ONE BALDWIN STREET
MONTPELIER, VT 05633-5701

SEN. M. JANE KITCHEL, CHAIR
REP. JANET ANCEL, VICE-CHAIR
SEN. TIMOTHY ASHE
SEN. CLAIRE AYER
REP. CAROLYN BRANAGAN

TEL: (802) 828-2295
FAX: (802) 828-2483
www.leg.state.vt.us/jfo

REP. MITZI JOHNSON
REP. BILL LIPPERT
SEN. RICHARD SEARS
REP. DAVID SHARPE
SEN. RICHARD WESTMAN

STATE OF VERMONT
LEGISLATIVE JOINT FISCAL COMMITTEE

Monday, July 25, 2016

Minutes

Members present: Representatives Ancel, Branagan, Johnson, Lippert, and Sharpe, and Senators Ashe, Ayer, Kitchel, Sears, and Westman.

Other Attendees: Administration, Joint Fiscal Office, Legislative Members, and various media, lobbyists, and advocacy groups.

The Chair, Senator Kitchel, called the meeting to order at 9:40 a.m., and Representative Ancel moved to approve the minutes of November 13 and December 1, 2015, and of April 7, 2016. Senator Ayer seconded the motion and the Committee approved.

B. Recap of Revenue Update

Tom Kavet, Legislature's Economist, reviewed the reasons for the revenue downgrade that was presented to the Emergency Board on July 21. The State revenues were down 1.4% in General and Transportation Funds, and the forecast was off by 1% from the previously accepted forecast submitted in January 2016. In addition, there was a glitch in how the Department of Motor Vehicles determined two-year registrations that created a gap in revenues. In response to Representative's Sharpe's question, Mr. Kavet referred to the last page of the forecast (page 37 - Addendum: Administration and JFO Revenue Comparison) and explained how May 2016 assumptions for the FY2018 budget used the January 2016 revenue forecast as its estimate. Another factor for the decrease in revenues lower-than-expected corporate income tax receipts which tended to be a more volatile revenue source. Representative Sharpe inquired if the student debt bubble within banking institutions was an issue with economic stability. Mr. Kavet stated the majority of student debt was held by the federal government and did not have the volatility the banking industry had with subprime mortgages during the recent recession. However, student debt in addition to fewer available jobs could lower the overall economic buying power of Vermonters, lower the house turnover or building rate, and then have the effect of delayed or reduced family size. Mr. Kavet added that credit standards had been tightened since the recession, which caused more hurdles for new home buyers.

Mr. Kavet referred to the forecast (page 6) showing U.S. Unemployment Rate by Age. Representative Ancel suggested a break-out of the Vermont demographics of age in the workplace and the various economic constraints those groups are challenged by over time. Mr. Kavet agreed the information would be interesting to follow on a regular basis but would have to investigate whether the data could be broken out to reflect just Vermont. Senator Kitchel added that data reflecting Vermont could be important to Committee policy discussions because of possible social implications that may drive human services and education delivery systems.

The Chair reflected on the last page of the July 2016 revenue forecast, offering that the information in the addendum helped to put revenue changes over time in perspective.

C. Administration's Fiscal Updates – 1. Unencumbered Balances

Michael Pieciak, Commissioner, Department of Financial Regulation, distributed a memo showing the FY2016 receipts available to the General Fund. Senator Ashe asked for clarity on how the receipts would impact the FY2016 and FY2017 budgets. Stephen Klein, Chief Fiscal Officer, Joint Fiscal Office, responded that the funds would help in the close-out of FY2016. Representative Ancel added that these receipts were part of the estimation of the normal revenue and budget process. Emily Byrne, Director of Budget and Management Division, Department of Finance and Management, offered that the receipts were $2 million above the previous estimate of $11.2 million.

Senator Kitchel inquired what the potential impacts were for other states' legislation to domicile captives within their own states. Commissioner Pieciak responded that Vermont had a good infrastructure compared to other states which equated to almost an industry to support captives. There will always be competition amongst the states but Vermont has the most aggressive and helpful laws to assist captives. Senator Westman inquired how Vermont could do a better job of marketing itself to avoid failures such as those in Bermuda. Senator Kitchel offered that Vermont has an annual captive insurance conference through the Department that has had a large turnout each time. Commissioner Pieciak stated that the Department was confident of Vermont's ability to retain captives.

