MINUTES
LEGISLATIVE FINANCE COMMITTEE
March 17, 2008

Senator John Arthur Smith, Chairman, called the Legislative Finance Committee (LFC) to order on Monday, March 17, 2008, at 10:15 a.m.

The following LFC members were present: Senator John Arthur Smith, chair; Representative Luciano "Lucky" Varela, vice chairman; Representatives Don E. Bratton, Rhonda King, Brian K. Moore, Edward C. Sandoval, Jeannette O. Wallace, Nick L. Salazar, and Henry "Kiki" Saavedra; and Senators Mary Kay Papen, Carol Leavell (for Sue Wilson Beffort), Phil A. Griego, Cisco McSorley (for Pete Campos), Leonard Lee Rawson and Carlos Cisneros. Representative Roberto "Bobby" J. Gonzales attended as a guest.

Post-Session Financial Report

Michelle Aubel, LFC fiscal analyst, presented a preliminary post-2008 legislative session fiscal overview. The 2008 session began with estimated new money of about $369 million. At $6 billion, general fund recurring appropriations grew by $360.2 million, or 6.3 percent, over the FY08 operating budget. The average growth in expenditures from FY98 to FY08 was also 6.3 percent. General fund spending as a share of New Mexico personal income declined to under 8 percent in FY09, the lowest in a decade.

The total General Appropriation Act (GAA) nonrecurring general fund expenditures total about $147.6 million. Total expenditures are expected to leave the general fund reserves strong at 10.3 percent of recurring FY09 appropriations.

Ms. Aubel presented a pie chart showing FY09 recurring general fund appropriations for the state's largest sectors. Funding for public education increased by $121.2 million, or 5 percent, over FY08; higher education funding increased by $33.8 million, or 4 percent, not including Chapter 6 appropriations; Medicaid increased by $91 million, or 13.1 percent, over FY08; Corrections increased by $17.2 million, or 6.2 percent; Department of Public Safety (DPS) increased $6.2 million, or 6.8 percent; and, the GAA also provided $106.2 million for special appropriations for FY08 and FY09, which included $24 million to supplement the highway maintenance fund.

Norton Francis, LFC senior economist, provided more detail on the economic forecast, emphasizing to the committee that 23 percent of the growth in recurring general fund appropriations for FY09 was for Medicaid, which grew 12.3 percent. Six percent and less growth in other categories made room for that growth.

Mr. Norton said $1.4 million of increased revenue will impact future revenues, primarily due to the Taxation and Revenue Departments' (TRD) enhanced audit program, which will provide funding for more auditors. That funding will offset revenue losses. The locomotive fuel and fuel facility tax exemption effective date has been pushed back to 2010 from 2009. This will mean an additional $5 million in FY10 estimated revenue because the exemption was already built into the revenue forecast.

Tax cuts in the 2007 health package are still being phased in and are expected to have about a $100 million impact in FY09.

Mr. Francis presented a table showing a three-year outlook of a "bare bones" budget through FY12 with existing significant new spending initiatives, including expansions in Medicaid, transportation and education. The general fund revenue growth rate is expected to increase by 3.1 percent in FY10 and by 2.5 percent in FY11 and FY12. However, baseline general fund expenditures, including allowances for inflation and population growth, are expected to increase by 3.4 percent in FY10, FY11 and FY12. Mr. Francis emphasized to the committee the "bare bones" budget is growing faster than the revenues. At current projections, general fund revenue will be $8 million short of expenses in FY10 and $63 million short in FY11, which will mean the state will need to either increase revenues or decrease expenditures to maintain a balanced budget. In addition, several initiatives in transportation, education, and health care, not yet authorized by the Legislature, will add significantly to these baseline budget projections.

Mr. Francis presented the general fund financial summary and said general fund reserves for FY09 are being maintained at 10.3 percent. Reserves could be used for a deficit in FY10; however, the governor must issue a declaration and the Legislature must act with a "super majority" before the state can access certain reserve funds, such as the tax stabilization fund. The GAA authorizes the transfer of up to $150 million from general fund reserves to the operating fund reserve and the appropriation contingency fund. Director Abbey clarified that the operating reserve transfer authority exists only in the current year.

