STATE OF LOUISIANA
LEGISLATIVE AUDITOR

State of Louisiana's Management and Oversight of Long-Term Bonded Debt

April 1993

Performance Audit

Daniel G. Kyle, Ph.D., CPA
Legislative Auditor

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April 26, 1993

Honorable Samuel B. Nunez, Jr.,
President of the Senate
Honorable John A. Alario, Jr.,
Speaker of the House of Representatives
and
Members of the Legislative Audit Advisory Council

Dear Legislators:

This is our report of the performance audit of the State of Louisiana's Management and Oversight of Long-Term Bonded Debt. This audit was conducted under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. All performance audits are conducted in accordance with generally accepted governmental auditing standards.

The report presents our findings, conclusions, and recommendations as well as the Division of Administration's and Department of Treasury's responses to the findings. We have also identified and reported several matters for legislative consideration.

Sincerely,

Grover C. Austin, CPA
Assistant Legislative Auditor

GCA/dl

[bonddebtltr]

Office of Legislative Auditor

Executive Summary

Performance Audit
Louisiana's Management of Long-Term Bonded Debt

At the close of fiscal year 1991-92, Louisiana had almost $3.9 billion in outstanding state tax-supported bonded debt. The state allocates a significant portion of its revenue to fund annual debt service on these bonds and has one of the highest ratios of debt per capita of the 50 states. Currently, Moody's Investors Service, Inc. gives Louisiana's general obligation bonds a Baa1 rating, the lowest of any state.

Our performance audit of the state's management of long-term bonded debt revealed that:

- The state does not have a formal long-term debt management plan which addresses all state tax-supported bonded debt and coordinates with the state's capital planning.
- Some state capital projects do not go through the formal capital outlay review process.
- Nonstate capital projects have become a significantly larger percentage of the general obligation bond section of the capital outlay budget. Because funding is limited, the nonstate projects can have the effect of displacing state projects.
- The State Bond Commission staff needs to improve its financial analyses of debt applications. Several staff functions could either be eliminated or performed more efficiently.

Daniel G. Kyle, Ph.D., CPA, Legislative Auditor
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Audit Objectives

This audit of the management of Louisiana's long-term bonded debt was conducted by the Performance Audit Division of the Office of Legislative Auditor. The audit objectives were to determine:

- the various types and costs of state long-term debt;
- how state tax-supported bonded debt has been used in Louisiana;
- the adequacy of the state's capital planning process; and
- the adequacy of the state's debt management and oversight.

State Tax-Supported Debt

Moody's Investors Service, Inc. gives Louisiana general obligation bonds a Baa1 rating, the lowest of any state. At the close of fiscal year 1991-92, Louisiana had almost $3.9 billion in outstanding state tax-supported bonded debt. Annual debt service on these bonds was equivalent to approximately seven percent of the state's General Fund expenditures. If the state's total tax-supported bonded debt as of June 30, 1992, were apportioned to Louisiana citizens, each person would owe $917. (page 2)

Summary of Division of Administration's Response

The Division of Administration responded that, while Moody's Investors Service considered the debt listed in our report state tax-supported debt, the debt of the Greater New Orleans Expressway Commission, pre-1974 university debt, and the Louisiana Agricultural and Finance Authority's nonloan debt program should also be considered state tax-supported debt.

Auditors' Comments

Moody's Investors Service, which provides bond ratings for state bonded debt, limits state tax-supported debt to the $3.9 billion listed in this report. However, we do not disagree that the more conservative approach used by the Division of Administration to identify total state tax-supported bonded debt might be appropriate for use in any subsequent state debt management plan. This inclusion would raise the reported level of state tax-supported debt $134,308,000, from $3,885,198,000 to $4,019,506,000.

No Formal Debt Management Plan

The state's cost of borrowing is affected by many factors. Some, such as those related to economic conditions, cannot be directly controlled by improved debt management. Other factors, such as following a sound debt management policy, can impact the state's credit worthiness.

Louisiana does not have a formal debt management plan that includes all types of state tax-supported debt, forecasts annual debt capacity, and coordinates with the state's capital planning. Furthermore, the state has used bonded debt in ways which contribute to lower bond ratings and increased costs. The state has used bonded debt to finance previous years' General Fund shortfalls. (pages 22-23)

Bonds are most appropriately used to finance capital projects so that current and future taxpayers who benefit from the projects pay for them. By financing prior operating expenses, taxpayers pay for services for which the benefit has already been realized. The financial community considers use of long-term debt to fund operating expenses a sign of poor financial management. (pages 20-21)

Matter for Legislative Consideration

The legislature may wish to consider legislation requiring the development of a multi-year, comprehensive debt management plan. This plan should include all types of state tax-supported debt, forecast annual debt capacity, and coordinate the state's five-year capital plan with future debt capacity estimates. It should consider targets for debt burden and other qualitative factors, such as economic projections, overall state financial management, other state debt, and administrative policies and practices. (page 23)

Capital Planning Process

The state's capital planning needs improvement. The planning process that produces the state's capital outlay budget is an important part of the state's financial management. This is because many projects in the capital outlay budget are financed with general obligation bonds.

Louisiana has a statutorily mandated capital budgeting process, but that process is not always followed. Ten of the 34 projects (29%) we examined did not follow the required review process. (page 26)

Matters for Legislative Consideration

The legislature may wish to set stricter guidelines for exempting projects from the statutorily mandated capital outlay review process. (page 28)

The legislature may also wish to restrict the automatic reauthorization of unfunded capital outlay projects that bypassed the statutorily mandated review process in previous years. These projects could be reviewed and prioritized with new capital outlay requests. (page 28)

Nonstate Projects

The state has not had the resources to fund all state capital project requests. However, since fiscal year 1986-87, nonstate projects have become a significantly larger percentage of the general obligation bond section of the capital outlay budget. Because funding is limited, the addition of nonstate projects to the capital outlay budget can have the effect of displacing state projects. (pages 30-32)

Matters for Legislative Consideration

The legislature may wish to require examination of nonstate (parish, city, or local authority) entities' willingness

and ability to fund their own projects before appropriating state capital outlay funds for those projects. (page 33)

The legislature may also wish to develop a policy concerning the amount or percentage of state capital outlay funds appropriated for nonstate entities to ensure that the capital needs of the state are met. (page 33)

Lines of Credit

The state uses lines of credit as interim funding for some capital outlay projects in anticipation of future general obligation bond sales. However, the state does not ensure that projects with outstanding lines of credit are addressed in subsequent capital outlay budgets. (pages 33-35)

Matter for Legislative Consideration

The legislature may wish to implement controls to ensure that outstanding lines of credit at the end of the fiscal year are addressed in the capital outlay budget. (page 35)

Summary of Division of Administration's Response

The Division of Administration responded that it had a mechanism to insure that projects with outstanding lines of credit were addressed in subsequent budgets, in the introduction of the capital outlay bill. However, this did not guarantee that the legislative process would not make changes affecting the reauthorization of lines of credit. The division also noted that lines of credit were subject to reauthorization approval by the State Bond Commission.

General Obligation Bond Authorization

The general obligation bond portion of the five-year capital plan is not tied to a realistic debt funding estimate. For the state to fund the general obligation bond projects in the fiscal year 1992-93 five-year capital plan, it would have to issue approximately $272 million in general obligation bonds in each of the next five years. The original general obligation bond funding estimate for 1992-93 was $192 million. (pages 36-37)

Matter for Legislative Consideration

The legislature may wish to implement a mechanism to develop long-term capital outlay debt funding estimates, including proposed allocation levels for all entities with capital outlay funding. These capital outlay funding estimates would coordinate with the debt management plan. (page 37)

Summary of Division of Administration's Response

The Division of Administration responded that "Several *references to a breakdown in the [capital planning] process occur,* yet in no section [of Chapter Three of this report] does it indicate where, or what entity was responsible for the breakdown. . . . The Division fulfilled its responsibilities under the law . . ."

State Bond Commission Staff

State Bond Commission staff's review of proposed fees associated with bond issues helps contain these types of costs. However, other functions need improvement.

There was no indication from some files we reviewed that staff considered key financial information and assumptions. Some files contained insufficient financial information with which to evaluate applicants' repayment capability. Occasionally the staff did not inform the State Bond Commission of relevant financial facts concerning an application. Staff did not always use its standard procedure to ascertain if applicants already had outstanding loans. (pages 42-53)

We recommended that commission staff:

- receive training, if needed, and develop guidelines to ensure that appropriate financial analysis is done for every application; (page 46)

- establish guidelines specifying information required for financial analysis and set time frames for submitting this information; (page 49)
- ensure that they obtain all necessary financial information and document it in commission files; (page 49)
- clearly disclose limitations of staff analysis when necessary information is not submitted; (page 49) and
- implement a system to monitor outstanding indebtedness more accurately and applicants' use of the same security more than once. (page 53)

We also recommended that the State Bond Commission consider adopting a policy to defer considering applications until commission staff has received all information necessary for required financial analysis. (page 50)

Summary of Department of Treasury's Responses

The Department of Treasury responded that:

- The Staff of the Bond Commission now receives ongoing training in public finance. All efforts are made to do a uniform financial analysis on all applications but the staff does recognize unique situations.
- The Treasurer appointed a Rules Subcommittee in 1992 creating a mechanism for the revision and updating of State Bond Commission Rules. However, it should be noted that the staff strictly follows statutory and administrative rule guidelines for the review of different forms of debt.
- A desired time frame for the submission of information is in place, but the Staff is often unable to enforce the rule because of the realities of local debt management and the practical problems Bond Commission members are presented with by the applicants.
- The staff, absent enhanced reporting requirements, has operated under the "prudent business person" rule of business in that the required information would be that

which would be required by a prudent business person making informed decisions.

- The Department of Treasury concurred with the recommendation that the State Bond Commission consider a policy to defer considering applications until all necessary information has been received.

Recommendations for Improved Efficiency

Several functions performed by the commission staff could either be eliminated or performed more efficiently. The commission is legally required to review certain election propositions that have nothing to do with incurring debt or levying taxes. The preliminary approval process, legally required for certain types of bonds, is of limited benefit. Finally, staff review of budgetary loans and certain election applications can be accomplished more efficiently. (pages 54-58)

Matters for Legislative Consideration

The legislature may wish to consider eliminating:

- **the State Bond Commission's review of home rule charter proposals and elections having nothing to do with incurring debt and levying taxes; (page 55) and**
- **the requirement that certain revenue bonds receive preliminary approval. (page 56)**

Summary of Department of Treasury's Responses

The Department of Treasury responded that the Treasurer has requested legislation relating to the review of home rule charter proposals.

The Department of Treasury disagreed with the suggestion that the legislature consider eliminating the preliminary approval of certain revenue bonds.

We also recommended that commission staff:

- consider establishing a more efficient method of reviewing budgetary loan applications which indicate no financial difficulties; (page 57) and
- institute procedures to streamline review of nonissue elections. (page 58)

Summary of Department of Treasury's Responses

The Department of Treasury responded that an advisory panel was being created to review how the State Bond Commission considers local government affairs. The department also noted that while staff prepares an analysis sheet for each application, the State Bond Commission typically considers all election requests in one combined motion at commission meetings.

Chapter One: Introduction

This audit of the management of Louisiana's long-term debt was conducted by the Performance Audit Division of the Office of Legislative Auditor. This audit was initiated by the Legislative Audit Advisory Council at its August 4, 1992, regular meeting. The audit objectives were to determine:

- the various types and costs of state long-term debt;
- how state-supported bonded debt has been used in Louisiana;
- the adequacy of the state's capital planning process; and
- the adequacy of the state's debt management and oversight.

Report Conclusions

At the close of fiscal year 1991-92, the state had almost $3.9 billion in outstanding state tax-supported bonded debt. Moody's Investors Service now gives Louisiana's general obligation bonds a Baa1 rating, the lowest rating of any state. This results in higher borrowing costs for the state.

The state's credit rating is affected by many factors. Some, such as those related to economic conditions, cannot be directly controlled by improved debt management. Other factors, such as following a sound debt management policy, can impact the state's credit worthiness and help decrease the costs of borrowing.

Louisiana does not have a formal management plan that includes all types of state tax-supported debt, forecasts annual debt capacity, and coordinates with the state's capital planning. Furthermore, the state has used bonded debt in ways which contribute to lower bond ratings and increased costs. The state has used bonded debt to finance previous years' General Fund shortfalls, a practice the financial community considers a sign of poor financial management.

The state's capital planning also needs improvement. The state does not always follow its statutorily mandated review process. Louisiana has not had enough resources to fund all state capital project requests. However, since fiscal year 1986-87, nonstate projects have become a significantly larger percentage of the general obligation bond section of the capital outlay budget. Because funding is limited, this can have the effect of displacing state projects. Furthermore, authorizing projects in the capital outlay budget's general obligation bond section does not guarantee that they can be funded because the general obligation bond authorization is not tied to a realistic debt funding estimate.

Finally, the State Bond Commission has responsibility for overseeing all bonded debt issued by Louisiana or any of its political subdivisions. The commission has a staff to assist it in carrying out its oversight responsibilities. The staff's performance of its oversight mission needs improvement. Several functions performed by the commission staff could either be eliminated or performed more efficiently.

Long-Term Debt Outstanding

As of June 30, 1992, Louisiana had more than $3.9 billion of state tax-supported bonded debt outstanding. The debt service (the periodic payment of principal and interest to bondholders) for this debt is paid (either directly or indirectly) by statewide tax revenues. This outstanding debt includes general obligation bonds, dedicated tax bonds, long-term lease obligations, and certain revenue bonds.

If the total tax-supported bonded debt as of June 30, 1992, were apportioned to citizens of Louisiana, each person in the state would owe $917. In fiscal year 1991-92, the debt service on these bonds was equivalent to approximately seven percent of the state's General Fund expenditures.

In addition to tax-supported debt, almost $1.08 billion of revenue bonds are shown as state debt on Louisiana's Comprehensive Annual Financial Report (CAFR). Although statewide tax revenues are not used to pay debt service for these bonds, the state has a significant oversight responsibility for the entities issuing them. Thus, guidelines issued by the Governmental Accounting Standards Board require that this debt be reported as state long-term obligations. Accordingly, financial statements for Louisiana show state long-term debt of almost $5.0 billion.