2. FY 2016 Contingent General Fund Appropriations Status – a. Housing and Global Commitment

Andy Pallito, Commissioner, Department of Finance and Management, distributed a document with information for the next five agenda items. He summarized the contingent appropriations in FY2015 for LIHEAP, temporary housing, and Global Commitment.

b. 53rd Week of Medicaid and d. FY2016 Preliminary Close-out

Commissioner Pallito reviewed the FY2016 General Fund close-out which showed a total revenue shortfall of $11.19 million. Of this amount, $16.21 million was forecasted revenues coming in below expectation that were partially offset by higher transfers from other funds, including Department of Financial Regulation's (DFR) abandoned property and tax system development funds. The $11.21 gap was closed by $6.5 million of unobligated funds, i.e., left on the bottom line in FY2016, and $4.87 million that was appropriated but unspent in Medicaid funds that were reverted to bring the FY2016 General Fund budget balance position to $0.

c. Fiscal Year 2017 One-time 53rd Week of Medicaid Cost Funding

Commissioner Pallito explained that the actual cost of the Medicaid 53rd week payment at $7 million was lower than the initial estimate of $10 million and that this cost was fully covered in FY2016 within existing Medicaid resources. This allowed for $5.29 million in the FY2017 appropriation to be set aside in the new 53/27 reserve fund, created in the 2016 session. Senator Kitchel offered that the Legislature established the fund because every seven years Medicaid, and every 13 years the State employee payroll had an additional payment on a cash basis. Representative Johnson stated that in 2022 both the payments would be due, causing significant stress on the General Fund. She explained that it was important to understand not only that FY2016 closed in balance, but FY2017's $20 million revenue downgrade was addressed without program impact. In addition the first installment for these 7/13 year payments was made with this additional $5.29 million in reserves.

D. Governor's Proposed FY2017 Rescission Plan

The Committee dialed in the conference number for participating members. Representative Peter Fagan was the only member on the conference call. Commissioner Pallito reviewed the Governor's Proposed FY2017 Rescission Plan by referring to page 2 of his earlier handout. The revenue downgrade was $20.75 million minus $20.51 million of underspending within the Agency of Human Services, and other available funds brought the budget gap down to $240,000 which would be covered through a technical adjustment to the stabilization reserve in FY2016.

The Chair recessed the meeting and convened a public hearing at 11:00 a.m. She explained that there was a statutory requirement for a public hearing with a rescission plan per 32 V.S.A. § 704. She then offered for anyone to testify regarding the proposal.

Karen Lafayette, Vermont Low Income Advocacy Council, asked about the $1.7 million contingent fund for LIHEAP and how it was reflected in the proposed plan. Mr. Klein responded that the Legislature had a contingent $1.2 million saved in a reserve for LIHEAP in case of a downgrade, which was still available. The allocation would need to be approved at the Committee's September or November meeting, or the Emergency Board could transfer the money from that reserve to LIHEAP.

Representative Barbara Murphy, Franklin-2 district, asked for clarification on the 53rd Medicaid and 27th pay period reserve funds. Commissioner Pallito explained that the Administration would develop an amortization schedule in the fall to determine the actual amount needed to set aside each fiscal year for the 2022 payments, but the amount set aside in FY2017 was untouched. Senator Kitchel added that the Legislature had learned a lesson from preparedness of future obligations, such as teachers' retirement and was determined to have the 53/27 payments ready in 2022.

The Chair asked if Representative Fagan had any questions on the proposed plan and he responded that he did not.

The Committee adjourned the public hearing and reconvened the Committee meeting. The Chair then asked for a motion on the proposed plan since the Committee had no further questions and declined discussion. Senator Ayer moved to accept the Governor's Proposed FY2017 rescission plan, and Representative Johnson seconded the motion. The Committee unanimously accepted. Representative Ancel commented that the rescission plan presented and approved had been a much easier path to travel compared to past rescission plans, and she was relieved.

The Chair postponed action on the agenda item pertaining to the Vermont Economic Growth Incentive updates.

