](#)

Mr. Teal stressed that the state's reporting system is very powerful and maintained that Alaska is very open and honest in comparison to other states. The state of Alaska does not sweep capital funding under the rug.

Representative Joule wondered how capital projects get "typed" and assigned to districts. He objected to the assignment of the Dalton Highway to his district and argued that it is a statewide expense. Co-Chair Stoltze agreed that there is difficulty in the assignment of capital projects.

Mr. Teal related that the Legislative Finance Division tries to improve the process. The Legislative Finance Division is unbiased, but must know the legislature's wishes for groupings and reporting.

[1:55:41 PM](#)

Vice-Chair Thomas agreed with Representative Joule's comments. He gave an example of a statewide project that was charged to his district.

[1:57:20 PM](#)

Co-Chair Hawker explained that subcommittees work independently but require a final summary document that should be structurally similar. There is a proposal to have a subcommittee management worksheet. He asked for staff feedback.

AMANDA RYDER, FISCAL ANALYST, LEGISLATIVE AFFAIRS, LEGISLATIVE FINANCE, described the qualities in the worksheet on page 13a. She stated that the transactions will be able to be read clearly due to new formatting. She expressed excitement with the new spreadsheet and discussed various ways in which it will streamline information. The new spreadsheet will allow staff to run "what if" scenarios. The base spreadsheet will contain the governor's budget transactions as a starting point. Any difference between the governor's budget and the subcommittee's recommendation will be highlighted in green. Staff will only input data into the blue cells.

[2:03:08 PM](#)

Ms. Ryder shared that the spreadsheet changes are not set in stone and she hoped that the committee would give the department its feedback. She continued to explain the various qualities of the new spreadsheet.

[2:04:50 PM](#)

Ms. Ryder explained that the governor amendments will also be highlighted in green. She explained that the division will enter the information into the subcommittee reports to make sure that the LFD reports match; any item that does not match will show in red. Co-Chair Hawker added that the color coding has been added to make the spreadsheet easier to read, audit and review.

Ms. Ryder stressed that the color coding in the spreadsheet provides a tool to quickly notice discrepancies. The spreadsheet also allows subcommittee members to annotate their decisions.

[2:09:21 PM](#)
[2:16:12 PM](#)

RECESSED
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ANNETTE KREITZER, COMMISSIONER, DEPARTMENT OF ADMINISTRATION, discussed the challenges facing her department. She said the recruitment and retention of employees has been the biggest challenge. She observed that the geographical differential study came out of Governor Palin's appointed of an executive working group to address recruitment and retention. She noted that \$400 thousand was appropriated in 2008 for a geographical differential study, which would be in addition to any merit increases or cost of living allowance (COLA) adjustments. She noted the difficulty of implementing major initiatives during the 90 day legislative session.

[2:18:23 PM](#)

Vice-Chair Thomas inquired the total cost of implementation. Commissioner Kreitzer acknowledged that there would be a total cost for implementation of the legislature if the governor were to accept the report as written; however, the goal of the hearing was only to provide background. She noted that the department is in the middle of union negotiations. Commissioner Kreitzer observed that the report has been on the department's website.

[2:21:35 PM](#)

JIM CALVIN, MCDOWELL GROUP, JUNEAU, provided background information on the study, which is the most comprehensive overview of the cost of living allowance in Alaska since the 1985 geographic study (also done by the McDowell Group). He referred to a handout entitled, "Alaska Geographic Differential Study - 2008" (copy on file). He related that McDowell worked with EcoNorthwest (data management) and GMA Research, Bellview, which did the urban telephone research. The McDowell group did the rural surveying, which is more complicated. All of the research was done in fall of 2008 (October through December). The final report was provided to the administration in April 2009.

[2:24:06 PM](#)

Mr. Calvin described the study's methodology. He explained that 2,547 randomly selected households in 74 Alaskan communities were surveyed. There were fifty questions in the survey regarding household spending patterns in order to understand the shape of household budgets in different communities throughout Alaska.

Co-Chair Hawker asked if they received good voluntary compliance. Mr. Calvin replied that people were very receptive to talking about their household budgets.

Mr. Calvin noted that they surveyed 634 stores throughout 58 communities collecting data on a household market basket of approximately 200 items.

[2:27:05 PM](#)

Mr. Calvin explained that the basic modeling used the household survey and shape of the market basket to determine the importance of the following items: housing, transportation, and food. The price information allows a differential for specific items.