Vice Chairman Varela asked for the status of appropriations that come from the education lockbox for FY08. Paul Aguilar, LFC analyst, provided a breakdown of expected expenditures that included test development and administration, professional development for teachers, and the student tracking database called STARS.

Chairman Smith and Vice Chairman Varela thanked the House Appropriations and Finance Committee and the Senate Finance Committee for their efforts this past session.

Linda Kehoe, LFC principal analyst, presented the capital outlay outcomes of the 2008 legislative session. Ms. Kehoe reported two major capital outlay bills passed this last session. Senate Bill (SB) 471 authorized 1,780 projects that totaled over $356 million. More than half of the appropriations in the bill were for projects $50 thousand and less. This brings the number of outstanding projects to a total of 10,500. Funding within the bill will also allow for the completion of certain infrastructure projects such as the Court of Appeals and the state police district offices in Las Vegas and Las Cruces. The committee heard discussion on the various public projects.

The other major capital outlay bill was Senate Bill (SB) 333, requiring voter's approval in the general election, authorizing the issuance of general obligation bonds totaling $223.8 million, including the cost of debt service. The four bond issues include $14.7 million for senior center projects, $11 million for public and tribal library acquisitions, $57.8 million for health facilities, and $139.9 million for higher education special schools. At least 82 percent of the general obligation bonds were authorized for higher education facilities.

Director Abbey congratulated the LFC staff on a job well done. Ms. Aubel will provide the final report.

Second Quarter FY08 Investment and Pension Report

Mr. Francis presented a report addressing results through the second quarter ending 12/31/07.

Mr. Francis introduced staff members from the State Investment Council (SIC), the Education Retirement Board (ERB), and the Public Employees Retirement Board. The committee expressed concerns as to why the Retiree Health Care Authority (RHCA) was not present. Mr. Abbey stated Mike Custer from SIC presented a report to RHCA last week and will be available for questions.

Mr. Francis stated RHCA is generally not included in this type of report. Adam Levine, deputy state investment officer, explained the managed funds and how they differ from the pension funds. Mr. Levine further explained that the agencies that invest with SIC invest in several investment pools. RHCA decides what asset allocation to choose based on information provided by SIC, SIC does not choose for them.

The funds missed quarterly internal benchmarks and lost money. This was for the first time since March 2005 that all funds had a negative quarterly return. The funds included in this report are the Educational Retirement (ERB) fund, Public Employees' Retirement Funds (PERA), land grant permanent fund (LGPF) and the severance tax permanent fund (STPF). Peer rankings place all of the funds in the bottom quartile for the quarter and PERA and ERB for the year. Mr. Francis emphasized this report only reflects quarterly performance, and it is better to look at one- and five-year performance targets when evaluating a fund.

The total asset value is $38 billion, down a net of $684 million from the previous quarter. For the calendar year, the asset value of all funds increased $2.3 billion. The results reflect turmoil in the financial markets as well as a "flight to quality" in the credit markets.
Mr. Francis presented charts reflecting the four funds compared with the policy index and "60/40" benchmarks for the quarter ending 12/31/07, one year ending 12/31/07 and five years ending 12/31/07. The "60/40" was explained as a traditional conservative asset allocation that includes domestic equity (60 percent) and fixed income (40 percent). For the one-year period, the investment returns all remain below their benchmarks except for LGPF, which met its target of 9.2 percent. For the five-year investment performance, funds are well above their actuarial targets of 8 percent and 8.5 percent.

Mr. Francis presented a table of asset fund allocation and return and provided more detail. Most of the funds have the majority of their investments in equity asset classes. All of the funds are now moving into alternative asset classes, such as private equity and hedge funds. U.S. equity asset fund performance pulled down other funds because of their high asset allocation.