E. Medicaid Year-End Report for FY2016

Stephanie Barrett, Associate Fiscal Officer, Joint Fiscal Office, and Emily Byrne, Director, Budget and Management Division, Department of Finance and Management, gave a summary of the Medicaid year-end report that was distributed at the Emergency Board meeting of July 21, 2016. Ms. Barrett explained that there was underspending of expenditures in both State Only funded programs (pharmacy, clawback payment, and cost sharing assistance) and $28 million in Global Commitment. Ms. Barrett stated approximately one-half of the reason for this occurrence was a better-than-expected rebate experience for the pharmacy program. The Administration changed Pharmacy Benefit Managers (PBM) mid fiscal year (January 2016) and the rebates were coming in higher under the PBM. Further investigation was needed to discover how much of the gain was from one-time and ongoing actions. Representative Branagan inquired about the process of the rebate program. Ms. Barrett explained that there was a federal process in place for rebates to acquire the best price possible for pharmaceuticals.

In responding to Senator Kitchel, Ms. Byrne explained that the Department of Vermont Health Access (DVHA) was determining whether these gains in rebates were from the new PBM who had recouped the costs of rebates from the previous PBM, or whether drug manufacturers were doing a better job with rebate costs. Representative Sharpe asked if there were a more transparent way to determine the rates of rebates and best practices of individual PBMs. Ms. Barrett suggested the Committee hear from DVHA on specifics to do with the program and the change of PBMs. Representative Johnson expressed frustration that the State was only allowed to review the cost of a specific pharmaceutical but not the rebate amount, which made it difficult for legislators to understand the net cost of a drug when appropriating funds for the program. Senator Sears asked if experience rates of rebates could be compared with other states. Ms. Barrett stated she would be comparing data with other states at the National Council of State Legislatures (NCSL) at its next conference. Senator Ashe requested that DVHA inquire of other states on rebate experience rates and then report back to the Committee, and the Chair agreed.

The Chair requested the Commissioner of DVHA brief the Committee on the PBM change and what information led to that decision. She then asked Ms. Barrett for the information on the other half of the underspent expenditure gains. Ms. Barrett explained that they were awaiting the redetermination assessments that should become clearer by the end of the year. Additional information on expenditures had not yet been broken out into smaller categories of cost and Medicaid eligibility groups for review but was on track for the fall. She concluded by pointing out that within the report there was a summary on the redeterminations, and HROC would be receiving a more in-depth presentation on that information per reporting requirements.

Senator Ashe inquired why it was so difficult to determine eligibility of the redeterminations when it was a relatively small group of people. Ms. Barrett responded that DVHA was redetermining 9,000 households a month for the Modified Adjusted Gross Income (MAGI), and 700–900 a month for the Aging, Blind and Disabled (ABD) category. Within this process, it could become potentially lengthy with people not responding to DVHA and with additional notices and timelines occurring. The Chair added that some of the process was not automated and may slow the process down.

Representative Sharpe expressed concern on recent media reports of hospitals receiving triple profits, while the State struggled to pay for Vermonters' health insurance. Representative Ancel suggested HROC invite the Chair of the Green Mountain Care Board to give more information on this issue.

<u>F. Vermont Economic Employment Growth Incentive (VEGI) Program - 1. Cost-Benefit Model Proposed Update</u>

Mr. Kavet explained the technical aspects of the proposed updates to the Vermont Economic Growth Incentives program submitted by the Vermont Economic Progress Council. He recommended approving the proposed update with the caveat that more information be submitted to the Joint Fiscal Office as listed in his memo.

Fred Kenney, Executive Director, Vermont Economic Progress Council, and Ken Jones, Economic Research Analyst, Agency of Commerce and Community Development, reviewed the proposed updates to the VEGI model with the Committee as explained in a memo dated July 11. Mr. Kenney in responding to Representative Sharpe's question stated an estimated average of $2 million in incentives had been paid out annually from VEGI, and there was additional authority to approve $10 million annually that would be paid out over nine years to businesses. He agreed with Kavet's suggestions and confirmed the Council would follow up with that requested information.

Mr. Kavet clarified that typical VEGI expenditures (expenditures paid out) were $2 million annually but the previous fiscal year they were $4 million. He added he was comfortable with Mr. Kenney's stating that VEPC would follow through with the suggestions in his memo.