Exhibit 1 delineates the types and amounts of each type of state bonded debt shown on the state's June 30, 1992, financial

Exhibit 1
State Bonded Debt
June 30, 1992
(in thousands of dollars)

Type of Debt	**Amount**
Part 1: Tax-Supported Bonded Debt	
General obligation bonds	$2,605,917
Dedicated tax bonds	968,208
Long-term lease obligations	243,180
Other revenue bonds	67,893
Total Tax-Supported Bonded Debt	**$3,885,198**
Part 2: Bonded Debt Obligations for Financial Reporting Purposes	
Revenue bonds issued by entities with significant state oversight	$585,645
Unemployment compensation bonds	691,850
Less - two long-term lease obligations reported as capital leases in the CAFR	(90,440)
Less - reimbursement contracts with political subdivisions (considered tax-supported debt by the financial community)	(94,971)
Total State Bonded Debt Obligations as shown in the CAFR	**$4,977,282**

Source: Compiled by Legislative Auditor's staff from Louisiana Comprehensive Annual Financial Report for the year ended June 30, 1992, and information from Moody's Investors Service, Inc.

Note: See Appendix C for detailed listing of bond issues.

statements (CAFR). Part 1 of the exhibit shows outstanding bond obligations which are considered tax-supported debt by the financial community. Part 2 adds other bonded debt which is considered state bonded debt obligations for financial reporting purposes. Part 2 subtracts other types of debt which the financial community considers state debt but which is classified elsewhere for financial reporting purposes. Appendix C of this report provides a more detailed schedule of outstanding bonded debt as well as future debt service requirements.

Since this audit deals with bonded debt management rather than financial reporting, we use the financial community definitions for tax-supported bonded debt. Thus, unless otherwise stated, discussions and recommendations addressing state bonded debt will include the types of bonded debt shown in Part 1 of Exhibit 1 which total $3,885,198,000.

Long-term municipal bonded debt may be divided into two main categories: general obligation and revenue. General obligation bonds are secured by the full faith and credit of the issuer. Revenue bonds are all types of bonds other than general obligation.

Revenue bonds are payable from a specific source of revenue and do not permit the bondholders to compel taxation or legislative appropriation of funds not pledged for payment of debt service. In Louisiana, some debt service for revenue bonds is funded by tax monies. These revenue bonds are considered obligations, or debt, of the state. They differ from general obligation bonds in that only revenue from specified taxes (for example, sales tax) can be used to pay debt service.

Generally, a capital project is defined as a project intended for long-term use or possession, such as a highway, building, or other facility. The project usually:

- involves new construction or the acquisition of land or buildings, and the original equipment associated with a new facility; or
- is a major improvement or alteration that has a multi-year life and/or costs above a certain dollar amount.

A capital outlay budget is prepared each year to determine what capital projects in the state will be funded. State agencies begin the budgeting process by preparing and submitting their capital outlay requests to the Division of Administration (division). At the same time, political subdivisions submit their capital outlay requests to their senator and representative who forward such requests to the division. After review by the division, legislative committees, and others, the legislature approves a capital outlay budget each year. The planning process that produces this capital outlay budget is an important part of the state's financial management because many of the projects which are initiated or continued each year are paid for by issuance of bonded debt.

Although some capital projects are funded with cash, long-term debt is used to finance many projects because it is equitable that projects which will be used for years be repaid over time by each generation of users. Using debt can be more expensive than directly paying for projects because the costs of the borrowing (primarily interest payments) are added to project costs. These extra costs can be justified because the costs are intended to be spread over the useful life of the project and shared over time by users of the project. Conversely, if there is no future benefit for the taxpayers who pay off debt principal and interest, debt should not be used.

Several states have instituted debt management plans to manage their state debt. Debt management plans provide multi-year forecasts of debt capacity which can be coordinated with capital planning needs to establish priorities for projects funded by long-term debt. A recently defeated amendment to the Louisiana Constitution called for the legislature to adopt a comprehensive debt management plan which would have taken effect no later than December 31, 1993.

Division of Administration's Comment

It is our position that information contained on pages 2 and 3 of the report requires clarification namely that: Exhibit 1 was compiled by the Legislative Auditors Office, utilizing state tax supported debt parameters defined by the 1/1/93 Moody's Investors Services report, and information contained in the State's 1992 Comprehensive Annual Financial Report (CAFR). Part 1 of the exhibit shows outstanding bond obligations which are considered state tax supported debt by the financial community and the state and reflected in the CAFR under the debt unit. Part 2 adds certain other bonded debt which is considered state bonded debt obligations for financial reporting purposes and financial community purposes which is also contained within the

CAFR under the debt unit. Also Part 2 subtracts other type of debt both the financial community and the CAFR consider as state tax supported debt, which is reflected under the Capital Leases unit, rather than the Debt unit, of the CAFR.

It is the Division of Administration's position that certain debt of the state and its instrumentalities which should be considered as net tax supported debt and which is contained in the CAFR and recent Official Statements, is not included in the 1/1/93 Moody's listing. Those debt items include the debt of the Greater New Orleans Expressway Commission, pre-1974 debt of the colleges and universities, and the non-loan program debt of the Louisiana Agricultural and Finance Authority.

Auditors' Comments

Moody's Investors Service, which provides bond ratings for state bonded debt, limits state tax-supported debt to the $3.9 billion listed in this report. However, we do not disagree that the more conservative approach used by the Division of Administration to identify total state tax-supported bonded debt might be appropriate for use in any subsequent state debt management plan. This inclusion would raise the reported level of state tax-supported debt $134,308,000, from $3,885,198,000 to $4,019,506,000.

Public Entities Involved With the State's Long-Term Debt

To assist understanding of the remainder of this report, several of the major private and public entities involved with state debt and capital budgeting are briefly described.

Public entities involved with state debt include the:

- State Bond Commission,
- Department of Treasury,
- Division of Administration, and
- Office of the Attorney General.

State Bond Commission

The State Bond Commission (commission) was created to centralize and administer state debt, including indebtedness incurred by boards, agencies, and commissions. Article VII, Section 8 of the State Constitution provides that no bonds or other obligations be issued or sold by the state directly or through any state board, agency, or commission, or by any political subdivision of the state, unless prior written approval of the commission is obtained.

Department of Treasury

Article IV, Section 9 of the State Constitution gives the State Treasurer responsibility for the custody, investment, and disbursement of the public funds of the state unless provided otherwise by the constitution. In addition, the State Treasurer must provide advice regarding the issuance and sale of bonds as well as the management of the state's debt.

Division of Administration

The Division of Administration (division) was created in the Office of the Governor by Louisiana Revised Statute (LSA-R.S.) 39:1 *et seq.* and is charged with providing accounting supervision and fiscal reporting for all state agencies and the state as a whole. The division maintains amortization schedules of all outstanding state debt and provides financial information for inclusion in the Official Statements for state bond issuances. Also, the division reviews requests for state capital projects.

Office of the Attorney General

Article IV, Section 8 of the State Constitution creates a Department of Justice, headed by the Attorney General, who is the chief legal officer of the state. The Attorney General provides opinions on the legality of state bond issues.

Private Entities Involved With the State's Long-Term Debt

In addition to the public agencies, private entities are also involved with state debt. These include the financial advisor, bond counsel, and paying agent banks.

Financial Advisor

The financial advisor advises the state on matters pertinent to new bond issues, such as structure, timing, and terms. The financial advisor reviews and comments on information contained in the Official Statements for state bond issues and prepares financial analyses in connection with the sale of these bonds. The commission selected a new state financial advisor in January 1993.

Bond Counsel

A bond counsel is an attorney or law firm retained by the state to give a legal opinion on each bond issue. The opinion affirms that Louisiana is authorized to issue the proposed bonds, has met all legal requirements necessary for issuance, and that interest on the proposed bonds will be exempt from federal and state income taxation.

Paying Agent Banks

Once state bonds are issued, the paying agent banks are responsible for the payment of principal and interest on behalf of the state. The paying agent bank may also be required to reconcile the bond principal and interest amounts paid to bondholders with the money paid to it by the state.

Scope and Methodology

This audit was conducted under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. All performance audits are conducted in accordance with generally accepted governmental auditing standards as promulgated by the Comptroller General of the United States. Preliminary audit work began in August 1992, and fieldwork was completed in January 1993.

We identified and reviewed federal and state laws and regulations pertaining to the administration and oversight of long-term debt.

To determine the amount and types of Louisiana's long-term debt, we reviewed the state's Comprehensive Annual Financial Reports and associated accounting records. We also interviewed staff at the Department of Treasury, the Division of Administration (division), public trusts (such as the Louisiana

Public Facilities Authority), members of the financial community, and staff at the Office of Legislative Auditor's Financial and Compliance Division.

We reviewed the constitutional and statutory requirements for the state's capital planning and budgeting processes. We documented the processes through interviews and review of documents at state departments, the division, legislative offices, and the State Bond Commission. We conducted limited testing of the capital outlay review process at the division. We did not, however, evaluate the quality of these reviews.

We analyzed the last ten years' Capital Budget Acts and supporting materials for evidence of long-term planning. We also compared the final acts to the capital outlay requests of the Department of Health and Hospitals and the Department of Public Safety and Corrections, Corrections Services.

The capital outlay review process was examined. We noted if any capital projects were included in the Capital Budget Act that were not reviewed. We also examined other aspects of the legislative process.

The use of long-term debt was also evaluated. We reviewed the use of these types of debt and the costs of the debt.

Furthermore, we examined the state's management of debt. We reviewed debt levels and ratios and compared them to other states. We interviewed representatives of national bond rating agencies regarding the characteristics they desire in debt management plans.

Finally, we reviewed the oversight activities of the State Bond Commission and its staff. We reviewed constitutional, statutory, and regulatory requirements. We interviewed commission staff and documented their oversight activities. We also reviewed the commission staff's analyses of bond, loan, and election applications to determine the quality of the analyses. Further, we reviewed the staff's activities and identified responsibilities that could be eliminated to increase the efficiency of the commission staff's oversight of debt.

Report Organization

The remainder of this report is organized into three additional chapters and five appendixes.

- **Chapter Two** is a discussion of the state's types and uses of debt.
- **Chapter Three** is a review of the state's capital budget process.
- **Chapter Four** is an evaluation of the State Bond Commission staff's oversight of debt.
- **Appendix A** is a glossary of terms used in this report.
- **Appendix B** is a detailed description of the state's capital budgeting process.
- **Appendix C** provides detailed schedules of outstanding bonded debt issues as of June 30, 1992.
- **Appendix D** contains the full text of agency responses to report recommendations.
- **Appendix E** includes supplemental information on the auditors' review of the State Bond Commission staff's files and financial analysis.

Officials of the Department of Treasury and the Division of Administration were given an opportunity to provide written responses to the report. Excerpts from these responses have been inserted in the report directly following the relevant sections and are summarized in the report's executive summary. The full text of the responses is included as Appendix D. The Department of Treasury's responses questioned some of the rationale for audit conclusions presented in Chapter Four. Appendix E includes supplemental information responding to those questions.

Chapter Two: Debt Management

Chapter Conclusions

As of June 30, 1992, the state had almost $3.9 billion in tax-supported bonded debt outstanding. During fiscal year 1991-92, taxpayers paid over $596,347,696 for debt service on outstanding debt, which is equivalent to approximately seven percent of the state's General Fund expenditures.

Moody's Investors Service's latest rating of Louisiana's general obligation bonds is Baa1, the lowest of any state. The state has relied on bond insurance to raise the rating of recent general obligation bond issues to AAA. The one-time cost of insurance for the March 1992 general obligation bond issue was $10,154 per million dollars which totaled over $2.3 million.

While long-term bonded debt is most appropriately used to finance capital projects, Louisiana has used debt to finance previous years' General Fund shortfalls and operating expenses. Using bonded debt to finance budgetary shortfalls can negatively impact the state's credit worthiness and, thus, can result in higher bond interest costs. The state's credit worthiness could be enhanced by the development of a debt management plan which includes all state tax-supported debt.

Tax-Supported Bonded Debt

State tax-supported debt includes all debt serviced by statewide tax revenues, whether or not the state itself issues the bonds. Louisiana has four types of tax-supported bonded debt: general obligation, dedicated tax, long-term lease obligations, and certain other revenue bonds.

- General obligation bonds are secured by the full faith and credit of the state.
- Dedicated tax bonds are a type of revenue bond secured by specified taxes (for example, fuel taxes). For any type of revenue bond, bondholders cannot compel taxation or legislative appropriation of funds

not pledged for payment of debt service. These bonds include the Louisiana Recovery District and the Transportation Infrastructure Model for Economic Development (TIME) bonds.

- Long-term lease obligations include bonds issued by an entity which builds or purchases a facility or equipment and then leases the facility or equipment to a state entity. The lease payment/debt service paid by the leasing state entity is subject to annual appropriation.
- Other revenue bonds include revenue bonds which are not included in the previous categories but whose debt service may be directly or indirectly secured by state tax revenues or fees.

While the financial community limits tax-supported bonded debt to the types of bonds listed above, Louisiana's Comprehensive Annual Financial Report (CAFR) includes additional bonds as state obligations. Government Accounting Standards require that revenue bonds issued by entities which have been determined to be component units of the State of Louisiana by the Louisiana Division of Administration (division) be included as state debt. The CAFR shows state bonded debt of almost $5.0 billion outstanding as of June 30, 1992. See Appendix C for a detailed listing of all types of bond issues.

General Obligation Debt

General obligation bonds are secured by the full faith and credit of the issuer. Prior to the 1974 Louisiana Constitution, the state issued bonds for specific purposes payable from specific "dedicated" taxes. Unlike most dedicated tax bonds, these bonds are full faith and credit obligations of the state. An example of these pre-1974 bonds are the Charity Hospital of Louisiana at New Orleans bonds issued in 1967 and 1968.

The 1974 Louisiana Constitution authorized the state to issue general obligation bonds. Since then, bonds have been issued and the proceeds have been allocated among various state agencies. As of June 30, 1992, general obligation debt principal outstanding was $2,605,917,000.

There are two statutory limits on state general obligation debt. Under LSA-R.S. 39:1365(25), the legislature cannot authorize general obligation bonds if the amount authorized but unissued, plus the amount outstanding, exceeds two times the average annual revenues of the Bond Security and Redemption Fund for the last three completed fiscal years. As of June 30, 1992, total general obligation bonds authorized was $3,677,250,000, or 35.9 percent of the $10,237,288,000 bond authorization limit.