The fixed income performance was also low (comparatively) at around 2 percent. Pension fund consultants reported a collateralized debt obligation market loss of 15.6 percent was the main driver for the performance of the SIC funds.

SIC and ERB hedge funds strategy included looking at matching the risk of fixed income with returns slightly above fixed incomes. Hedge fund performance helped SIC funds by being a positive 2.6 percent while other asset classes were turning negative.

Ms. Aubel stated ERB and the SIC funds achieve diversification using a "fund-of-funds" approach, to mean a "basket" manager who has several funds in a particular fund. PERA is doing a direct strategy, investing in specific managers with specific mandates. This strategy takes longer and may help explain the difference in returns. Additional detail will be provided in future reports.

ERB used real estate investment trusts (REITS) as a "place-holder" to gain real estate exposure while moving toward direct investments in real estate partnerships. While providing excellent returns in prior years, equity market exposure and mortgage issues have caused REITs to decline by 13.6 percent during 2007. Given the fund's 4 percent allocation to REITs, this was another driver for ERB's overall negative returns this quarter and for the year.

Due to significant changes in the market from January until now, the committee requested a report of decisions made by agency fund advisors, as well as policy decisions made by each board regarding fund management. Mr. Francis stated final results for the first quarter will probably not be available for the April meeting; however, an update from all agencies as to the status of their funds will be provided.

LFC staff will be looking further at how investment advisors choose the next top performers as they move forward into alternatives; and, how these alternatives are being valued over time. The staff will also review any lack of transparency and identify any other reporting issues that the committee should know about.

The committee heard further discussion about the volatility of today's market. Mr. Francis emphasized that the state has such a diverse portfolio, that any single exposure is somewhat mitigate by that diversity.

Action Items

Representative Varela moved to adopt the January 2008 minutes, Senator Smith seconded the motion, and it passed with no objection.

LFC obtained additional funding in the GAA this year to help with financial analysis. Next year the LFC will have a full-time position available for this purpose. In the meantime, Director Abbey asked for $25 thousand to assist with soliciting three proposals to provide expertise in debt management as well as investments. Representative Varela moved to adopt the contract approval, Senator Smith seconded the motion, and it passed with no objection.

Information Items

Director Abbey presented proposed dates for the LFC meeting calendar to the committee. A fourth day has been added in September for the sunset committee because 10 agencies are sunsetting in this cycle. The committee heard discussion on alternate dates, meeting sites and possible side-trips.

A trip report to Chihuahua, Mexico, including passport information, will be made available to the committee.

Director Abbey will provide a revised meeting calendar for the year to the committee in April.

Director Abbey provided the committee an update on analyst staff reassignments. Three performance reviewer positions are open. In July two more positions will be open for assistants to Ms. Kehoe and Mr. Francis.

The LFC FY08 budget projections as of March 14, 2008, were provided to the committee.

The cash balance report for 2006-2007 was provided to the committee.

The LFC budget adjustment reports (BARS) for state agencies for January-February 2008 were provided to the committee. The committee heard discussion of various findings within the reports. Chairman Smith postponed further discussion of RHCA' actuarials and investments until April. The committee will be requesting the authority's attendance at that hearing.

An LFC staff member will be asked to attend the governors' task force meetings regarding incarceration alternatives and report back to the committee.

SHARE Update

Aurora B. Sánchez, LFC program evaluation manager, provided an update on certain issues raised during a November 2007 LFC information technology (IT) program evaluation report on SHARE, the state personnel and finance computer system. Eighty-nine state agencies submitted completed audits to the State Auditor's Office (SAO). Sixty-eight percent of completed audits were submitted by the deadline of December 15 for FY07 audits. Forty-one agencies had yet to submit a completed report to SAO as of March 11, 2008.

Committee members expressed concern regarding reasons why the 41 agencies had yet to complete their audits. The committee requested an agency-by-agency report of audits not completed on time. Anthony Armijo, state controller, stated he will also include a report to the committee on the anticipated completion days of the missing audits.