[2:28:04 PM](#)

Representative Paul Seaton asked how rural communities were surveyed. Mr. Calvin reported that people were asked where they bought their groceries. Groceries bought in neighboring large cities were accounted for in the cost analysis.

[2:28:56 PM](#)

Representative Nancy Dahlstrom asked if subsistence was taken into account. Mr. Calvin explained that the focus was on the cash economy but that subsistence activities were captured through the cost of tools associated with subsistence.

[2:30:35 PM](#)

Mr. Calvin continued to discuss the methodology in measuring the differentials. Communities were aggregated into eighteen geographic pools or sample blocks that are generally similar in terms of size of population, transportation infrastructure access, and geographic location within the state. Anchorage was used as the base community and given a differential of one. All costs are relative to Anchorage.

Co-Chair Stoltze wondered how fuel costs were estimated.

[2:32:21 PM](#)

Mr. Calvin clarified that the household surveys captured how much gas is spent on fuel. The cost of fuel compared to Anchorage is used to create a differential. How much is bought is as important as the relative cost.

Mr. Calvin referred to the profile on page 17 of the study, which shows the factors that went into determining a cost differential (copy on file). Each profile contains the population of the community and number of state employees. Fairbanks' cost differential came in at 1.03. Housing is a little bit less expense in Fairbanks but food and

transportation is a little higher. The Parks/Elliott/Steese Highways community was significantly lower.

Representative Crawford observed that Anchorage, Fairbanks, and MatSu were pooled together and there is an eight percent difference between these communities.

[2:35:23 PM](#)

Mr. Calvin clarified that Anchorage was calculated by itself and offered to provide more information on the pooling later in the presentation.

Mr. Calvin observed that Glennallen, Delta Junction, and Tok all have highway access, which is critically important for the cost of living calculation. The cost of housing is significantly lower than Anchorage, but the cost of clothing, food and transportation is higher. Blended together the cost of living is not dramatically higher than Anchorage.

Mr. Calvin observed that the first significant difference occurs in the roadless interior pool of Fort Yukon, Galena, and McGrath, which have high housing and food costs across the board of 1.31. Juneau has higher housing and food costs than Anchorage and has a differential of 1.11.

[2:37:14 PM](#)

Vice-Chair Thomas wondered about the difference in income levels throughout the state. He expressed concern for basing the differentials on the price of housing. He shared several observations he felt should be considered when the surveys were conducted such as income.

[2:39:38 PM](#)

Mr. Calvin acknowledged the difficulties in conducting a survey in Alaska. Household income can be determined but the challenge is in the comparison since households vary. The market basket focuses on what is available in rural areas. The key issue is housing.

[2:41:41 PM](#)

Vice-Chair Thomas maintained that there would be a difference between professional communities versus a more working class community.

[2:42:51 PM](#)

Co-Chair Stoltze thought that the discussion on geographical differentials was necessary in order to truly understand the

issues. He expressed a desire for a conclusion of the cost differential issues.

[2:44:00 PM](#)

Vice-Chair Thomas agreed and noted that cost differential changes take years to implement. Co-Chair Hawker acknowledged that the cost differential issue is one of three top issues in the state along with subsistence, and abortion. Mr. Calvin emphasized the complexity and challenge of cost of living research in the state of Alaska.

[2:44:52 PM](#)

Mr. Calvin continued with his presentation and noted that higher costs in Juneau for housing (15 percent), food (3 percent) and transportation (9 percent).

Mr. Calvin observed that Ketchikan and Sitka were initially grouped together because they are similar in terms of population and geography, but further analysis discovered that they are quite different and suggested that they be split apart. There were much lower costs in the southeast mid-size communities of Craig, Haines, Klawock, Metlakatla, Petersburg, and Wrangell. Transportation costs are somewhat higher but not significant since these communities have the benefit of ferry service. Their cost differential was 1.05.

Mr. Calvin reviewed the southeast small communities of Elfin Cover, Gustavus, Hoonah, Pelican, Skagway, Tenakee Springs, and Yakutat. He acknowledged that there is a size and quality issue in housing, but the housing available is significantly lower. He concluded that the cost of living is about equal to Anchorage (1.02). He emphasized that Anchorage is not a cheap place to live primarily due to housing costs.

Mr. Calvin observed that the Matsu Borough was split into different communities, but it is the lowest cost area in Alaska (0.95). Housing is less expensive in Matsu than Anchorage.