Secondly, the State Bond Commission cannot issue general obligation bonds if the highest annual debt service for the current or any subsequent fiscal years on such bonds (including other general obligation bonds then proposed to be sold) exceeds 10 percent of the average annual revenues of the Bond Security and Redemption Fund for the last three completed fiscal years prior to such issuance [LSA-R.S. 39:1402(D)]. As of June 30, 1992, the highest current or future annual general obligation debt service requirement was $359,932,000, or 70.3 percent of the debt issuance limitation.

Dedicated Tax Debt

Dedicated tax bonds are a type of revenue bond that are payable from a specified source of revenue and do not permit the bondholders to compel taxation or legislative appropriation of funds not pledged for payment of debt service. Debt service for bonds funded by a dedicated tax are payable solely from the proceeds of the specific tax, such as the $264 million of Transportation Infrastructure Model for Economic Development bonds issued in April 1990. Under LSA-R.S. 47:820 *et seq.*, these bonds are secured by a four cent ($0.04) per gallon tax on gasoline and motor fuels used, sold, or consumed in the state. Although these bonds are not full faith and credit obligations of the state, they are considered to be tax-supported debt by the financial community. As of June 30, 1992, tax-supported dedicated tax debt principal outstanding was $968,208,000.

Long-Term Lease Debt

Under this type of financing mechanism, bonds are issued by a public or private entity with borrowing authority. The issuer then uses the debt proceeds to acquire facilities or equipment for lease to a state entity. The state entity enters into an agreement with the issuing agency which requires it to make lease payments to the bond issuer. These lease payments are contingent upon annual legislative appropriation.

The Louisiana Correctional Facilities Corporation issued $156 million in bonds to acquire land and construct five medium security prisons, of which three have been completed. The Department of Corrections leases these three prisons, and the lease payments are used to pay debt service on the bonds. Since these bonds are repaid by the Department of Corrections using annual appropriations received from the legislature, they are considered to be tax-supported debt by the financial community. In addition, the Louisiana Public Facilities Authority issued bonds in 1985 and 1991 primarily to acquire equipment for the state's public colleges and universities. As of June 30, 1992, government lessee debt principal outstanding was $243,180,000.

Other Revenue Bonds

Whereas general obligation bonds are secured by the full faith and credit of the issuer, revenue bonds are all types of bonds other than general obligation bonds. They include a range of debt instruments, including the dedicated tax bonds and long-term lease debt discussed previously. Other types of revenue bonds may be issued on behalf of private or other governmental entities. Revenue bonds are payable from a specific source of revenue and do not permit the bondholders to compel taxation or legislative appropriation of funds not pledged for payment of debt service.

The financial community includes some types of revenue bonds as tax-supported debt. As of June 30, 1992, the tax-supported revenue bond principal outstanding (other than dedicated tax and long-term lease debt) was $67,893,000.

Outstanding State Tax-Supported Bonds

Over the last four years, the level of outstanding tax-supported debt has remained relatively stable at approximately $3.9 billion. State tax-supported bonded debt includes more types of debt than general obligation bonds. Exhibit 2 on page 16 shows the types and levels of tax-supported debt outstanding since fiscal year 1985-86.

The exhibit shows that the amount of general obligation debt outstanding decreased for four years beginning in fiscal year 1986-87 and for the last two fiscal years has remained at approximately the same level.

The "Other Tax-Supported Debt" category includes long-term leases, dedicated tax, and certain other revenue bonded indebtedness. This category increased dramatically in fiscal year 1988-89 and has not decreased since then.

The state issued no general obligation bonds in fiscal years 1988, 1989, and 1990. The total amount of debt decreased in fiscal year 1986-87 and again the next fiscal year. This was because the amount of general obligation debt, which constituted the bulk of total debt, decreased during those years. The large increase in "Other Debt" in fiscal year 1988-89 increased the total amount outstanding in that year even though the amount of general obligation debt decreased. In other words, the increase in the amount of "Other Debt" outstanding that year more than offset the reduction in the amount of general obligation debt outstanding.

In the next fiscal year, an increase in "Other Debt" again offset a decline in general obligation debt. Since fiscal year 1989-90, the amount outstanding in each category has remained relatively stable.

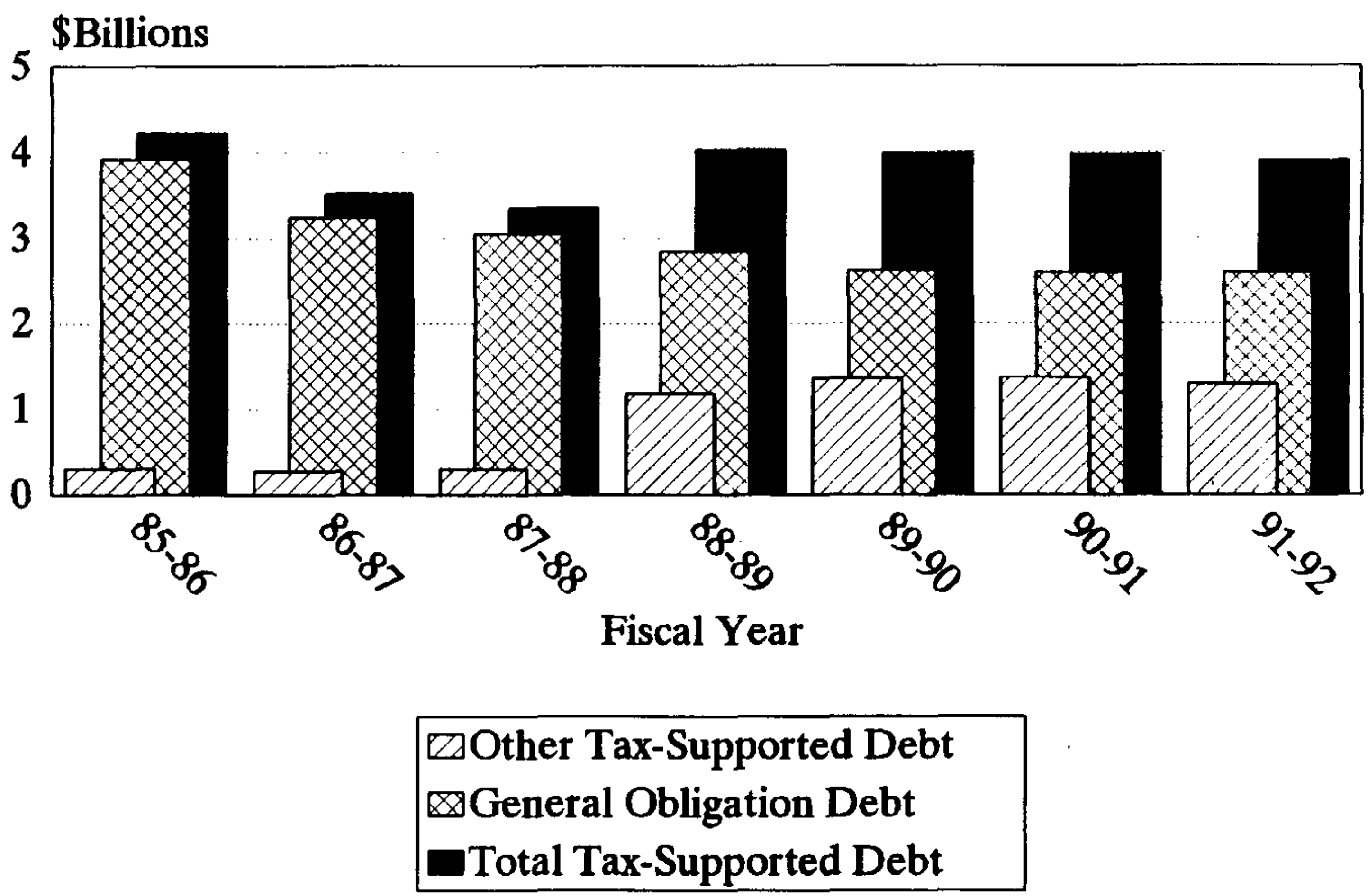
Credit Worthiness

Louisiana's general obligation bonds are rated Baa1 by Moody's Investors Service, Inc. (Moody's) and A by Standard & Poor's Corporation, two of the rating agencies used to evaluate the credit worthiness of state bond issues. The Moody's rating is the lowest of any state in the country. Bonds with this low a rating have higher interest cost. As a result, the state has relied on bond insurance to raise the rating of recent general obligation bond issues to AAA. While less costly than issuing bonds with very low ratings, bond insurance is generally more costly than maintaining a favorable bond rating. The one time cost of insurance for the March 1992 issue was $10,154 per million dollars of debt for a total cost of over $2.3 million.

When rating agencies and other members of the financial community evaluate the state's credit worthiness, they examine its debt ratios, economic environment, financial operations, debt factors, and administration.

Exhibit 2

Louisiana Tax-Supported Debt Outstanding



Source: Listing of tax-supported debt from Moody's Investors Service, Inc.; outstanding tax-supported debt from fiscal years 1986, 1987, 1988, 1989, 1990, 1991, and 1992 CAFR and CAFR supplements.

Note: Other tax-supported debt includes dedicated tax debt, long-term lease obligations, and other revenue debt. General obligation debt is NOT net of reimbursement contracts.

Debt Ratios

Debt ratios provide a measure against which the state can assess its current debt burden and measure its progress toward stated targets. Rating agencies use three primary debt ratios to compare state debt burdens:

- debt per capita;
- debt as a percentage of personal income; and
- debt as a percent of estimated full value of taxable property.

Although debt ratios are used as indicators of a state's credit worthiness, there is little relationship between a state's debt ratios and its credit rating. This is because the ratios must be considered along with other administrative, financial, and economic factors which affect the borrower's ability to pay its debt service.

Debt Per Capita

Debt per capita is calculated by dividing a state's outstanding net tax-supported debt by its population. This debt ratio is the easiest to calculate. However, small changes in population can greatly impact this ratio, and the size of a state's population has little correlation with its ability to repay debt. Based on estimated 1991 population, Moody's Investors Service calculated Louisiana's median 1992 net tax-supported debt per capita as $934, thus ranking the state seventh-highest in the nation with a ratio 2.6 times the national median.

Debt as a Percentage of Personal Income

Debt as a percentage of personal income is calculated by dividing a state's outstanding net tax-supported debt by its citizenry's total personal income. This ratio is a reasonable measure of a state's ability to repay. However, lags exist in the publication of personal income data by the United States Department of Commerce. Based on 1990 personal income, as reported by the United States Department of Commerce, Louisiana's 1992 net tax-supported debt as a percentage of personal income was 6.5 percent according to Moody's. This ranks the state fifth-highest in the nation with a ratio 3.0 times the national median.

Debt as a Percentage of Estimated Full Value of Taxable Property

Debt as a percentage of estimated full value of taxable property is calculated by dividing a state's outstanding net tax-supported debt by its estimated taxable property value. This ratio is more useful for local governments which rely more heavily on property taxes for revenues than do states. This ratio is the least useful for interstate comparisons because of differences in the methods states use to value property. Again, according to Moody's, Louisiana's 1992 net tax-supported debt as a percent of estimated full value of taxable property was 3.1 percent, ranking the state fifth-highest in the nation with a ratio 3.4 times the national median.

Evidence suggests that debt ratios do not correlate closely to credit rating. Therefore, rating agencies assess not only debt ratios but also qualitative factors bearing on the likely repayment of debt obligations. The most important qualitative items fall into the following categories:

- economic factors,
- financial factors,
- debt factors, and
- administrative factors.

Economic Factors

A state's economy is the driving factor behind its general obligation bond rating. A state's economy includes the social characteristics of its citizenry which are looked at both in the absolute sense and in comparison to the corresponding characteristics of other states. Characteristics considered include a review of a state's assets, liabilities, infrastructure, and demographics. In addition, the diversity and growth of a state's employment base is evaluated. Louisiana's rates of growth of personal income and employment have continued to increase even as these rates have slowed nationally. However, rating agencies still consider the state's economy to be narrowly based.

Financial Factors

Louisiana's financial operations are extremely important to the rating process because of chronic budget imbalances. Financial factors considered include accounting and reporting methods, sources and uses of revenue, and balance sheet history.

States are expected to supply adequate and timely financial reports based on the guidelines of generally accepted accounting principles. The composition of revenue sources and expenditures is examined, focusing primarily on debt service funds and the General Fund. Debt service costs, as a part of total operating expenditures, are also evaluated to assess the burden of debt retirement.

Rating agencies like to see General Fund surpluses because they provide for future flexibility. Conversely, operating deficits have a negative impact on a state's credit rating. The state generated surpluses in 1989 and 1990; however, these funds were used to meet operating deficits in 1991 and 1992.

Debt Factors

Debt factors include a state's pledged security, bond maturity schedules, current debt burden, and future financing needs. A state's full faith and credit is pledged to support its general obligation bonds. Bonds supported by a dedicated tax, such as the Louisiana Recovery District, are evaluated on their own credit worthiness. For capital projects, a typical maturity schedule is 25 percent in five years and 50 percent in ten years; however, the preferred rate of principal repayment depends on the items to be financed with the bonds. Current debt burdens are evaluated both absolutely and comparatively.

Currently, Louisiana's debt burdens are among the highest in the nation. However, high debt burdens are acceptable if debt is used judiciously, and low debt burdens can signal under-investment in infrastructure to the financial community.

Administrative Factors

Administrative factors include budgeting practices and revenue forecasts. In evaluating budgeting practices, major items considered are a history of passing budgets on time and a capital budget that includes a well-documented capital improvement program. Revenue estimates are key because they determine a state's ability to repay its bonded debt obligations. Rating agencies have praised Louisiana's Revenue Estimating Conference for focusing debate on well-analyzed budget problems.

A state with a diverse economy, broad-based tax structure, and strong financial management will have a better credit rating and, hence, lower interest costs on its general obligation bonds than those that do not. According to Moody's, Louisiana's general obligation bond rating is currently Baa1, the lowest in the country. Bonds which are rated Baa1 are considered to be medium grade obligations lacking outstanding investment characteristics and possessing speculative characteristics.

Uses of Bonded Debt

In 1988, the state used bonded debt to finance previous years' General Fund shortfalls. Bonds are most appropriately used to finance capital projects so that current and future taxpayers who benefit from the projects pay for them. By financing prior operating expenses, taxpayers are paying for services for which the benefit has already been realized. The financial community considers use of long-term debt to fund operating expenses a sign of poor financial management.

Louisiana, like most states, sells long-term bonds to finance capital projects, such as highways, buildings, and other facilities. Generally, a capital project is defined as a project intended for long-term use or possession. The project usually:

- involves new construction or the acquisition of land or buildings, and the original equipment associated with a new facility; or
- is a major improvement or alteration that has a multi-year life and/or costs above a certain dollar amount.