The Chair asked for a motion to accept the proposed updates to the VEGI cost-benefit model per Mr. Kenney's memo with the understanding that VEPC would provide further information as requested in Mr. Kavet's memo. Representative Sharpe moved to postpone action on the updates until a more conclusive evaluation of the impacts to the VEGI model, as written in Mr. Kavet's memo, was sent to the Joint Fiscal Office. Representative Ancel seconded the motion for the purposes of discussion, and a discussion ensued on whether to postpone action on the proposed updates. Mr. Kenney showed concern for delaying the updates if consideration of applications were to be delayed as well. Representative Ancel stated that the technical working group on the VEGI cost-benefit model would be the most critical in determining any changes needed to the model. She expressed concern that delaying the updates could interfere with the group's work moving forward.

Based on comments by Mr. Kavet that he was comfortable with the approval of the updates and supplying the additional information on the impacts later, Representative Sharpe withdrew his motion. Representative Ancel moved to accept the updates with the understanding that Mr. Kavet's suggestions be completed by VEPC. Representative Branagan seconded the motion and requested that another update on VEGI and the working group be included in the Committee's September meeting agenda. The Committee approved the motion with Representative Sharpe voting no.

2. Presentation – VEGI Incentive Program – Technical Working Group

Sara Teachout, Senior Fiscal Analyst, Joint Fiscal Office, listed the members of the working group as follows: Tom Kavet for the Joint Fiscal Office, Ken Jones for the Agency of Commerce and Community Development, Matt Barewicz for the Department of Labor, and Rebecca Sameroff for the Department of Taxes. The Group's first meeting was scheduled for the following day along with a meeting the first week in August. The findings would be presented in January 2017 with the final report.

The Chair requested a motion to approve the VEGI technical working group's membership as listed by Ms. Teachout, and to convene its first meeting. Representative Ancel made the motion and Senator Ayer seconded it. The Committee approved.

G. Federal Single Audit Review; CAFR – 1. Auditor's Office (KPMG)

Shawn Warren, Audit Partner, and Renee Bourget-Place, Audit Partner, KPMG, were contracted by the State Auditors' Office for the federal single audit review process. Ms. Bourget-Place gave a summary of the audit reports' findings for FY2015. The first audit report related to the CAFR on controls and compliance that had ten findings with five material weaknesses and five significant deficiencies. The second report reviewed controls and compliance over federal rewards with an estimated $2.1 billion in FY2015 from federal grants. Out of the 27 programs audited in FY2015, 21 of those were repeated in the previous fiscal year, due to continued significant findings or high risks. The Committee requested a written summary sheet to be sent to them. In responding to Senator Ayer, Ms. Bourget-Place explained that a finding of material weakness was a higher risk. She then stated that of the 48 findings for the federal rewards audit, 26 were repeat findings, and 22 were new. In FY2015, for the first time, KPMG gave adverse opinions on Medicaid and CHIP (Children's Medicaid), and 12 programs with modified opinions.

Ms. Bourget-Place offered that with the revised regulations for federal rewards audits in FY2016, it would not be necessary to repeat audits on programs with significant deficiencies. Senator Kitchel offered these new rules should reduce costs to Vermont and Ms. Bourget-Place agreed. Representative Lippert inquired what the impacts were for the adverse opinions to Medicaid and CHIP programs. Mr. Warren responded that the federal agency in charge of the grant awards would assess what the penalty would be to Vermont, and whether it would be retroactive or prospective. It could range from increased scrutiny or regulation, a demand for returned funds, or elimination of future funding. In responding to Representative Lippert, Ms. Bourget-Place explained that it took 6 to 12 months for the federal government to review the audit findings. Senator Ashe asked what led KPMG to determine that Medicaid and CHIP would be afforded an adverse opinion. Ms. Bourget-Place responded that there were very significant deficiencies in the eligibility findings in terms of the volume of items not in compliance. In addition, almost every other area, besides eligibility, had a finding.

The Chair reiterated the Committee's request for a summary of the audit reports. She added that the summary should highlight the key findings that legislators should understand for each of the programs. Representative Branagan asked for the full audit report, and Mr. Klein stated JFO would send a link to Committee members. The Chair asked for a few printed copies for members that preferred that type of media. Representative Ancel requested additional information within the requested summary, from the Auditor's office, on how audits were performed; and a continued discussion at the Committee's September meeting.