Mr. Calvin addressed other areas in the state. The Kenai Peninsula was similar to Anchorage at 1.01. Prince William Sound was 1.08, but Valdez and Whittier are quite different and he suggested that they be split. Kodiak came in at 1.12. The Arctic region of Barrow, Kotzebue and Nome had a high cost of living differential of 1.48 due to high housing and utility costs, along with high food and transportation costs. Bethel and Dillingham were at 1.49 but might be better split.

[2:47:33 PM](#)

Mr. Calvin continued discussing other areas of the state. He observed that the Aleutian region of Adak, Cod Bay, King Cove, Sand Point, Unalaska and Dutch Harbor were at 1.50 with high housing and transportation costs. Southwest small communities are the smallest communities of Alaska and had a differential of 1.44. He noted in some cases communities of sufficient size were isolated. Barrow was 1.50, Bethel was 1.53, and Dillingham was 1.37 (even though it was grouped with Bethel in the study). Cordova was 1.13 and Valdez was 1.08. Homer was on par with the Kenai Peninsula Borough analysis. Ketchikan and Sitka were grouped together, but they found that they are quite different. Ketchikan had a differential of 1.04 and Sitka was 1.07. Unalaska and Dutch Harbor were the highest in the state at 1.58, which was higher than some of the smaller surrounding communities in the region.

[2:49:39 PM](#)

Mr. Calvin shared that it was informative to examine the changes in differentials from 1985. In some areas, such as Ketchikan and Prince of Wales Island, there has been no change over the last 23 years. Wrangell and Petersburg are up slightly from .98 to 1.04. Sitka is way up from 1.01 to 1.17 due to housing costs. Juneau is up from 1.03 to 1.11 due to housing. Valdez and Cordova are slightly down. There was virtually no change in Icy Strait, Palmer, Wasilla, Kenai, Cook Inlet and Fairbanks. Seward is up slightly from 1.0 to 1.03. Kodiak is up from 1.06 to 1.12. Aleutians are up significantly. Areas on the road system did not increase much, while off the road system and remote communities had significant change. Bristol Bay is up from 1.29 to 1.37. Bethel is up from 1.39 to 1.53. Yukon Kuskokwim shows a drop but he pointed out that it was the result of a small sample size. Barrow, Nome and Kotzebue were up slightly.

Mr. Calvin discussed factors that influence the change in the cost of living differentials. He observed increases in Juneau and Sitka. Urban areas have seen a growth in the retail environment, which has caused a downward pressure on the cost of living over the last 23 years. Rural communities have not benefited in the same way. Increased fuel costs have been a factor in rural areas.

[2:52:58 PM](#)

Co-Chair Stoltze wondered about the labor pool and free market factor as far as the employment situation in different communities. Mr. Calvin explained that employment situations are not factored in except to pool similar communities together.

Representative Doogan questioned if the affect of taxes on the communities in the study were taken into account. Mr. Calvin noted that the tax burden was captured.

Representative Kelly felt that the survey was conducted at a poor time economically. Mr. Calvin acknowledged that fuel prices were exceptionally high and trending down while they were in the field. Steps were taken to test how the price of oil would change the differentials between communities statewide. The price of fuel did not change the differentials between Fairbanks and Anchorage, since they are in the "same boat" in relation to cost. Fuel costs did have some affect in rural areas. In areas with high differentials (1.45 - 1.50) a one-third reduction in fuel prices could lower the differential slightly (by .02).

[2:57:43 PM](#)

Mr. Calvin discussed the recommendations. He concluded that it makes sense to depart from a plan that is based strictly on election district boundaries and to group communities in terms of economics, social characteristics, location, and infrastructure. The program administrative costs need to be considered. He acknowledged that there is some uncertainty in the differentials. He emphasized that it also makes sense to aggregate into geographical differential pools.

[2:59:10 PM](#)

Co-Chair Hawker questioned if the methodology that incorporated the housing costs in communities was consistent with the 1985 study. Mr. Calvin stated that the methodologies have been consistent. He observed that it is not possible to take the average quality home in Anchorage to Dillingham and price it.

In response to a question by Representative Kelly, Mr. Calvin acknowledged that the 1985 study was the target of consternation among many groups and the subject of discussion concerning its methodology. He concluded that the 1985 study "stood the test of time". The first month of their 2009 project was spent on design to address these critically important issues. He felt that the methodology was strong.