Debt is used to finance these projects, in part, because it is equitable that projects that will be used for years be repaid over time by each generation of users. Using debt is more expensive than directly paying for a project because the costs of the borrowing, interest payments primarily, are added to the costs of the project. The extra costs of debt financing are justified because the costs are intended to be spread over the useful life of the project and shared over time among its beneficiaries.

Conversely, if there is no future benefit for the taxpayers paying off debt principal and interest, debt should not be used. The use of debt to fund deficits or shortfalls unfairly transfers the responsibility and cost of current liabilities to future taxpayers with no accompanying benefit.

In July 1988, the Louisiana Recovery District issued $979 million in sales tax bonds. The district was created by the Louisiana Recovery District Act (LSA-R.S. 39:2001 *et seq.*) with boundaries coterminous to those of the state. The district has the authority to levy and collect a sales and use tax, effective on or after July 1, 1988. The district's tax, combined with all other statewide sales tax, cannot exceed four percent.

As of the bond sale, the state had recorded General Fund deficits in six of the previous seven fiscal years, including an estimated $350 million deficit for fiscal year 1987-88. The estimated accumulated General Fund deficit was $800 million. The bonds provided for a total of $850 million to eliminate the accumulated General Fund deficit and to fund the cash flow deficit as of August 31, 1988. An additional $14 million was set aside to fund capitalized interest through September 30, 1988, and $8 million of the proceeds were used to pay for the costs of issuing the bonds. A $98 million debt service reserve fund was also established.

In the two years following the creation of the Louisiana Recovery District, the state reported operating surpluses. However, Louisiana drew down General Fund balances in fiscal years 1991 and 1992. In addition, the state refinanced a portion of the Louisiana Recovery District bonds to defer the $85 million in principal that fell due July 1, 1992, and replaced the approximately $96.6 million in the debt service reserve fund with a surety bond.

The state has also used bonds to finance other types of operating expenses. Although not state tax-supported debt, in August 1987, the Louisiana Public Facilities Authority issued $1.3 billion in special assessment revenue bonds for the Louisiana Department of Labor's Office of Employment Security.

The Unemployment Compensation Program was created by Title IX of the Social Security Act of 1935 as a joint federal-state program to provide benefits for workers who lose their jobs. The program is financed by state and federal taxes paid by employers based on their wage base and employment history.

Louisiana did not have sufficient revenues to finance its share of the unemployment compensation fund and consequently received advances from the federal account between 1982 and 1987. The State was required to pay interest on these advances.

In August 1987, the Louisiana Public Facilities Authority issued $1.3 billion in special assessment revenue bonds to repay the federal advance (approximately $856 million). The balance of the proceeds was used to defease (pay off) another bond issue ($240 million), fund a debt service reserve fund, finance costs of the program, and finance approximately six months of interest on the bonds. These bonds are not considered net tax-supported debt by the financial community because their debt service is not paid by tax revenues but rather by a temporary special assessment on Louisiana employers.

The financial community considers the issuance of bonded debt to finance previous years' deficits an indication of poor financial management. According to bond rating agencies, long-term debt issued to fund deficits has a negative credit impact. This negative credit impact can translate into a lower bond rating for state issues and, consequently, higher interest costs. The issuance of additional deficit funding bonds in addition to the outstanding Louisiana Recovery District bonds would be viewed very negatively in the financial community, however, less negatively than allowing currently outstanding bonds to default.

Debt Management

Louisiana has no formal plan to monitor the future use of its long-term bonded debt. However, there are some statutory limitations on the annual issuance of general obligation debt. Furthermore, Louisiana's previous financial advisor addressed a debt management plan and wrote a preliminary report, which has not yet been adopted.

Tax-supported debt is those bonds that the state is directly responsible for repaying. The Division of Administration is responsible for accounting for the state's debt service requirements. The Department of Treasury and the State Bond Commission staff are responsible for seeing that the debt payments are made to bondholders.

Several states have instituted debt management plans to manage their tax-supported debt. According to the financial community, the essential components of a debt management plan vary. However, a good plan runs all tax-supported debt decisions through an accountability process. The process should also ensure that there are no loopholes which allow debt decisions to be made outside of this process.

A state debt management program is closely related to the concept of debt capacity, that is, striking the proper balance between the state's capital needs and the ability and willingness of the state to repay debt issued to finance these needs. This requires that debt planning and management be coordinated with capital planning. A significant amount of debt is not in itself bad, if it is used to fund capital and infrastructure needs. The concept of debt capacity recognizes that a governmental unit has a finite capacity to issue debt at a given credit level. Issuance of debt beyond that point can cause an erosion of credit rating.

Matter for Legislative Consideration 1

The legislature may wish to consider legislation requiring the development of a multi-year, comprehensive debt management plan. This plan should include all types of state tax-supported debt, forecast annual debt capacity, and coordinate the state's five-year capital plan with future debt capacity estimates. It should consider targets for debt burden and other qualitative factors, such as economic projections, overall state financial management, other state debt, and administrative policies and practices.

Chapter Three: Capital Planning

Chapter Conclusions

The state's capital planning needs improvement. The state has a statutorily mandated capital budgeting process, but that process is not always followed. The state has more state capital project requests than it authorizes, yet the state is authorizing increasing numbers of nonstate capital projects in the capital outlay budget. Furthermore, the authorization *of projects in the general obligation bond section of the* capital outlay budget does not guarantee funding because the general obligation bond authorization is not tied to a realistic debt funding estimate.

Capital Outlay Budgeting Process

The State of Louisiana has five major participants in the capital budgeting process. These participants include the political units requesting projects, the Division of Administration, the Joint Legislative Capital Outlay Committee, the State Legislature, and the Governor.

Annually, each state department prepares a prioritized five-year capital outlay request. By November 1, the head of each budget unit presents this request to the Facility Planning and Control section of the Division of Administration, the Joint Legislative Capital Outlay Committee, and the Legislative Fiscal Office. Personnel within the Division of Administration perform architectural and financial reviews of project requests, and the Capital Outlay Coordinator within Facility Planning and Control prepares the Governor's preliminary capital outlay recommendation. Meanwhile, the Joint Legislative Capital Outlay Committee and Subcommittees hold a series of public hearings and caucuses to review capital outlay requests and make a formal recommendation to the legislature one week before the session begins.

Not later than the eighth day of each regular session, the Governor gives the legislature the proposed capital outlay bill implementing year one of the five-year program, the Omnibus bond authorization bill for the sale of bonds for capital projects, and the concurrent resolution for adoption of the remaining four years of the five-year capital outlay program. These documents are prepared by the Capital Outlay Coordinator. The capital outlay bill and Omnibus bond authorization bill are introduced in the House of Representatives and must be passed by both the House and the Senate and signed by the Governor. Once the capital outlay budget is enacted, the Division of Administration notifies each political unit which projects are authorized under the act and provides instructions on how to request funding. A detailed description of the capital budgeting process is provided in Appendix B.

Project Review Process

Projects can be added to the capital outlay budget without going through the statutorily mandated review and prioritization process if an exemption statement is included with each budget amendment. Based on our limited review, 10 of 34 projects (29 percent) did not follow the statutory review process. This included 5 of 21 projects subject to review by the Division of Administration and 5 of 13 projects subject to review by the Department of Transportation and Development.

Division of Administration/Joint Legislative Capital Outlay Committee Review

The Division of Administration conducts technical reviews of capital outlay requests submitted under LSA-R.S. 39:101 *et seq*. The Joint Legislative Capital Outlay Committee conducts reviews of capital outlay requests through a series of public hearings. In general, the primary review of state agency projects is performed by the Division of Administration, and the primary review of nonstate projects is performed by the Joint Legislative Capital Outlay Committee. Reviews by both the Division of Administration and the Joint Legislative Capital Outlay Committee focus on new project requests.

We reviewed 21 capital outlay projects randomly selected from the general obligation bond section of the capital outlay budget, Act 1137 of 1992. Based on our examination of request files at the Division of Administration and minutes and reports from the Joint Legislative Capital Outlay Committee and Subcommittee meetings, we identified 5 projects which neither party reviewed. None of these 5 projects had request documentation submitted by the statutory deadline. We found no examples of projects with requests submitted before the statutory deadline which were not reviewed by either the Division of Administration or the Joint Legislative Capital Outlay Committee.

The majority of unfunded projects authorized in the previous fiscal year's capital outlay budget are reauthorized in the capital outlay budget without necessarily undergoing additional review. Five of the 21 capital outlay budget projects we reviewed were reauthorizations from previous fiscal years, and one project was a request which was reviewed the previous fiscal year. All 5 reauthorizations were authorized in fiscal year 1992-93 without subsequent review. We also reviewed the fiscal year 1992-93 capital outlay requests for the Department of Health and Hospitals and the Department of Public Safety and Corrections, Corrections Services. Approximately 85 percent of their Priority 1 projects and almost three quarters of both their Priority 1 and Priority 2 projects were reauthorizations. (See Exhibit 4, page 29)

Department of Transportation and Development Review

The capital outlay request and review requirements set forth under LSA-R.S. 39:101 *et seq.* do not apply to all projects. The projects covered under LSA-R.S. 48:228 (state highways) and LSA-R.S. 38:90.1 *et seq.* (statewide flood control) are subject to separate review and prioritization by the Department of Transportation and Development. The Joint Legislative Capital Outlay Committee hears testimony from Department of Transportation and Development officials on their capital outlay requests and includes some Department of Transportation and Development projects in the committee's recommendation to the legislature.

We compared the Department of Transportation and Development request for capital outlay bond funding to Act 1137 of 1992. A total of five highway projects not requested by the Department of Transportation and Development and not recommended by the Joint Legislative Capital Outlay Committee were included with the department's authorization in the capital outlay budget.

Matter for Legislative Consideration 2

The legislature may wish to set stricter guidelines for the exemption of projects from the statutorily mandated capital outlay review process.

Matter for Legislative Consideration 3

The legislature may wish to restrict the automatic reauthorization of unfunded capital outlay projects which bypassed the statutorily mandated review process in previous years. These projects could be reviewed and prioritized with new capital outlay requests.

Project Authorization

The state does not have the resources to fund all state capital project requests. Nevertheless, the number and dollar amount of nonstate projects authorized through the capital outlay budget has increased significantly since fiscal year 1986-87.

Exhibit 3
Number of Capital Outlay Project Requests for Two Surveyed Departments

Department Request Category	Year Agency Requested Funding		
	Year 1	Years 2-5	Total
Category A - Emergency Needs	60	0	60
Category B - Current Needs	100	71	171
Category C - Anticipated Needs	27	15	42
Total Needs	187	86	273

Source: Prepared by Legislative Auditor's staff from information in the capital outlay requests for fiscal year 1992-93 from the Department of Public Safety and Corrections, Corrections Services and the Department of Health and Hospitals.

Authorization and Funding of State Agency Projects

We reviewed the fiscal year 1992-93 capital outlay requests for the Department of Health and Hospitals and the Department of Public Safety and Corrections, Corrections Services. These two departments have 2,552 buildings containing approximately 14,696,538 square feet of floor space, and the two departments represent 13.9 percent of the general obligation bond authorization in the fiscal year 1992-93 capital outlay budget.

We identified 187 first-year project requests (Exhibit 3) plus 69 project reauthorizations (Exhibit 4) for the two agencies, totaling 256 projects considered for authorization. Exhibit 3 shows a breakdown of the fiscal year 1992-93 project requests for the two agencies. Of those 256 projects, 111 were authorized in the 1992-93 capital outlay budget. Exhibit 4 shows fiscal year 1992-93 project authorizations. Based on the data available as of December 29, 1992, we estimate that including Interim Emergency Board changes, only priorities 1 and 2 and projects not requiring a priority will be funded in fiscal year 1992-93.

Exhibit 4
Capital Outlay Project Authorizations for Two Surveyed Departments

Capital Outlay Budget Priority	New Projects		Reauthorized Projects		Total	
Priority 1	2	15%	11	85%	13	100%
Priority 2	12	29%	29	71%	41	100%
Priority 3	24	49%	25	51%	49	100%
Priority 4	2	33%	4	67%	6	100%
Priority 5	1	100%	0	0%	1	100%
Not Requiring Priority	1	100%	0	0%	1	100%
Total	42	38%	69	62%	111	100%

Source: Prepared by Legislative Auditor's staff from information in the capital outlay budget, Act 1137 of 1992.

Note: Projects authorized in multiple priorities in the Capital Outlay Act are counted only in the highest priority authorized.

Therefore, we estimate that 55 of these projects are high enough in priority to be funded without intervention by the Interim Emergency Board. As a result, 201 unfunded first-year projects must wait until next fiscal year or be funded through another source.

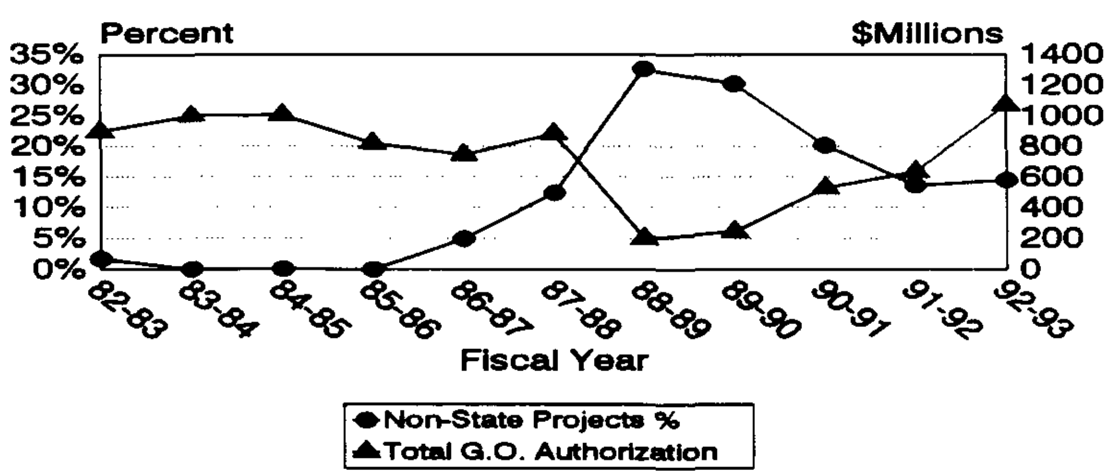
Act 1137 of 1992 specifies that projects included in the capital outlay budget can also be funded through the Public Trust Act (LSA-R.S. 9:2341 *et seq.*) or the State Lease Purchase Act (LSA-R.S. 39:1761 *et seq.*). In fiscal year 1992-93, the purchase of Hotel Dieu to replace Medical Center of Louisiana at New Orleans was funded through the issuance of revenue bonds by the Louisiana Public Facilities Authority under the Public Trust Act. The debt service on these revenue bonds is subject to annual appropriation; therefore, the revenue bonds are considered state tax-supported debt by the financial community.