The committee heard discussion on the various reasons why an agency may not be able to complete its audits on time. Vice Chairman Varela stated certain agencies should be allowed to maintain their own internal systems until problems inherent in the SHARE have been worked out. Ms. Sanchez believes other reasons why agencies have not completed their audits are outside of the SHARE system.

From September 2007 through February 14, 2008, 105 FTE in 40 state agencies have attended training on the human capital management module. From July 2006 through February 2008, $146.1 thousand has been spent to train 39 Department of Finance and Administration (DFA), Department of Information Technology (DoIT) and State Personnel Office (SPO) technical FTE.

The Taxation and Revenue Department (TRD) was chosen as the first agency to conduct a SHARE-to-agency subsidiary system reconciliation test. A review of the available reconciliations show improvements. TRD is reconciling its GenTax books to SHARE.

LFC's preliminary review also show the interface between Medicaid system and SHARE may not be working properly, resulting in cash balances being over-stated.

Committee members expressed concern over the $400 million unmatched items in cash and investments. Karen Kendall, DFA SHARE team lead, explained the $400 million is actually down from $1.5 billion in December 2007, and DFA and STO staff continues to work to get items reconciled. In April 2008, Bank of America (BOA) will also be working with a technical team to find solutions to more consistently match items electronically to alleviate STO staff from having to do it manually.

The transition from Wells Fargo to BOA as the new fiscal agent is complete. Ms. Kendall stated various reasons why there might be such a large number of items left reconciled between BOA and the state's records. Ms. Kendall further stated that the way certain transactions are handled at DFA and STO are also complicating the reconciliation process. Roy Soto, DoIT secretary, reassured the committee BOA will pay for any costs it incurs in working toward resolving these reconciliation issues.

Mark Valdes, deputy state treasurer, detailed three projects to help address reconciliation issues. The first project is to modify the bank file that goes into SHARE. Mr. Valdes believes this is the process that has the most errors and is causing many of the reconciliation issues. The $40 thousand project cost is to be paid for by the fiscal agent on the state's behalf. The second project is to develop an interface compatible with SHARE that will resolve a lot of the investment accounting issues. The third project is to program SHARE to assist STO in calculating interest on the 150 self-earning accounts.

Mr. Valdes further reported that certain agency practices of providing wire transfers plus printing out warrants for large disbursements (what used to be the "superbowl" process) is also causing reconciliation issues. When the bank receives the warrant and the wire transfer, it acts as a double payment. DFA and STO are working to assist the agencies in changing their business processes so the warrant will no longer be used, and only a wire or ACH will be standard practice.

Committee members expressed concern over the SHARE enhancement appropriations that continue to be needed despite the fact the state moved to SHARE as the system of record in July 2006. Mr. Soto stated SHARE initially received $20 million in appropriations and $10 million in contributions from state agencies. Mr. Soto emphasized that any system of this nature will require upgrades, patches, and maintenance.

Committee members expressed further concern regarding agencies not participating in SHARE. Ms. Sánchez believes STO and DFA need to work with the agencies to reengineer their processes to operate in a more efficient manner. Mr. Armijo stated that DFA has issued the model accounting practices for agencies to follow, which also address a statutory requirement. The committee encouraged DFA, as the oversight agency, to mandate agencies to comply.

A review of 14 of the 34 agencies receiving interest from self-earning accounts showed all but three agencies had the interest on investments posted. DFA has taken over calculating the interest of the 150 self-earning accounts for STO and will post the operating transfers to correct accounts by the 10th of each month.

The amount available for SHARE contracts and system maintenance is $37.6 million, inclusive of agency contributions of $10.2 million. Total expenditures for SHARE for FY07 were $24.4 million. Total expenditures for FY08 were not available.

The Federal Highway Administration has reinstated reimbursements for highway construction costs suspended when SHARE failed to produce requisite reports. NMDOT has requested it be allowed to have its own SHARE system and negotiations are still underway.

On March 5, 2008, DFA provided training to LFC staff on how to produce SHARE reports. Ms. Sánchez believes that access to SHARE financial information will enhance the fiscal analysts' ability to oversee state agencies.