[3:01:54 PM](#)

Mr. Calvin discussed statistically based geographical differential pools based on communities that are generally similar in terms of their cost of living. They were grouped together for an administratively functional plan for applying differentials to wages as one methodology. The state was split into five geographical pools (GDP).

- Anchorage, Fairbanks, Delta/Tok, Glennallen, KPB, Mat-Su, Parks/Elliott/Steese, Small & Mid-size SE - .95 to 1.05, weighted average of 1.0
- Cordova, Juneau, Kodiak, Sitka, Valdez - 1.08 to 1.17, weighted average of 1.11
- Dillingham, Nome, Roadless Interior - 1.31 to 1.39, weighted average of 1.37
- Barrow, Bethel, SW Small communities - 1.44 to 1.53, weighted average of 1.50
- Kotzebue, Unalaska/Dutch Harbor - 1.58 to 1.61, weighted average of 1.60

Mr. Calvin explained that the weighted average represents the number of state employees. He acknowledged the challenge of keeping like communities together but observed that the program would be easier to administer than one with 30 differentials. The grouping also acknowledges the ratio for error in survey research. An aggregate approach provides a range not a single value, without a scientifically based number of districts. He concluded that there were natural breaks that allowed Alaska to be broken into five districts.

[3:06:03 PM](#)

Representative Dahlstrom wondered about the out-of-state firms that had helped with the study. She wondered if there had been a competitive bid process. Mr. Calvin explained that they chose firms that they had established relationships with and they trusted and were familiar with the quality of their work. The McDowell Group did not do a competitive bid process.

[3:07:13 PM](#)

Vice-Chair Thomas asked if state employees included teachers. Mr. Calvin replied no. Vice-Chair Thomas expressed concern for out migration of workers in rural areas.

Annette Kreitzer stressed that the governor has not recommended implementation of the system. The purpose of the meeting was to provide information.

[3:09:41 PM](#)

KEVIN BROOKS, DEPUTY COMMISSIONER, DEPARTMENT OF ADMINISTRATION, stated that the department is satisfied with the work done by the McDowell Group. He observed that the focus was on the executive branch but that the research could be applied to school districts. He referred to page 5 of the differential study. He provided members with a chart indicating the full and part time employee count by location (copy on file).

[3:11:25 PM](#)

Mr. Brooks clarified that the employee count was derived from the employee's employment location. Co-Chair Stoltze observed that employee work place location versus residence would affect the Matsu. Ms. Kreitzer clarified that the study is not based on the numbers in the employee count.

Mr. Brooks stated that the employee numbers were pulled from OMB budget data for 2010. The focus was on the top 20 communities in terms of employee count. Each of the five GDP was color coded.

[3:13:13 PM](#)

Mr. Brooks also provided members with a chart demonstrating employee count by bargaining unit and location. He observed that each of the bargaining contracts address geographical differentials. Some locations have as many as four different geographical differentials in a single city. He mentioned the geographic difference percentages of the different bargaining units. He observed that the data used for these differentials is 20 years old in some cases.

Ms. Kreitzer pointed out the differences among communities and bargaining units. She noted that arbitration is also a contributing factor.

Mr. Brooks concurred and pointed to correction officers in Juneau and Ketchikan and their supervisors. He concluded that geographical differentials are complicated to administer and that the goal is to achieve consistency across bargaining units.

[3:17:34 PM](#)

Representative Doogan asked if the intent is to not only equalize the cost of living in contracts but to also equalize the other pieces in contracts. He observed that one bargaining unit might negotiate a higher differential in exchange for less time off than another.

Ms. Kreitzer commented that the goal is to achieve fair contracts.

Representative Seaton commented on the Fairbanks differential between different covered employees. There is a ten percent variation between various bargaining units, but there is also a 10 percent variation between different cities.

[3:20:19 PM](#)

Ms. Kreitzer clarified that she did not want to get into the specifics of their intention. The purpose is to provide the underlying methodology. Representative Seaton clarified that he was speaking to the statistical basis for the variance and whether it is accepted in one format but not another.

Mr. Brooks commented that the statistical analysis allowed a range of numbers. He stressed that the differential is based on the relative difference of the cost of living between Anchorage and other communities.

[3:23:01 PM](#)

Representative Joule informed about the state employees in his district. Most state employees in his district have transferred in to the district. He pointed out that high geographical differentials allow for greater retirement in terms of an employee's three high years. He expressed concern that motivation for increased retirement does not always translate to a benefit for the area. Ms. Kreitzer acknowledged the issue but pointed out that the study does not represent a change from current practices. She emphasized that the intent is to hire locally.