Authorization and Funding of Nonstate Entity Projects

Since fiscal year 1986-87, nonstate projects have become a significantly larger percentage of the general obligation bond section of the capital outlay budget, as shown in Exhibit 5. Nonstate entities include police juries, municipalities, school

Exhibit 5

Nonstate Projects as a Percentage of Total General Obligation Bond Authorization



Source: Prepared by Legislative Auditor's staff from Division of Administration records.

boards, and other political subdivisions. Exhibit 5 shows the dollar authorization of nonstate entity projects as a percentage of the total general obligation bond authorization. This is plotted against the left axis. The total general obligation bond authorization in dollars is plotted against the right axis. Generally, as the authorization level has declined, nonstate projects have made up a larger percentage of authorized dollars and state projects a smaller percentage. However, in fiscal year 1992-93, the authorization level increased, but the percentage of nonstate entity projects remained nearly the same.

Prior to fiscal year 1986-87, the nonstate portion of general obligation bond authorization consisted of one or two major projects, such as the New Orleans Exhibition Hall or the Chennault Industrial Air Park. The trend since fiscal year 1986-87 has been for the nonstate portion of the general obligation bond authorization to include more, but less costly, projects.

Exhibit 6 illustrates the changes in number and dollar amount of nonstate projects funded since fiscal year 1982-83. The last column in Exhibit 6 gives the dollar amount of the largest nonstate project funded during that fiscal year and the percentage of the total nonstate project funding that project represents. We also identified nonstate projects, for example parish roads, which were authorized under the Department of Transportation and Development. These projects are not included in Exhibits 5 and 6. Therefore, it is possible that Exhibits 5 and 6 understate the level of nonstate project funding.

Because funding is limited, the addition of nonstate projects to the capital budget displaces state projects. Approximately $38.4 million in first year Department of Transportation and Development requested bond funded highway projects were excluded from the 1992-93 capital outlay budget. As a result, these projects will not be funded this fiscal year. At the same time, approximately $33.7 million in nonstate highway projects were included in the 1992-93 capital outlay budget. This $33.7 million is allocated across 13 parishes and 27 projects.

It is unclear whether the appropriation of state capital outlay funds for nonstate projects is based on need. We examined 12 parishes, including 5 of the 13 parishes which had highway projects in the capital outlay budget which were not part of the Department of Transportation and Development request (non-department projects). The 5 parishes, which had non-department highway projects in the capital outlay budget, have approved only 33.33 percent (5 of 15) of tax and bond elections to fund local road improvements since January 1990. Three of these 5 approvals were in one parish. The 7 parishes in our survey which did not have non-department highway projects in the capital outlay budget have approved 81.82 percent (18 of 22) of tax and bond elections to fund local road improvements since January 1990.

Exhibit 6
Allocation of Bond Proceeds to Nonstate Projects
Fiscal Years 1982-83 to 1991-92

Fiscal Year	Number of Projects	Total Funding	Largest Project (% of total)
1982-83	0	$0	N/A
1983-84	2	41,390,000	$26,390,000 (64%)
1984-85	0	0	N/A
1985-86	1	600,000	600,000 (100%)
1986-87	2	35,450,000	35,000,000 (99%)
1990-91	6	71,955,000	31,500,000 (44%)
1991-92	14	29,755,000	8,750,000 (29%)

Source: Prepared by Legislative Auditor's staff using capital project lists from general obligation bond sales, fiscal years 1982-83 to present.

Note: Fiscal years 1987-88 to 1989-90 are not included because the state did not sell general obligation bonds those years.

Matter for Legislative Consideration 4

The legislature may wish to require examination of nonstate (parish, city, or local authority) entities' willingness and ability to fund their own projects before appropriating state capital outlay funds for those projects.

In addition to the highway projects, we identified numerous other nonstate and noncapital projects included in the fiscal year 1991-92 and fiscal year 1992-93 capital outlay budgets. These included funding for the purchase of playground equipment for a nonstate entity, reroofing nonstate buildings, deferred maintenance for a port, vegetative maintenance for a levee district, construction of a parish warehouse, and assistance to private ventures, including construction of parking lots and relocation of utilities. In another instance, the state moved the multi-million dollar appropriation to the Department of Environmental Quality for remediation of "Superfund" sites from the general appropriation budget to the capital outlay budget.

Matter for Legislative Consideration 5

The legislature may wish to develop a policy for the amount or percentage of state capital outlay funds appropriated for nonstate entities to ensure that the capital needs of the state are met.

Use of Lines of Credit

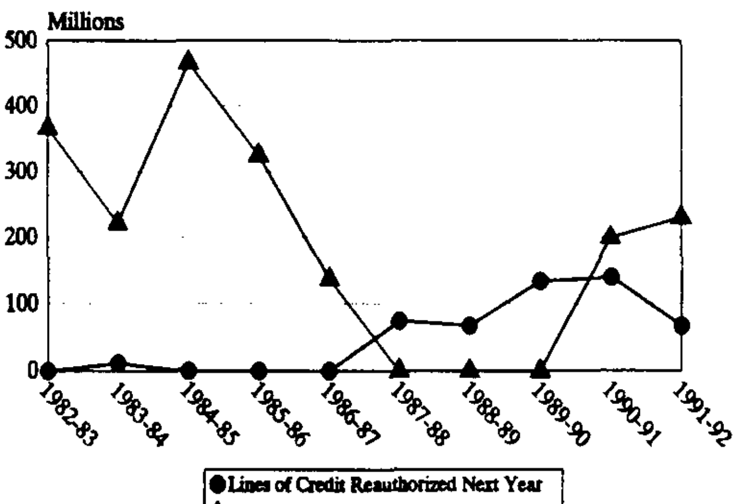
Since fiscal year 1988-89, the state has implemented the practice of reauthorizing lines of credit across fiscal years. However, the state has not implemented a mechanism to ensure that projects with outstanding lines of credit are addressed in subsequent capital outlay budgets. Prior to fiscal year 1988-89, this control was not needed because the state attempted to sell general obligation bonds to fund all outstanding lines of credit prior to the end of the fiscal year.

A line of credit is an authorization to a state agency or nonstate entity to proceed with a capital outlay project and draw from the State Treasury funds for that project. Line of credit requests are submitted to the Commissioner of Administration and must be approved by the State Bond Commission. No lines of credit may be granted for a project unless and until either the bonds have been sold or lines of credit have been granted for all projects of higher priority in the capital outlay budget. Lines of credit cannot span fiscal years, just as the capital outlay budget cannot cover more than one fiscal year. If bonds are not sold to cover outstanding lines of credit by the end of the fiscal year, those projects must be reauthorized in the capital outlay budget and the Omnibus bond authorization. Likewise, the lines of credit must also be reauthorized by the State Bond Commission for the new fiscal year.

Exhibit 7 illustrates the relationship between the availability of general obligation bond funding and the reauthorization of lines of credit. Note the substantial increase in lines of credit requiring reauthorization from fiscal year 1987-88. General obligation bond sales decreased at the same time. Also note that general obligation bond sales have been increasing again the last two fiscal years and have returned to the fiscal year 1986-87 level. However, while line of credit reauthorizations decreased, they have not also returned to the fiscal year 1986-87 level.

Exhibit 7

Line of Credit Reauthorizations v. General Obligation Bond Sales



Source: Division of Administration records and Senate Fiscal Staff records.

Note: Lines of credit are plotted in the fiscal year FROM which they were reauthorized. (e.g., Lines of credit reauthorized in 1988-89 were outstanding but not covered by bond sales in 1987-88, so they are plotted in 1987-88.)

The state did not issue general obligation bonds to fund capital projects for three years beginning in fiscal year 1987-88. During that time, the state funded capital projects with lines of credit. Lines of credit on these projects in process were reauthorized each fiscal year in anticipation of a future bond sale.

The state sold general obligation bonds again in fiscal year 1990-91 and fiscal year 1991-92. However, the practice of authorizing more in lines of credit in a fiscal year than the state covers with general obligation bond sales during the same fiscal year has continued. The ability to reauthorize lines of credit gives the state flexibility in funding capital projects and can save the state bond interest and issuance costs by allowing the deferral of general obligation bond issues.

However, the state has not implemented a mechanism to ensure that projects with outstanding lines of credit are addressed in subsequent capital outlay budgets. In fiscal year 1989-90, the funding was reduced on a Department of Transportation and Development project with an outstanding line of credit. Because the funding had already been committed at $4.75 million, and the project and line of credit were reauthorized at only $3.9 million, a difference of $805,000 occurred. Therefore, the State Treasurer's office showed this as a reconciling item for three years until the $805,000 was reauthorized in the 1992-93 capital outlay budget.

Matter for Legislative Consideration 6

The legislature may wish to implement controls to ensure that outstanding lines of credit at the end of the fiscal year are addressed in the capital outlay budget.

Division of Administration's Response

It is our position that clarification on information on pages 33 and 35 regarding the Use of Lines of Credit is required. The Division of Administration has a mechanism to insure that projects with outstanding lines of credit are addressed in subsequent budgets, in the introduction of the Capital Outlay Bill (the Original Bill); however, this does not guarantee that the legislative process will not make changes which affect the *reauthorization of these lines of credit. These lines of credit are also subject to reauthorization approval by the State Bond Commission.*

The Five-Year Capital Plan

Long-term capital planning is an integral component of a debt management plan. However, the state does not have consistent or realistic five-year planning. The Joint Resolution adopting the second through fifth years of the five-year plan is not passed on a consistent basis. Since the five-year plan was statutorily mandated in 1980, we found that the legislature passed the capital outlay joint resolution only six times, in 1982, 1983, 1988, 1990, 1991, and 1992.

The Executive Branch consistently publishes a five-year capital plan; however, the plan does not necessarily match the Joint Resolution passed by the legislature. In fiscal year 1992-93, the net difference between the two plans is $11.2 million. This consists of eight projects for $23.9 million in general obligation and revenue bond funding included in the Executive plan but not in the Joint Resolution, and one project for $9.1 million in federal funds and $3.6 million in unspecified state funds included in the Joint Resolution but not in the Executive plan.

Matter for Legislative Consideration 7

The legislature may wish to designate which of the two five-year capital plans is the state's official plan. All subsequent actions and revisions would be related to that plan.

The five-year capital plan consists of the one-year capital outlay budget plus a non-binding two through five-year capital outlay funding plan. The five-year capital plan gives long-term funding estimates for both the cash and general obligation bond sections of the capital outlay budget. The general obligation bond authorization is not tied to a realistic debt funding estimate.

The concept of debt capacity recognizes that a governmental unit has a finite capacity to issue debt at a given credit level. A state debt management program is closely related to the concept of debt capacity, in that debt management involves striking the proper balance between the state's capital needs and the ability and willingness of the state to repay debt issued to finance these needs. Over the past several years, the State Bond Commission has restricted the amount of general obligation bonds sold to fund capital projects. Yet, the capital outlay budget and five-year capital plan do not reflect that funding limitation.

The general obligation bond authorization for fiscal year 1992-93 is higher than it has been in 10 years, yet general obligation bond funding availability is still considerably lower. For the state to fund the general obligation bond projects contained in the fiscal year 1992-93 five-year capital plan, it would have to issue approximately $272 million in general obligation bonds for each of the next five years. The original general obligation bond funding estimate for 1992-93 was $192 million.

In addition, new projects are added to the one year capital outlay budget each fiscal year. Over the last eleven years, an average of $364 million in new projects was added to the capital outlay budget each year. If this amount of general obligation bond authorizations is added to the one-year capital outlay budget for each of the next four years, the state will have to sell that much more in general obligation bonds to fund all of the projects.

Matter for Legislative Consideration 8

The legislature may wish to implement a mechanism to develop long-term capital outlay debt funding estimates, including proposed allocation levels for all entities with capital outlay funding. These capital outlay funding estimates would coordinate with the debt management plan.

Division of Administration's Comment

It is our position that clarification of the conclusions and comments made in Chapter 3 must be delineated. Several references to a breakdown in the process occur, yet in no section *does it indicate where, or what entity was responsible for the breakdown (the faulty party is implied but not stated). As stated in the exit conference, it is my belief that failure to indicate specific responsibility results in an implication that all parties are responsible and share equivalent fault. It is my belief that this is not the case. The Division fulfilled its responsibilities under the law and is willing to accept responsibility when and if it has failed, however, we should not be held responsible, either directly or by implication, for failures outside that responsibility scope.*

Chapter Four: Bond Commission

Chapter Conclusions

The State Bond Commission has responsibility for oversight of all debt issued by Louisiana or any of its political subdivisions. The commission has a staff to assist it in carrying out its oversight responsibilities. The staff's performance of its oversight mission needs improvement. While staff's review of fees associated with bond issues helps contain these types of costs, the staff needs to improve its financial analysis of loan and bond applicants' ability to repay indebtedness.

Several functions performed by the commission staff could either be eliminated or performed more efficiently. The commission is required by law to review certain election propositions which have nothing to do with incurring debt or levying taxes. This requirement could be changed. The preliminary approval process, legally required for certain types of bonds, is of limited benefit. Staff review of budgetary loans and certain election applications can be accomplished more efficiently.

Bond Commission Staff Oversight

The State Bond Commission (commission) was created in 1968 and is mandated by the 1974 Constitution to monitor the issuance of all debt in Louisiana. The commission is directed by the Louisiana Constitution to approve, in writing, all bonds and other obligations issued or sold by Louisiana or any political subdivisions. All Louisiana governmental agencies and political subdivisions must obtain the consent and approval of the commission before holding any election to authorize incurring debt or levying a special tax. Furthermore, any election which requires submission to voters of a proposition or question is constitutionally required to be approved by the commission. To carry out these directives, the commission is composed of 14 members who meet monthly. The commission is supported by a staff of 10 professionals who are divided into 2 sections - local debt and state debt.

Louisiana's treasurer must provide advice regarding the issuance and sale of bonds as well as the management of the state's debt. Statutorily authorized to establish a State Debt Management Section to carry out these responsibilities, the treasurer relies on the commission staff's State Debt Section to help achieve these mandates.