The $500 thousand appropriated to DFA during the 2008 legislative session for a data warehouse for analytical and oversight purposes was vetoed by the governor. Ms. Sánchez believes the data warehouse would have provided access to non-confidential financial data to the general public and made government more transparent, in addition to enhancing state employee efficiency.

The 2008 legislative session also appropriated $250 thousand for a business processes, needs assessment, and gap analysis of the SHARE system to address capital project reporting, budget, and the GAA preparation.

Student, Teacher Accountability Reporting System Status Report

Ms. Sanchez provided a report on the second review to assess the current status of the Public Education Departments' (PED) Student, Teacher Accountability Reporting System Status Report (STARS) project from August 2006 through February 2008. Ms. Sanchez provided background on the STARS project, which aims to benefit the state in the collection, storing, analysis, and reporting of data for state and federal mandated requirements.

STARS project appropriations through December 2007 are $8.2 million, with $4.5 million still available. PED continues to rely on outside vendors and consultants to perform activities that could be handled in-house. Ms. Sánchez stated reviewers will follow up on the award to a sole bidder of a new services contract worth up to $13.5 million.

Data validation for school program year 2006-2007 for six small school districts revealed no significant anomalies. It is uncertain if this will also be the case with larger school districts, once assessed. PED staff continues to indicate a lack of confidence in STARS data.

Ms. Sánchez believes the issues that affect timely and accurate data submission may be too many steps involved, a lack of training, staff turnover and data errors requiring manual entries.

PED is looking at hosting the data warehouse within New Mexico, as opposed to White Plains, NY.

PED does not have a comprehensive plan to train all staff and users. Staff interviewed at six districts stated the training they received did not focus enough on data validation and verification.

Veronica Garcia, PED secretary, presented to the committee the PED response to the STARS' project second review. Ms. Garcia began by recognizing the LFC's oversight responsibilities to the department, and recommended quarterly presentations on deliverables to ensure the committee receives timely information.

According, to Ms. Garcia, STARS has made data errors more apparent. PED continues to develop tools to assist districts with data validation and certification.

PED believes the LFC second review stating a lack of staff confidence in STARS data is not current.

The number of days to transmit and certify STARS' data for school year 2007-2008 has seen significant improvement over 2006-2007. Ms. Garcia provided examples of district improvement in this area.

PED will continue to execute its training strategy using the data conferences and on-site support as appropriate. Ms. Garcia says that regional trainers are needed to keep up with the training needs of new staff due to staff turnover and small school districts.

PED will continue to evaluate the hosting alternatives, but Ms. Garcia supports its move to New Mexico.

The cost for STARS hosting, maintenance, support, and processing activities in White Plains, NY, is approximately $877 thousand annually.

Robert Piro, PED chief information officer, provided the committee more details on the project contracts awarded to support the data warehouse system.

Francis Maestas, Legislative Education Study Committee (LESC), reported to the committee that the data received from PED has not been of great quality. In addition, LESC would like to have greater access to the data to help organize their reports. The committee encouraged PED to continue to value and support staff training.

Mr. Piro gave an overview of phase three to the committee, soon to be implemented. This will ensure that principals and teachers will have access to student data to better focus on student achievement.

Ms. Garcia stated that the data can provide preschool through college (P-20) data for tracking purposes. PED is working towards sharing of data with the Higher Education Department (HED) to track the progress of students by a unique identification number and by institution.

Ms. Maestas believes an upgrade of the "Banner" system in higher education institutions is necessary to be able to share P-20 data with STARS. The committee was concerned funding is not available to assist both systems to share data. Mr. Dasenbrock stated 24 out of 27 higher education institutions have the "Banner" system in place. In the 2008 session, $1 million was reauthorized to support the "Banner" system upgrade.

Vice Chairman Varela stated that if the state is going to build a STARS system for the purpose of tracking and monitoring P-20 students, the state needs to fund the interface necessary to interface the two systems. The committee requested a collaborative report from PED, HED, and other stakeholders.