[3:27:18 PM](#)

Representative Kelly addressed the issue of raising pay levels where there is high unemployment.

Mr. Calvin observed that the heart of the economic situation is how does cost of living and pay differentials relate to supply and demand for labor in a community and how does it disjoint the economic environment to have a handful of high paying jobs where there may not be qualified people or where it would be an inducement to pull people in temporarily.

[3:30:42 PM](#)

Ms. Kreitzer informed that the cost of implementing the study as presented would be \$35 million including benefits. The impact on the unfunded liability for retirement and benefits would be \$3.8 million the first year. The impact on the unfunded liability is \$50 million over 25 years.

Vice-Chair Thomas asked about the effect on private industry in small communities. Ms. Kreitzer acknowledged that there are a lot of policy implications.

[3:32:58 PM](#)

Mr. Brooks clarified that no one would see a fifty percent increase in pay. Any increase would be incremental. Geographical differentials already exist and would only be updated.

Representative Dahlstrom asked for the definition of a confidential employee. Ms. Kreitzer responded that they are employees that generally work for the Division of Personnel on labor relations.

[3:35:23 PM](#)

Ms. Kreitzer reiterated that it would cost \$35 million to implement the geographical differentials as presented in the study.

AT EASE [3:36:22 PM](#)
RECONVENED [3:47:56 PM](#)

ATTORNEY GENERAL, DAN SULLIVAN, DEPARTMENT OF LAW (DOL), introduced his staff. He addressed the strategic direction of the Department of Law, which is focused on engagement with the legislature, and different elements of Alaskan society. He stressed the importance of being more proactive on litigation such as in the endangered species listing.

[3:53:52 PM](#)

Commissioner Sullivan observed that the four core functions of the Department of Law are: protecting the safety and physical wellbeing of Alaskans, fostering the conditions for economic opportunity and responsible development and use of the state's natural resources, protecting the fiscal integrity of the state, and promoting and defending good governments.

Commissioner Sullivan observed that criminal issues including child, consumer, environmental protection takes up 67 percent of DOL's budget. The department helps to shape the broader economic environment in Alaska, such as the department's support in the Kensington mine case. The department protects the fiscal health of the state by assuring payment of taxes and royalties, recovery of money owed to the state, and defending monetary claims against the state. Protecting the state's fiscal integrity accounts for 19 percent of the department's budget. Promoting and defending good governance includes ethic issues, Indian law issues, elections and initiatives, legislation, and public record requests.

[3:57:47 PM](#)

Commissioner Sullivan felt DOL was a good return on the state's investment. The state received \$560 million in claims and judgments as a result of the department's efforts, which represents \$6 dollars on every \$1 dollar spent on the department or a 35 to 1 ratio if only the civil division is considered.

Commissioner Sullivan touched briefly on four issues: cruise ship tax litigation, Mercer Case, Carlson Case, and permanent fund loss accounting.

Co-Chair Hawker observed that any confidential material would be discussed in executive conference.

[4:00:59 PM](#)

Commissioner Sullivan began with the cruise ship head tax issue. He had an opportunity to testify before the House Judiciary Committee. The Parnell Administration has great respect for the cruise ship industry and the tourism industry, but he stressed that DOL is defending the suit diligently as is their statutory duty. The economic benefits are clear as are the impacts of one million visitors a year to a state with a population of 700 thousand. He noted that state communities have spent funds to provide services and build infrastructure. He observed that law allows the user of services to pay their fair share under the U.S. Constitution when local communities provide significant infrastructure and services to hosted travelers, whether in or out of state. The cruise ship industry complaint focuses on the violations of the U.S. Constitution in relation to the Tonnage Clause, Commerce Clause and the Transportation Security Act and is seeking to declare the tax unconstitutional and enjoin collection of the tax in cost and fees. He reiterated that there is a well established principle that passengers can be required to pay a fair share for required facilities and services. The question is to what degree the \$46 per passenger tax is roughly calibrated to cover the cost to state and local communities. The department is undergoing a study on the issue

[4:05:20 PM](#)

Co-Chair Hawker noted the issue of documenting that maintaining ports and harbors is only a small portion of the cost of hosting cruise ship passengers. Commissioner Sullivan agreed and explained that the law allows services in the areas where there are large numbers of passengers.