The commission's operating expenditures were $639,564 for fiscal year 1990-91 and $795,102 for fiscal year 1991-92. Its operating budget for fiscal year 1992-93 is $877,341. By charging fees on certain applications and bond issues, the commission is self-supporting. In accordance with LSA-R.S. 39:1405.1, if closing fees collected exceed the commission's expenditures in a given year, the excess amount is rebated by the Department of Treasury to applicants who paid fees during the fiscal year.

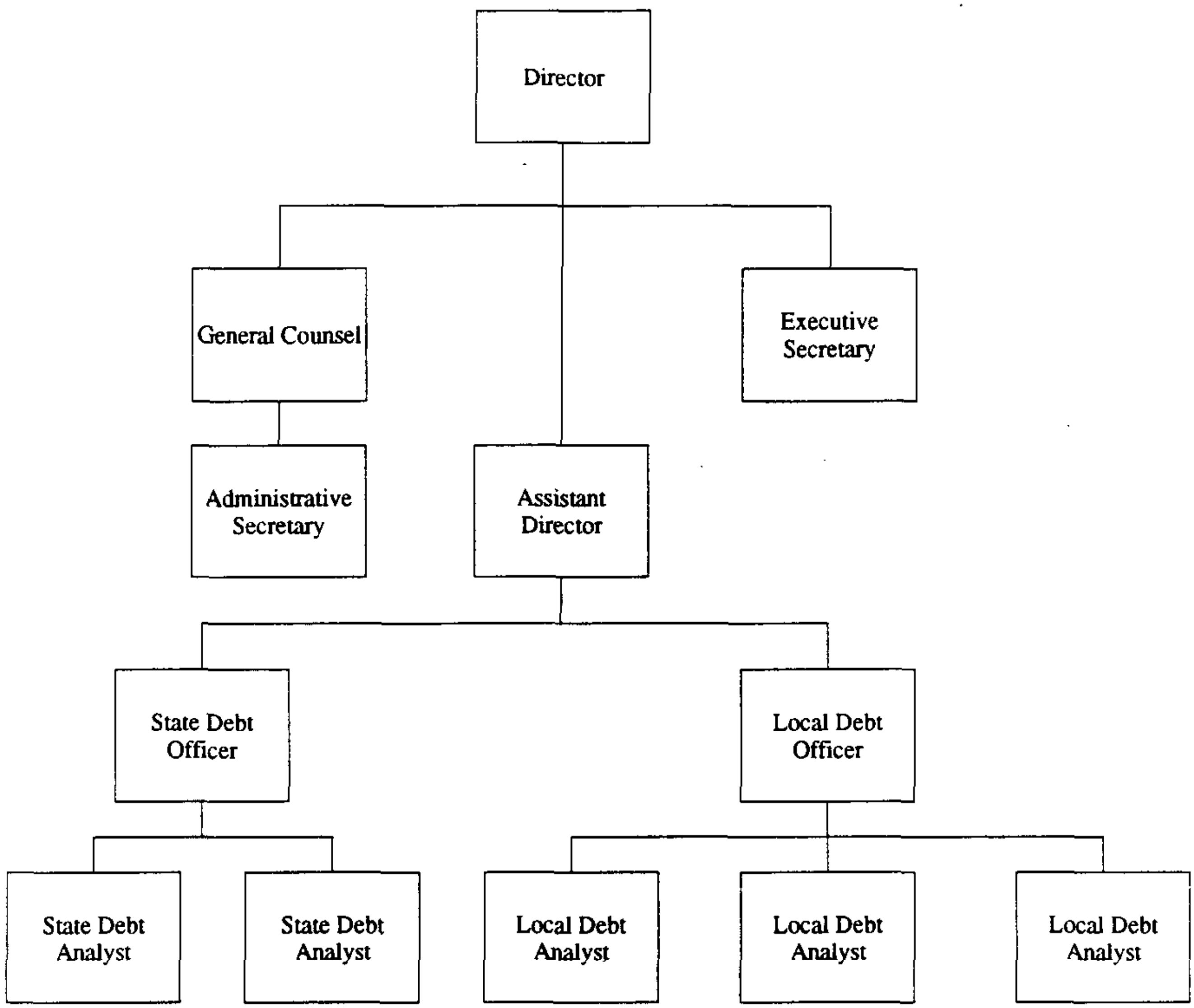
An organizational chart of the commission's staff is shown on the following page. The State Debt Section reviews bonds issued by state agencies and public trusts (for example, the Louisiana Public Facilities Authority). The Local Debt Section reviews elections and short-term and long-term debt of all political subdivisions. Political subdivisions include not only towns and municipalities but also such governmental units as school districts, levee districts, and harbor and terminal districts. According to commission staff, there may be as many as 1,000 different political subdivisions in Louisiana with authority to issue debt.

At least 20 days before the commission's monthly meeting, applications are submitted to commission staff for review and analysis. Commission staff reviews and prepares an analysis sheet for each application. The analysis sheet summarizes basic financial facts concerning the applicant and indicates the statutes under which the applicant's debt is authorized to be incurred. The analysis sheet also shows staff's recommendation of approval or non-approval of the application and notes any problem area.

These analysis sheets are combined into notebooks which are distributed to each member of the commission immediately before the monthly meeting which is held on the third Thursday of each month. Several days preceding the Thursday meeting, the Local Debt Section staff, an attorney from the Attorney General's office, and a representative from the Office of Legislative Auditor meet to review each application scheduled for presentation to the commission. This meeting is referred to as the "docket meeting."

Exhibit 8

State Bond Commission Staff



Source: Director of State Bond Commission Staff.

Staff Financial Review

Commission staff's financial review and analysis of loan and bond applicants' ability to repay indebtedness needs improvement. We reviewed 43 randomly selected files from both the state and local debt sections. There was no indication from some files we reviewed that staff considered key financial information and assumptions. Six of the 43 files contained insufficient financial information with which to evaluate an applicant's repayment capability. Occasionally the staff did not clearly inform the commission of all relevant financial facts concerning an application. Also, our fieldwork revealed two instances where staff did not use its standard procedure to ascertain if an applicant already had a loan outstanding.

Applicants performed their own financial analysis and sent schedules of their analysis to the commission staff as part of the application package. The staff reviewed this analysis and obtained more information if needed. Staff did not generate its own schedules for financial analysis.

Nineteen of 43 sample files we reviewed (44%) contained inadequate financial analyses and/or data. Of the 43 files reviewed, 39 were final approvals and 4 were preliminary approvals. Sixteen of 39 final approvals (41%) and 3 of the 4 preliminary approvals (75%) contained inadequate financial analyses and/or data.

Lack of Consideration of Key Financial Information

In some files we reviewed, there was no indication that the commission staff considered key financial information and assumptions. Applicants use different assumptions in the financial schedules sent to the staff. This can result in different financial conclusions. Some files had unlikely assumptions and thereby generated acceptable financial numbers to the staff which were then entered on the application's analysis sheet for presentation to the commission. In some files we reviewed, there was no evidence that staff questioned these assumptions.

In January 1991, the director of the commission staff formulated guidelines for refunding bonds. These guidelines are to be used by the staff to analyze proposed refunding issues. The guidelines provide that:

1. depending upon the term of the bonds and the call provisions, a present value savings target of five percent is optimal, and

2. the amount of the savings less costs of issuance should be at least 1.5 times the total cost of issuing the new, refunding bonds.

To do a financial analysis of a refunding bond, the interest payments resulting from a lower interest rate over the life of the refunding bond and its principal repayments are compared to the principal and interest payments remaining on the outstanding bond. These annual savings amounts are discounted using a discount rate. The total of the annual discounted savings is the net present value of savings. *Exhibit 9 on the following page* provides a brief discussion of financial analysis.

In an application to refund bonds issued by an industrial development board of one parish, the interest rate on the bonds to be refunded was 13.5 percent. The new bonds used a weekly floater rate and this interest rate, 3.85 percent at the time the application was submitted, was used as the interest rate for the life of the bonds until their maturity in 2002. In other words, the interest rate to borrow for a week was used to generate the financial savings for a 10-year bond issue even though this weekly interest rate could rise as high as 15 percent. Such a low rate produced very favorable financial results because a normal 10-year bond would have an interest rate higher than the 3.85 percent weekly rate; however, this fact is not mentioned in the file or on the analysis sheet.

Secondly, in 1991 the Louisiana Public Facilities Authority issued bonds to refund 1988 revenue bonds of a university. The refunding would save letter of credit expenses being incurred on the old bonds totaling almost two percent annually. There was approximately $4.6 million of prior bonds outstanding which were payable over a period of 19 years. The refunding bonds were not to exceed $4.71 million and had a maturity of 10 years. The financial analysis submitted to the commission staff assumed that there would be a "bullet" payment of $2.48 million in the tenth year of the refunding bonds. As a result of this bullet payment, the refunding bonds produced net present value savings in excess of 13 percent of par value of the prior bonds which is greatly in excess of the commission staff's guideline of 5 percent.

The financial analysis of this refunding did not take into account from where the $2.48 million payment in the tenth year would come. The savings generated by the refunding bonds as compared to the prior bonds were primarily obtained in years 11 through 19.

Exhibit 9

Fundamental Financial Analysis

Net present value is a financial principle based on the assumption that receiving a dollar today is worth more than receiving a dollar in the future because the dollar received today can be invested to start earning interest immediately. The principle of discount rate is used to measure the return required to induce an investor to take a dollar in the future instead of today. The following explanation will help illustrate these principles:

\$100 invested at 10 percent equals \$110 in one year. The discount rate for 10 percent for one year is .90909 (\$110 x .90909 = \$100). Thus, if an investor who desires a 10 percent rate of return expects to receive \$110 one year from today, the present value today to the investor of that expectancy is \$100. If the investor desires an 8 percent rate of return, receipt of \$110 one year from now would have a present value today of \$101.85 (\$110 x .92593 = \$101.85).

If there are two alternative investments, the discount rate is applied to the expected receipts from each alternative and the one with the higher net present value is generally the preferable investment. For example, investment proposals A and B each require an outlay of \$23,616 but have different streams of revenues as follows:

Year	Proposal A	Proposal B
0	-\$23,616	-\$23,616
1	10,000	0
2	10,000	5,000
3	10,000	10,000
4	10,000	32,675

If a discount rate of 10 percent is used, the net present values of proposals A and B are \$8,083 and \$10,347, respectively, and B would be preferable.

It was never stated how the university would come up with $2.48 million for the bullet payment. There was no evidence in this file that this fact was questioned by commission staff even though the assumptions for the financial analysis furnished by the applicant stated as follows:

> While the refunding savings generated are significant, they could be misleading due to the assumption in Sallie Mae's latest proposal that the University would pay a bullet principal maturity at the end of ten (10) years. If [the University] is not able to pay-off the $2.48 million bullet at maturity and has to amortize this amount for any additional term, the debt service savings and present value savings would be much less than indicated in this report.

When the refunding issue was presented at the State Bond Commission meeting, staff indirectly addressed this issue. According to meeting records, staff verbally stated, "We had some problems because this is another balloon note; however there are some limited payments that will be made toward the principal over the life of this loan." Staff went on to say they were comfortable with the refunding because the debt did not exceed the life of the project it was to finance.

There is, however, no evidence to suggest that staff conducted the systematic analysis necessary to determine the source of the bullet (balloon) payment and the extent to which amortizing the bullet payment would diminish projected savings.

Both of these examples relate to refunding issues for private activity bonds. An argument can be made that state and local bond applications (which are secured by public funds) should be scrutinized in more detail than private activity bonds (which are not secured by public funds). However, the commission's guidelines did not specify varying levels or types of analysis for public bonds and private activity bonds. Therefore, we used the same criteria in assessing the staff's financial analysis.

Recommendation 1

The commission staff should receive training, if needed, and develop guidelines to ensure that appropriate financial analysis is done for every application.

Department of Treasury's Response

In 1988, the State Treasurer, as chair of the State Bond Commission recognized the lack of in-depth analysis by the staff of the commission and instituted several reforms. The first was the introduction of the analysis sheet referenced earlier in this response statement. The Treasurer also worked out with the Bond Commission staff and the Legislative Auditor a greater role for the Legislative Auditor's staff and instituted a written Auditor's report with a much expanded scope and mission. The Staff of the Bond Commission now receives ongoing training in public finance. All efforts are made to do a uniform financial analysis on all applications but the staff does recognize unique situations.

Recommendation 2

The State Bond Commission may wish to consider directing commission staff to develop and use different guidelines for analyzing state, local, and private activity bond applications.

Department of Treasury's Response

The Bond Commission rules for non-traditional debt were adopted in 1979 and revised in 1982. The Treasurer appointed a Rules Subcommittee in 1992 creating a mechanism for the revision and updating of State Bond Commission Rules. However, it should be noted that the staff strictly follows statutory and administrative rule guidelines for the review of different forms of debt.

Insufficient Financial Information

We also found that six files contained insufficient financial information to evaluate an applicant's repayment capability. For example, an application for a commercial venture in New Orleans requesting issuance of $3.5 million of revenue bonds had no financial analysis whatsoever of repayment capability of the borrower. There was only a schedule indicating how proceeds of the bonds would be expended.

An application file for $7.5 million of bond anticipation notes to acquire an existing sewerage and water facility contained only a pro-forma (projected) one-year cash flow statement for the facility to be acquired. The file contained no financial statements showing the actual past results of the facility and no schedule showing how the proposed debt would be repaid.

Another application for $600,000 of certificates of indebtedness for a town was payable over a 10-year period out of excess revenues. The analysis sheet showed revenues in excess of expenditures in the amount of $34,932 for fiscal year 1990-91 and a budgeted excess of $25,042 for fiscal year 1991-92. A letter from the applicant's attorney stated that a debt service schedule was enclosed and that the debt service would not exceed $82,000 in any future year. No debt service schedule was contained in the file. Even though the attorney's letter stated that this town had $111,910 available to service debt, there was insufficient information in this file to ascertain how the $600,000 indebtedness would be repaid.

Finally, there was an application for a police jury to hold an election authorizing a $2.5 million bond issue secured by increased ad valorem taxes. A letter from the applicant's attorney stated, "The enclosed schedule shows the estimated debt service requirements on the existing and proposed new bonds." No such schedule was contained in this file.

Without appropriate financial information, commission staff cannot perform necessary financial analysis.