Ms. Garcia stated STARS data will also be able to assist the PED, HED and legislative agencies in making better programmatic and funding decisions.

Mr. Piro responded to committee concerns by stating PED can rely on the STARS data to meet the department's statutory deadline each year with respect to the unit value.

Review 2008 Interim Program Evaluation Work Plans

Manu Patel, LFC deputy director program evaluations, presented staff assignments and current program review projects to the committee.

The evaluation of the Children, Youth and Families Departments' domestic violence program is showing tremendous improvements. The evaluation will be completed mid-April.

A review of the status of all tax and motor vehicle suspense accounts within the Taxation and Revenue Department is 50 percent complete and should be finished April or May.

The status of a case study to evaluate local school district governance, resource allocation, teacher quality, and how these key features relate to student achievement outcomes is currently underway. The goal is to build a prototype evaluation by which other school districts may benefit. Rio Rancho was chosen because of its proximity, stable board and superintendent, and stable finance department. The study will be completed in May with a report to the committee expected in June. A presentation will also be made to Legislative Education Study Committee (LESC), which has expressed interest in the findings.

The New Mexico Environment Department was chosen for the first project in evaluating state government performance measures best practices. The review is 50 percent complete and will be completed in May. A performance measures review of other departments is expected to follow.

LFC evaluation program staff will be working on a review of the General Services Departments' Procurement Division to provide input on process re-engineering, integration of SHARE's purchasing module, and reducing manual work within the division. David Hadwiger has contracted with LFC to assist with this effort.

Mr. Patel provided a list of future priority program evaluation projects that included the following:

- A review of selected contracts, joint powers agreements, and memoranda of understanding of selected agencies from inception to see if the appropriation was actually directed to the agency that expended it;

- Follow-up of the 2007 review of the Retiree Health Care Authority to ensure recommendations were implemented and issues resolved;

- A review of PED student testing contracts and student short-cycle assessments to ensure accuracy and timely reporting of results to teachers and principals for program planning purposes;

- A review of the Human Services Departments (HSD) contracts for physical managed care. The data has been difficult for the evaluation staff to obtain because HSD has expressed concerns about the ability to abstract data and maintain patient confidentiality. Mr. Patel emphasized to the committee the data needed to conduct the review did not include confidential information.

Other potential projects include an evaluation of PED funding to certain transportation contractors to ensure the appropriation being used for the intended purpose by the contractor. Various agency information technology review projects will be scheduled this summer. Next priority information technology projects will include an evaluation of the electronic traffic citations processes within TRD, NMDOT and the Department of Public Safety.

Director Abbey introduced two new performance review auditors to the committee. Mr. Patel shared with the committee the vacancies within the program evaluation unit.

The committee requested a list of nonessential governmental appropriations that impact state budgets.

Review 2008 Interim Program Evaluation Work Plans

Cathy Fernandez, LFC deputy director, presented a general overview of common themes within the analysts and economists interim draft work plans. Activities include the following:

- Identify nonessential higher education special projects that either pertain to student services or are generating student credit hours that could be rolled into funding formulas;
- Monitor capital outlay projects greater than $1 million in an effort to ensure certain projects are noted, especially projects older than 2003-2004;
- Work with the executive, agencies and this committee toward more meaningful performance measures, especially within the Income Support Division of the Human Services Department and HED;
- Work closely with the Health and Human Services, Tobacco, and Corrections Oversight interim committees on issues that overlap with the committees' interests;
- Monitor agency contracts to identify ones that may be of interest to the committee;
- Analyze universal health care proposals;
- Analyze public school formula and higher education formula improvements;
- Analyze compensation, particularly for higher education and public school faculty, and how it compares to peer pay;
- Identify reasons for the decline of the inmate population;
- Work with performance evaluators on follow-up of recommendations made during an LFC performance review.

Various committee members support including a review of paper ballot efficiency measures that other states use in running elections.

The meeting adjourned at 4:30 pm.

Chairman

4-24-08
Date