Representative Austerman asked if there is similarity with the Carlson case in terms of a ratio of how much the state pays versus the fees charged.

Commissioner Sullivan stated that one of the concerns with the Carlson case is the way in which the judgment and interest on judgment continued to accrue. There is some similarity.

[4:08:31 PM](#)

Representative Austerman observed that the focus of the Carlson case is how much the state was paying to provide services versus the percentage charged to out of state applicants.

Commissioner Sullivan explained that the cruise ship head tax is more of a cost analysis and connection of tax to the costs and services provided.

Co-Chair Hawker asked if the current operating budget supports work for these cases or if additional funds would be requested for litigation costs. Commissioner Sullivan replied that he is working through the budget process with the governor.

[4:10:46 PM](#)

Commissioner Sullivan discussed the Mercer case. Mercer was the actuary for the public and teacher retirement systems since 1974. A 2002 audit recommended a number of changes to the modeling by Mercer. The recommendations by the audit firm were largely adopted by the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) boards. Mercer made changes based on the audit recommendations. In 2003, Mercer advised that PERS and TERS were unfunded to the total amount of \$4.4 billion. Of this amount, \$1.3 billion was a result of correcting the errors identified by the auditors in relation to Mercer's health cost modeling. An additional \$500 million in unfunded liability was discovered as the result of coding errors. In 2005, there was legislation enacted to close the PERS and TRS defined benefit plans to new participants. Defined contribution plans were created for new PERS and TRS employees. In 2006, the Department of Law investigated the work of Mercer and concluded that there was a basis for cause of action for negligence in the case. The Wall Street firm of Paul Weiss was retained on a contingency fee basis. A complaint was filed in December 2007. The complaint alleged professional negligence, malpractice, breach of contract, negligent misrepresentation, and unfair trade practices, alleging damages of \$1.8 billion. There has been extensive discovery. The complaint was amended in May to add fraud and punitive damages claims when the actuaries testified under oath that they discovered an error in the FY 02 PERS valuation that if corrected would have increased the PERS unfunded liability \$1 billion. The error was not corrected. Mercer representatives further testified under oath that they falsified the FY 03 PERS valuation to conceal the error and reduce the PERS unfunded liability by \$1 billion. A motion to dismiss was filed and argued in Juneau. The trial was moved to July from March. The state intends to take case to trial and win.

[4:14:48 PM](#)

Co-Chair Hawker pointed out the seriousness of alleging fraud and an intent to deceive. Commissioner Sullivan agreed and noted that their NY firm also agreed. Co-Chair Hawker understood that the allegation was not made lightly. He commended DOL for the hard work.

Commissioner Sullivan credited his co-workers with the hard work. He stated that he would continue to press forward and was disappointed in the delay of the trial.

[4:17:42 PM](#)

Commissioner Sullivan discussed the Carlson case and the significant developments in the case. The case has been under litigation for 25 years. The case has been before the Alaska Supreme Court four times. The original suit was a class action that claimed out of state fisherman were discriminated against based on the Commerce Clause of the U.S. Constitution and the Privileges and Immunity Clause due to the differential in the permits and crew licensing fees for instate and out of state fisherman. The state received a setback on the third time the case went before the court. The court ruled that the interest accrued on the case would be 11 percent quarterly compounded back to the original judgment. The state's primary liability is the interest due to this ruling. Last spring was the last time the case went to the Alaska Supreme Court. The overall judgment was reduced by 50 percent, but the total liability is still significant. The interest on the case is \$20 thousand a day. Refunds would cost \$68.3 million, which would have been \$93 million if they had not been reduced. The plaintiff's attorney is asking for \$21 million but has only spent \$250 thousand. There has not been a final judgment; a judgment is expected in January. An accounting firm is reviewing the numbers.

[4:23:00 PM](#)

Co-Chair Hawker asked if there is any ability or mechanism to stop the accrual of interest on the damage award. Commissioner Sullivan was reluctant to discuss options publically.

Co-Chair Stoltze asked if there were other settlements that might accrue interest. He also observed that the tourists and non-residence are paying toward the building of a fish hatchery in Fairbanks.

[4:25:54 PM](#)

Commissioner Sullivan observed that it would be worthwhile to work with the legislature to prevent similar results in other cases.