Department of Treasury's Response

This section of the report attempts to suggest that the staff of the Commission permitted approval of applications based upon insufficient data. In particular this section of the report cites a commercial venture in New Orleans that sought approval for $3.5 million in revenue bonds where the file supposedly contained no financial analysis whatsoever regarding repayment. What the audit report does not state is the file was opened for preliminary approval consideration by the Commission. Preliminary approval is designed to notify the Commission of a project and is intended *to establish the public purpose of the issue. The financial analysis would have been completed upon request for final approval which was never made by the applicant. HOWEVER, THE MATTER NEVER CAME BEFORE THE COMMISSION FOR FINAL APPROVAL AND THE COMMISSION NEVER APPROVED THE BOND ISSUE.*

In the audit report, there is a reference on page [47] *to $7.5 million of bond anticipation notes, critically noting lack of information in the supporting file. This criticism deserves specific response because it is indicative of the methodology and incomplete information on which the report is based. In 1992, St. Tammany Parish was permitted by the Legislature to form a parishwide water and sewerage district to consolidate and purchase existing facilities. (This file is reviewed above as number 4 in the file-by-file analysis.) The $7.5 million bond anticipation note application was actually only one part of a two-part request. The newly formed entity was seeking to purchase an existing facility for which the Dept. of Environmental Quality would not issue a permit until the purchase had been made. An initial issuance of $1,000,000 in Bond Anticipation Notes to effect the purchase was requested and permission was granted to hold a public hearing for the full $7.5 million. If no objections were received, permission was given to go forward with the full amount of bond anticipation notes. It should be noted here that bond anticipation notes are paid by the issuance of bonds. The intent for the issuance of the bond anticipation notes was to acquire the facility, and generate revenues from which the subsequent bonds would be paid.*

In response to the criticism of the file contents of another specifically-referenced application at page [47] *of the report, the application for $600,000 excess revenue certificates of indebtedness payable over a ten-year period (this file is addressed above as number 2), La. R.S. 33:2921 allows parishes and municipalities to incur debt, and pledge their excess of annual revenues, above statutory, necessary and usual charges for the* ***current*** *year. In other words the current year's excess revenues are compared to the annual debt service. Future years' excess revenues are not considered. This is a matter that should be addressed with legislation. Additionally, it has been determined that local governments can use their "fund balances" in determining excess revenues. The staff computes debt service using "level debt" and computes this themselves. The fact that the debt service schedule was not enclosed was not a factor, since* *the staff determined what the debt service would be and compared it to excess revenues.*

Auditors' Comments

Although Bond Commission staff responded that the first example cited under "Insufficient Financial Information" was for a preliminary approval rather than a final approval, minutes of the State Bond Commission's December 19, 1991, meeting document final approval of the application.

The auditors were aware of the descriptive information presented in the Bond Commission staff's response to the second example. This does not obviate the need for financial information to show that sufficient revenues will be generated to repay the subsequent bond issue.

Finally, the documentation in the third example showed current year's budgeted excess revenues of $25,042 and reserve fund balances of $111,910. This documentation indicates insufficient revenues to pay the debt service of a 10-year, $600,000 bond issue.

Recommendation 3

Commission staff should establish (1) guidelines delineating minimum financial and other information required to evaluate applications and (2) time frames for submission of this information. Staff should make every effort to ensure that they obtain all necessary financial information and that such information is documented in commission files. When applications are presented to the State Bond Commission, staff should clearly disclose the limitations of their analyses when necessary information is not submitted.

Department of Treasury's Response

A desired time frame for the submission of information is in place, but the Staff is often unable to enforce the rule because of the realities of local debt management and the practical problems Bond Commission members are presented with by the applicants. Bond Commission rules would generally require that applications be submitted 20 working days prior to the regular *meeting. In addition, the Bond Commission adopted a policy which sets the parameters for submission of additional data. The current requirements included in the Bond Commission rules can be amended to set specific guidelines delineating minimum financial information. However, the current rules of the Commission do impose certain requirements. The Office of the Commission welcomes the input of the Legislative Auditor with regard to certain enhancements to the Commission rules. The staff, absent enhanced reporting requirements, has operated under the "prudent business person" rule of business in that the required information would be that which would be required by a prudent business person making informed decisions.*

Recommendation 4

The State Bond Commission may wish to adopt a policy to defer considering applications until commission staff has received all information necessary for required financial analysis.

Department of Treasury's Response

We agree that this policy needs to be adopted. Currently, if the staff finds an application lacking sufficient data, the item is withheld from the agenda. However, the State Bond Commission operates under Roberts Rules of Order which allows items not on the agenda to be brought up under other business with 2/3 vote of members present and voting. On occasion, an entity that has not presented sufficient information for a recommendation will lobby the Bond Commission to have the item placed on the agenda for consideration and approval.

Important Facts Not Presented to the Commission

Staff does not always inform the commission of relevant financial facts concerning applications. The commission should be aware of such information before approving the application. Commission members receive staff analysis sheets immediately before the meeting each month. Since commission members typically have little, if any, time to review analysis sheets, key issues should be highlighted clearly and in an easy to follow format. The commission cannot properly perform its debt oversight mission without all pertinent facts.

A parish school board refunding request provides an example of staff not informing the commission of relevant facts. This application requested approval to refund and restructure bonds issued in 1982 and 1984. The analysis sheet stated the purpose of the restructuring was to free up sales tax revenues for needed capital improvements. The analysis sheet further noted that the refunding bonds would result in the school board paying additional debt service of approximately $209,000 over the life of the bonds and that virtually no present value savings would be achieved by the refunding.

The commission staff's refunding guidelines state that the optimal target for net present value savings should be 5 percent of par value and net savings should be 1.5 times the issuance costs of the bonds. The net present value savings of the refunding bonds was $1,638 on a $1,755,000 bond issue, less than one percent of par value compared to the commission staff's guideline of 5 percent. Application of the other guideline yielded less favorable results because the refunding bonds would cost the school board an additional $209,000 over the life of the bonds. The fact that the refunding guidelines were not met was not stated on the analysis sheet presented to the commission.

The stated purpose of this refunding was to reduce debt service to a point where the general obligation bond *ad valorem* tax would fully pay the debt service during the early years of the issue, *thus allowing the district to use for capital improvements* the one percent sales tax revenues which had been subsidizing the debt service. Because the original maturity of the debt remained unchanged, the decrease in debt service payments in the early years would result in an increase in debt service payments (both principal and interest) in later years. While the analysis sheet stated the public purpose and short-term impact of the refunding issue, the analysis sheet did not provide any information on the increased debt service burden and its impact on the availability of sales tax revenues in the later years.

This refunding bond did not save this school board money. While the refunding bond may have provided short-term cash flow benefits, the staff did not analyze the potential for a harmful long-term effect on cash flow. Therefore, the commission did not have this information for its decision making. The analysis sheet states, "There are no problems with this request." Not being otherwise informed, the commission approved this application without discussion on July 23, 1992.

As another example, in an election application to issue general obligation bonds which would be repaid with increased ad valorem taxation, the 10 percent debt limitation in a road district would be exceeded by the proposed bonded indebtedness. (LSA-R.S. 39:562B provides that general obligation debt of a subdivision which is repayable solely from ad valorem taxation may not exceed 10 percent of the assessed valuation of taxable property of the subdivision.) Although the analysis sheet notes that the 10 percent limitation is exceeded, it also states, "The staff finds no technical problems with this election request . . ." Commission members have little time to review analysis sheets so it is necessary that information which relates to the impact of debt to be issued be highlighted clearly and in an easy to follow format.

Recommendation 5

Commission staff should provide all relevant information to the State Bond Commission and inform the commission when applications do not meet stated rules and guidelines. This information should be clearly disclosed as part of a standard summary on the analysis sheet. Thus, commission members can easily identify exceptions to guidelines as well as other information which may impact the advisability of individual applications.

Department of Treasury's Response

This recommendation suggests the Commission members are given inadequate information by the analysts. The analysis sheet was first introduced by the Treasurer in 1989. Prior to 1989, no formal format or presentation was made to the Bond Commission in consideration of applications. There is an ongoing effort to improve the format of the analysis sheet. Most notably, the staff of the Commission is currently developing an automated support system for the approval process. This integrated computer program will include the analytical framework for the various types of approval processes. Not only will the automated support system help to enhance the analysis sheet, but will also assist in developing a database on all state and local debt analysis.

Prior Loans Still Outstanding

Our fieldwork also revealed two instances where the Local Debt Section of commission staff did not use its standard procedure to ascertain if an applicant already had a loan outstanding. The commission staff has a set of log books in which all approved Local Debt Section applications are entered. In one file we reviewed, an outstanding loan of the applicant was not uncovered until a new loan was approved by the commission. In another instance, a school board submitted an application to borrow funds and secure the loan with 23 mills of ad valorem taxation. The commission staff did not ascertain whether this school board had previously borrowed using this same 23 mills as security. The legislative auditor's representative to the docket meeting uncovered the fact that this school board had another loan outstanding secured by the same 23 mills and that the 23 mills did not generate sufficient revenue to provide adequate security for the requested borrowing.

Recommendation 6

Local Debt Section staff should implement a system to monitor outstanding indebtedness more accurately. Secondly, a system is needed to monitor an applicant's use of the same security more than once.

Department of Treasury's Response

Officewide use of computers were first implemented in the Commission offices in 1989. For the past two years, the staff has been actively engaged in the process of developing a database which will assist the staff, the Commission and the Legislature in closely monitoring outstanding indebtedness. In order to develop this database, a complete internal study of the operations of the office and records has just been completed to ensure that the database will include all pertinent data.

Staff Review of Fees for Bond Issues

Staff's review of proposed fees associated with bond issues helps contain these types of costs. Bond applications to the State Debt Section and certain bond applications to the Local Debt Section must contain information regarding anticipated fees associated with issuance of the debt. Staff reviews these amounts and often compares these fees to comparable bond issues to ensure that the proposed fees are not excessive. Staff reports the results of its review on the analysis sheet and also advises the Commission's Fee Subcommittee concerning the proposed fees.

Possibilities for Efficiency

Several functions performed by the commission staff could either be eliminated or performed more efficiently. The commission is required by law to review certain election propositions that have nothing to do with incurring debt or levying taxes. This requirement could be changed. The preliminary approval process, legally required for certain types of bonds, is of limited benefit. Finally, staff review of budgetary loans and certain election applications can be accomplished more efficiently.

Nondebt or Nontax Elections

All Louisiana political subdivisions must obtain the consent and approval of the commission before holding elections to authorize incurring debt or levying tax. Any election that requires submission to voters of a proposition or question is also constitutionally required to be approved by the commission. The legal authority for elections (and all applications to commission staff) is reviewed by an attorney from the Attorney General's office at the monthly docket meetings. In addition, an attorney at the Secretary of State's office reviews the legal authority under which each election is held. However, this attorney does not determine if an election would cause a political subdivision to exceed its taxing limits.

Little benefit is obtained from the commission's review of election propositions and home rule charter proposals which involve neither debt incurrence nor levying a tax. (A home rule charter is a basic governing document adopted by any local governmental subdivision after approval of the electorate. See the Constitution, Article VI, Section 5 and LSA-R.S. 33:1395 *et seq.*) However, elimination of commission review of such proposals will require either amendment of Article VI, Section 22 of the Constitution or enactment of legislation. Until the constitutional requirement is changed, staff review of these propositions could be eliminated by the Secretary of State's office informing the commission of the legality of such elections which could then be approved *en masse* at meetings of the commission.

Matter for Legislative Consideration 9

The legislature may wish to consider elimination of State Bond Commission review of home rule charter proposals and elections having nothing to do with incurring debt and levying taxes. Accomplishing this objective will require enactment of specific legislation concerning these elections (in accordance with Article VI, Section 22 of the Constitution).

Department of Treasury's Response

The Treasurer has requested this legislation to be filed. In 1974, there were few Home Rule Charter cities. We agree that such elections should be at the option of local government.

Recommendation 7

Until the legal requirement is changed, the commission is required to review these propositions. However, the State Bond Commission's staff should discontinue review of elections and home rule charter proposals which do not involve incurring debt and levying taxes. The Secretary of State's office should continue to review these types of propositions. The State Bond Commission and the Secretary of State's office should implement a procedure to eliminate commission staff review of these types of election propositions.

Department of Treasury's Response

The staff has initiated discussions with the Secretary of State's office to more efficiently handle election requests.

Preliminary Approval

The commission must provide preliminary approval for revenue bonds issued by certain political subdivisions and certain bonds issued by public trusts. The primary purpose of this procedure is for the commission to approve the notice of intention to be used by the entity in publicizing its intention to issue bonds. Applicants must return again to the commission to obtain final approval.

There is little, if any, benefit obtained by undergoing this procedure. Elimination of the preliminary approval process would save the commission and commission staff from having to review these files twice, and perhaps more importantly, would save the legal expenses applicants incur to take the application through the preliminary approval process.

Matter for Legislative Consideration 10

The legislature may wish to consider elimination of the State Bond Commission preliminary approval requirement contained in LSA-R.S. 9:2347.A(1) and R.S. 39:559.1.F.

Department of Treasury's Response

The office of the Commission strongly disagrees with the report's suggestion that the preliminary approval process of the State Bond Commission is of limited value. On the contrary, the preliminary approval process provides great benefit to both the Commission members and the entity requesting the issuance of the bonds. First, as a legal requirement, preliminary approval authorizes the publication of the notice of intention to issue the bonds. This publication provides true notification to the public of a governmental entity's desire to finance a specific project involving taxpayer's dollars. The result of this process is if the public purpose of the project is not justified, or if other legal questions arise, further cost of the issuing entity is avoided until such problems are resolved.

Further, from the practical point of view, the preliminary process allows the staff, the Commission members and the affected public to become more familiar with the project and to request additional information. The rules require that information should be submitted to the Bond Commission twenty days prior to the next meeting. With sometimes over sixty applications pending, the Bond Commission has come to expect a general preliminary discussion of the nature of the project the beneficiary of the project and the source of payment at the preliminary approval stage of review. If there is public opposition, it will usually surface between preliminary and final *approval. As a general policy matter, the more scrutiny a public borrowing request is given, the better the taxpayers are served.*

Budgetary Loans

Staff review of budgetary loans can be accomplished more efficiently. In order to pay current expenses, parishes (except Orleans) and municipalities (except New Orleans) may borrow funds from banks and other sources based on anticipating their revenues as provided in LSA-R. S. 39:745 *et seq*. These budgetary loans must be repaid by March 1 of the following year. Unless the borrowing entity has had past financial difficulties, there is typically no problem with repayment of these loans. Commission staff reviews each application and completes an analysis sheet.