Ms. Bourget-Place responded to Senator Westman that the audit report would not quantify the financial impacts of being out of compliance in regard to eligibility. Senator Ashe asked if historically audit findings from previous years had improved. Ms. Bourget-Place explained that with the current amount of reaudits, there appeared to be no improvement. Senator Ashe offered that there should be a conversation on how standing committees monitor adverse audit findings in departments. Senator Kitchel added it brought up the question on how a committee evaluates a department's full performance.

<u>2. Administration's Response to Auditor's Findings</u>

Commissioner Pallito and Brad Ferland, Deputy Commissioner, Department of Finance and Management, responded to the KPMG's audit findings. Deputy Commissioner Ferland explained that the Administration did not disagree with KPMG's audit findings, and agreed that the audits should be improved. There were two audits that the State was subject to: the basic financial audit and the federal funds audit. The basic financial audit included all State funds, such as General Funds, Special Funds, Transportation Funds, and other funds. These types of audits have received top ratings as good reports. The second audit on federal funds could have large implications and high risks to Vermont's bond rating opinions due to negative financial perceptions.

Deputy Commissioner Ferland offered that of the 27 programs audited, 7 had no findings. The Agency of Human Services (AHS) and Agency of Education each had 3 programs with no findings, and the Department of Military had 1 program with no findings. In addition, one-half of the programs from 2015 would not be reaudited in 2016. The Administration had established a new process of including commissioners and department heads into the entrance conferences with KPMG. KPMG has agreed to send periodic updates to departments before audits are reported, and the departments would send quarterly updates to the Administration to review their progress to address findings. New Policy, Bulletin 5, addresses all the federal requirements and the Administration's policies. A challenge that departments face in avoiding repeat findings was that the federal reporting deadline was toward the end of March and it made it programmatically impossible for some departments to implement a mediation plan in response to findings before the next audit began in July.

Deputy Commissioner Ferland explained that of the 27 audited programs, 14 were in AHS, 5 in Agency of Education, 2 each in the Agency of Transportation and Department of Labor, 1 each in the Department of Public Safety, Agency of Commerce, Department of Military, and Department of Environmental Conservation. An internal audit group was formed within AHS to address its repeat audit findings. Senator Ashe asked what could be done to enhance better internal controls reporting. Deputy Commissioner Ferland responded that documentation was important to the process along with expertise of federal requirements, and also an awareness of the magnitude of adverse findings.

The Chair suggested that standing committees would have an interest in the correction action plans for departments and could be included in findings discussions. Doug Hoffer, Vermont State Auditor, stated his office was pleased with the actions the Administration had taken to address the audit findings.

H. Fiscal Office Updates – 1. Education Fund Outlook

Mark Perrault, Senior Fiscal Analyst, Joint Fiscal Office, gave an update on the Education Fund Outlook. Based on the July revenue forecast, Lottery, Purchase and Use Tax, and Sales Tax receipts were down $3.8 million over 2 fiscal years (FY2016 and FY2017). This would be offset by the Property Tax adjustment from FY2016 of an estimated $8 million. Early estimates also predicted an additional $10 million available in FY2018. Part of this surplus is from a possible reversion from Special Education.

2. Future of Health Connect RFP

Catherine Benham, Associate Fiscal Officer, Joint Fiscal Office, referred to the statutory language that directed the Office to "conduct an analysis for the General Assembly on or before December 15, 2016 regarding the current functionality and long-term sustainability of the technology for Vermont Health Connect" per Sec. E.127.1 of Act 172 of 2016. The Office sent out a Request for Proposal (RFP) for a third party to assist in this analysis. In responding to Senator Kitchel, Mr. Klein estimated that a contract would be signed the following week or as soon as it possibly could in order to begin its work.

3. Fiscal Officers Report

Mr. Klein presented his report and the Committee had no questions.

Senator Ashe suggested a JFC subgroup be formed to discuss preliminary thoughts on future monitoring of audit findings. The Chair and Vice Chair volunteered to review information on how to manage and review audits along with the current findings and report back to the Committee at its September meeting. The Committee confirmed its next meetings: September 15 and November 14.

The Chair requested a motion to adjourn. Senator Ayer made the motion and Representative Sharpe seconded it. The Committee adjourned at 1:00 p.m.

Respectfully Submitted,

Theresa Utton-Jerman
Legislative Joint Fiscal Office