[4:27:18 PM](#)

Commissioner Sullivan highlighted the issue of the permanent fund realized losses in FY 09 of \$2.5 billion; of this amount, \$2.2 billion was attributable to realized investment loss and principle, the remaining \$300 million was attributable to realized investment loss in the Earnings Reserve Account. The issue is whether booking a \$2.2 billion loss from the principle and earnings reserve accounts requires legislative authorization because it reduces the balance of the Earnings Reserve Account, which is subject to appropriation. This issue is not in litigation. The department is making recommendations to the governor.

[4:30:53 PM](#)

Co-Chair Hawker noted that there are executive policy calls involved.

Mr. Teal pointed out that how the losses are accounted affects the legislature's power of appropriation. He suggested that it may be appropriate to consider statutory changes. From the fiscal prospective, \$2.5 billion missing from the Earnings Reserve Account could result in a cap on dividends. Dividends are capped by the amount of statutory income and the qualifier that they cannot exceed 50 percent of the amount in the Earnings Reserve Account. The Earnings Reserve Account is now at \$400 million dollars instead of \$3 billion dollars since the losses were attributed to this account.

Co-Chair Stoltze stressed that there are policy issues involved.

Mr. Teal noted that a lower reserve balance also affects the 17b draw or legislative appropriation from the CBR.

[4:35:30 PM](#)

Mr. Teal observed that FY 2010 revenues are \$2.7 billion lower than 2009. This creates the basis for the amount that would be drawn from the Constitutional Budget Reserve Account. The draw also includes the amount available for appropriations, which includes the balance of the Earning Reserve Account. Subtract the \$400 million and the draw becomes \$2.3 billion. If the balance were \$3 billion instead of a half a billion, the potential 17b CBR draw would "fold" substantially. Other revenue increases would also affect the draw. He observed that FY 2010 revenues may only be half a billion lower than FY 2009. The Earnings Reserve Account may also recover a billion dollars of the realized loss in FY 2010, which would reduce the 17b draw to zero. He could not

predict the end point. He acknowledged that the Permanent Fund Division has a different opinion.

[4:37:56 PM](#)

Co-Chair Stoltze asked if the intent was to make recommendations or investment advice regarding the fund's board of trustees. He asked if more oversight would be advantageous. Mr. Teal did not have a recommendation; he had no investment advice. His intent was to clear-up the statutory treatment whether an appropriation is needed to move funds from the Earnings Reserve Account to principle. Co-Chair Hawker added that the statutory oversight is vested with the Legislative Budget and Audit Committee.

[4:40:52 PM](#)

Representative Seaton recalled that the Permanent Fund Corporation was allowed to increase their alternative investments from 5 to 15 percent. The legislature has no way of knowing how the alternative investments are made. He opined that Co-Chair Stoltze's question was valid as there is so much potential exposure to derivatives.

Co-Chair Hawker encouraged review of guidelines for these funds. He appreciated the diversion to illustrate the complexity of the issue.

Commissioner Sullivan acknowledged the complexity of the issue and noted that DOL has not been looked at the broader issue.

[4:43:48 PM](#)

Representative Austerman suggested the need for a full day committee to address the issue of where the state of Alaska wants to be in fifteen years in regards to finances and if the House Finance Committee should lead the discussion. He noted that last year's budget was not sustainable. He maintained that the legislature is not looking at the 30,000 foot level in regards to a long term vision. He opined that the House Finance Committee should be the driving force to form a statewide vision.

[4:47:44 PM](#)

Co-Chair Hawker referred to HB 125, which was passed in a previous session. The legislation requires departments to create a 10 year plan. He agreed with Representative Austerman. Discussion ensued regarding timing for more discussions on the issue. Representative Kelly requested material about other states or countries that have benefitted from this type of vision or plan and stressed the importance of leadership by the executive branch.

[4:51:16 PM](#)

Representative Austerman observed that some work has occurred in the House Finance Commerce and Economic Development Subcommittee. Some other states have employed private sector groups for commerce and economic development.

Co-Chair Stoltze advised that in the absence of more pressing legislative issues, there would be time for discussions during the legislative session. Representative Joule agreed on the importance of long-range review that follows across departments.

[4:55:43 PM](#)

Co-Chair Hawker MOVED to convene an executive session under Uniform Rule 22(b)(1) for discussion of matters, the immediate knowledge of which would adversely affect the finances of a government unit. There being NO OBJECTION, it was so ordered.

[4:56:03 PM](#) Executive Session

ADJOURNMENT

The meeting was adjourned at 5:45 PM.