A preliminary review of each applicant's financial statements would show which ones are experiencing financial difficulty. Applicants with financial difficulty could continue to be subjected to the complete review process. For applicants without financial difficulty, we recommend that commission staff eliminates the time consuming process of completing an analysis sheet for such applications. The commission could approve the applicants without financial difficulties *en masse*, as they typically do at present.

Recommendation 8

The commission and its staff should consider establishing a more efficient method of reviewing budgetary loan applicants which have no financial difficulties.

Department of Treasury's Response

The Treasurer established the Rules Subcommittee of the Bond Commission to review ways to assist local government's which have established good financial practices and have sound credit ratings. The lease rule for local government which takes effect in April of this year establishes an expeditious review process for leases for movable equipment. A local government advisory panel is being created to review more thoroughly how the State Bond Commission may properly consider local government matters.

Elections

Of the elections reviewed by commission staff which involve a tax or debt proposition, many do not contain a proposal which is close to exceeding a statutory limitation. Such elections (hereafter referred to as "nonissue elections") typically do not need extensive review. However, the commission staff must type and process an analysis sheet for each election. This unnecessarily consumes much staff time. An analysis sheet should be made only for those elections which staff considers are worthy of the commission's attention. Thus, at the monthly meeting the commission could be presented a list of all nonissue elections (perhaps as are presently contained on the monthly meeting agenda). Such elections could then be approved *en masse*.

Recommendation 9

The State Bond Commission and its staff should institute procedures to streamline review of nonissue elections.

Department of Treasury's Response

The Bond Commission currently takes all election requests in one combined motion at Commission meetings unless there are distinguishing technical or financial issues which merit the Commission's individual attention to an election items. The analysis sheets are prepared during the review process which documents that each application contains the prerequisite information for approval.

Appendixes

Appendix A: Glossary

Analysis Sheet After commission staff has reviewed an application, an analysis sheet for that application is prepared. The analysis sheet summarizes basic financial facts concerning the applicant, shows the legal authority for incurring debt or holding an election, notes any problem area, and contains staff's recommendation of approval or non-approval of the application. Each month the analysis sheets for the applications on the commission's monthly agenda are combined into notebooks and each member of the commission is furnished a notebook for the monthly commission meeting.

Amortization The process of paying the principal amount of an issue of bonds by periodic payments either directly to bondholders or to a sinking fund for the benefit of bondholders. Payments are usually calculated to include interest in addition to a partial payment of the original principal amount.

Amortization Schedule A table showing the gradual repayment of an amount of indebtedness over a period of time.

Assessed Valuation The appraised worth of property as set by a taxing authority for purposes of ad valorem taxation, usually a percentage of "true" or "market" value. For example, Louisiana real property is assessed at ten percent of fair market value.

Bond Counsel An attorney (or firm of attorneys) retained by the issuer to give a legal opinion that the issuer is authorized to issue the proposed bonds, the issuer has met all legal requirements necessary for issuance, and interest on the proposed bonds will be exempt from federal income taxation and, where applicable, from state and local income taxation.

Bond An interest-bearing certificate of debt, being one of a series constituting a loan made to, and an obligation of, a government or business corporation; a formal promise by the borrower to pay to the lender a certain sum of money at a fixed future day with or without security, and signed and sealed by the maker (borrower); a promise to pay a principal amount on a stated future date and a series of interest payments, usually semiannually until the stated future date. A bond differs from an investment note only in the time which it has to run before maturity. Ordinarily the dividing line is five years; if the term of the debt exceeds this period, the issue is called bonds; if within this period, notes.

Bond Resolution The document or documents representing action of the issuer authorizing the issuance and sale of municipal bonds. Issuance of the bonds is usually approved in the authorizing resolution, and the sale is usually authorized in a separate document known as the "award" resolution. All of such resolutions, read together, constitute the bond resolution, which describes the nature of the obligation and the issuer's duties to the bondholders.

Capital Outlays Expenditures to acquire land, buildings, equipment, or other property or to preserve, develop, or permanently improve such property.

Debt Limit The maximum amount of debt which an issuer of municipal securities is permitted to incur under constitutional, statutory, or charter provisions.

Debt Ratios Comparative statistics showing the relationship between the issuer's outstanding debt and such factors as its tax base, income, or population.

Debt Service The amount of money necessary to pay interest on an outstanding debt, the serial maturities of principal for serial bonds, and the required contributions to an amortization or sinking fund for term bonds.

Docket Meeting The monthly meeting of the State Bond Commission ("commission") is held on the third Thursday of the month. Several days preceding this meeting, the Local Debt Section of the commission staff, an attorney from the Attorney General's office, and a representative from the Office of Legislative Auditor meet to review all applications on the commission's meeting agenda. This meeting is known as the docket meeting.

Downgrade The lowering of a bond rating by a rating service. A downgrade would be considered if the issuer encountered major financial difficulties or economic decline, which may be viewed by the rating service as reducing the credit quality of the bond issue.

Feasibility Study A report of the financial practicality of a proposed project and financing thereof, which may include estimates of revenues that will be generated and a review of the physical, operating, economic, or engineering aspects of the proposed project.

Financial Advisor A consultant who advises the issuer of municipal bonds on matters pertinent to the issue, such as structure, timing, marketing, fairness of pricing, terms, and bond ratings. Such consultant may be employed in a capacity unrelated to issuance of municipal securities, such as advising on cash flow and investment matters.

General Obligation Bonds Bonds which are secured by the full faith and credit of the issuer. In the event of default, the holders of general obligation bonds have the right to compel a tax levy or legislative appropriation, by mandamus or injunction, in order to satisfy the issuer's obligation on the defaulted bonds.

Interest Compensation for the use of borrowed money, generally expressed as an annual percentage of the principal amount.

Investment Grade The broad credit designation given bonds which have a high probability of being paid. Such bonds have few, if any, speculative features and are rated at least Baa1 by Moody's and BBB by Standard & Poor's.

Issuer A state, political subdivision, agency, or authority that borrows money through the sale of bonds or notes.

Legal Opinion The written conclusions of bond counsel that the issuance of municipal securities and the proceedings taken in connection therewith comply with applicable laws, and that interest on the bonds will be exempt from federal income taxation and, where applicable, from state and local taxation.

Letter of Credit An agreement, usually with a commercial bank, to honor demands for payment upon compliance with conditions established in the agreement. Bank letters of credit are sometimes used as additional sources of security for municipal bond and note issues.

Mill An increment of taxation measured in units of one-tenth (0.1) of one cent or 0.001 of one dollar.

Municipal Bonds Bonds that are obligations of a state, county, city, town, village, tax district, or other civil division of a state, as distinguished from U.S. government bonds and bonds of business corporations. Municipal bonds constitute one of the basic types of civil (governmental) issues. A prime feature of municipal bonds is that interest on them is generally exempt from federal income taxation and from taxation by the state in which they are issued.

Municipal Debt Debt of state and local governmental units, apart from debt of the federal government.

Negative Credit Factors Those characteristics which could adversely affect the credit standing of an issuer, such as declining population, decreasing revenue sources, regulatory restrictions on operations of the issuer, poor debt ratios, and structural weakness of the issue (such as insufficient coverage requirements, weak additional bond tests, and subordinate lien position).

Notice of Sale A publication by an issuer describing an anticipated new offering of municipal bonds. It generally contains the date, time and place of sale, amount of issue, type of bond, amount of good faith deposit, basis of award, name of bond counsel, maturity schedule, method, time and place of delivery, and bid form.

Official Statement Document published by the issuer which generally discloses material information on a bond issue, including the purposes of the bond issue, how the bonds will be repaid, and the financial, economic, and demographic characteristics of the issuing government. Investors may use this information to evaluate the credit quality of the bonds.

Paying Agent The entity responsible for the payment of principal and interest on municipal bonds on behalf of the issuer. The paying agent is usually a bank or trust company, but may also be the treasurer or some other officer of the issuer.

Per Capita Debt The amount of an issuer's debt divided by its population, which is used as an indication of the issuer's credit position.

Private Activity Bonds One of two categories of bonds established under the Tax Reform Act of 1986. Depending on meeting certain tests, such bonds can be issued as tax-exempt, generally subject to state volume caps.

Ratings Evaluations of the credit quality of notes and bonds usually made by independent rating services, although financial institutions also rate bonds for their own purposes. Ratings generally measure the probability of the timely repayment of principal and interest on municipal bonds. Ratings are initially made before issuance and are continuously reviewed and may be amended to reflect changes in the issuer's credit position. Moody's Investors Service, Inc. (Moody's), Standard & Poor's Corporation (Standard & Poor's), and Fitch Investors Service rate municipal bonds.

Refunding A procedure whereby an issuer refinances an outstanding bond issue by issuing new bonds. There are generally two major reasons for refunding: to reduce the issuer's interest costs or to remove a burdensome or restrictive covenant imposed by the terms of the bonds being refinanced.

Revenue Bonds Bonds payable from a specific source of revenue and which do not pledge the full faith and credit of the issuer. Revenue bonds are payable from identified sources of revenue and do not permit the bondholders to compel taxation or legislative appropriation of funds not pledged for payment of debt service.

Sinking Fund An account, sometimes called a debt service fund, into which the issuer makes periodic deposits to assure the timely availability of sufficient monies for the payment of debt service requirements.

Syndicate A group of underwriters formed to purchase collectively (underwrite) a new bond issue from the issuer and offer it for resale to the general public. The syndicate is organized for the purposes of sharing the risks of underwriting the issue and for obtaining sufficient capital to purchase an issue.

Taxable Bonds Municipal bonds whose interest is subject to federal income taxation under the Internal Revenue Code of 1986, as amended.

Tax-Exempt Bonds Bonds whose interest is exempt from federal income taxation pursuant to the Internal Revenue Code of 1986, as amended.

Trustee A financial institution with trust powers which acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

Underwriting The process of purchasing all or any part of a new issue of municipal securities from the issuer, and offering said securities for sale to investors.

Underwriter A dealer which purchases a new issue of municipal securities for resale. The underwriter may acquire the bonds either by negotiation with the issuer or by award on the basis of competitive bidding.

Upgrade The raising of a bond rating by a rating service due to the improved credit quality of the bond issue.

Yield to Maturity The rate of return to the investor earned from payments of principal and interest, with interest compounded semiannually and assuming that interest paid is reinvested at the same rate. Yield to maturity takes into account the time value of the investment.

Appendix B: Capital Outlay Review Process

The Louisiana Constitution of 1974 and statutory law provide that the capital outlay budget must undergo a specified request, review, and approval process. Following this narrative summary of the process is a detailed flowchart of the process.

Project Requests and Review

Annually, each state department must prepare a prioritized five year capital outlay request. By November 1, the head of each budget unit presents this request to the Facility Planning and Control section of the Division of Administration, the Joint Legislative Capital Outlay Committee, and the Legislative Fiscal Office. Requests for projects by any non-state political subdivision must be submitted to both the senator and representative that represent the political subdivision. The legislators must both sign and then submit the request to Facility Planning and Control in the Division of Administration.

Personnel within the Division of Administration perform architectural and program review of project requests. Based on that technical review, with input from the Governor and the Commissioner of Administration, the Capital Outlay Coordinator within Facility Planning and Control prepares the Governor's preliminary capital outlay recommendation. Not later than March 1, and prior to the convening of each regular session, the Governor submits the preliminary capital outlay budget with a summary outlining the maximum amount of money to be spent in each department or political subdivision to the presiding officer of each house. The preliminary capital outlay budget is then referred to the appropriate standing committees in each house.

Exhibit B.1
Joint Legislative Capital Outlay Committee Subcommittees

Educational Institutions
Health and Corrections
Infrastructure
General Government

Source: *JLCOC Handbook*

In addition to the review by the Division of Administration, the four Joint Legislative Capital Outlay Committee subcommittees hold public hearings on capital outlay requests in December or January. In February or March, the subcommittees hold caucuses, attended by a representative from Facility Planning and Control, to review testimony from the public hearings and prepare recommendations for the full committee. The full committee then meets to consider the

Exhibit B.2

Participants in the Capital Budgeting Process

State Departments - The executive offices, agencies, and instrumentalities of the state (e.g., Department of Education).

Nonstate Political Subdivisions - Political entities within the state which are outside of the state budgetary process (e.g., police juries, municipalities, school boards, ports, levee districts, and other political subdivisions).

Division of Administration - The executive department charged with oversight of the capital planning process. Capital outlay is primarily the responsibility of Facility Planning and Control.

Joint Legislative Capital Outlay Committee - Joint legislative committee charged with oversight and review of capital outlay budget requests. Submits an annual recommendation to legislature on the capital outlay budget.

Legislature - Composed of the House of Representatives and the Senate. The House Committee on Ways and Means and the Senate Committee on Revenue and Fiscal Affairs review the bond portion of the capital outlay bill. The House Appropriations Committee and the Senate Finance Committee review the cash portion of the capital outlay bill.

Governor - Signs the capital outlay bill into law. The Governor has line-item veto authority.

Source: Compilation of information from Louisiana Constitution of 1974, Louisiana Revised Statutes, House Fiscal Staff, Senate Fiscal Staff, and the Division of Administration.

subcommittee recommendations and prepare a final Joint Legislative Capital Outlay Committee capital outlay recommendation which is submitted to the legislature one week prior to the beginning of the legislative session.

Capital Outlay Budget Approval

Not later than the eighth day of each regular session, the Governor submits to the legislature the capital outlay budget, proposed capital outlay bill implementing year one of the five-year program, the Omnibus bond authorization bill for the sale of bonds for capital projects, and the concurrent resolution for adoption of the remaining four years of the five-year capital outlay program, all of which are prepared by the Capital Outlay Coordinator.

The capital outlay bill is organized into three sections representing the project funding source: cash, general obligation bonds, and projects not requiring priority. The general obligation bond section is further organized into five priorities. Priority one includes all projects with outstanding lines of credit and projects ready for *immediate funding*. Priority two includes projects ready for funding in the first or second quarter of the fiscal year. Priorities three and four include projects which will be ready for funding in the third and fourth quarters of the fiscal year respectively. Priority five includes that portion of project funding for projects in higher priorities which will not require cash funding in the current fiscal year, but must be authorized for contracting purposes.

Exhibit B.3
Capital Outlay Budget Layout

Cash Section - Funding sources include General Fund, transportation trust fund, revenue bonds, self-generated funds, federal funds, et cetera.

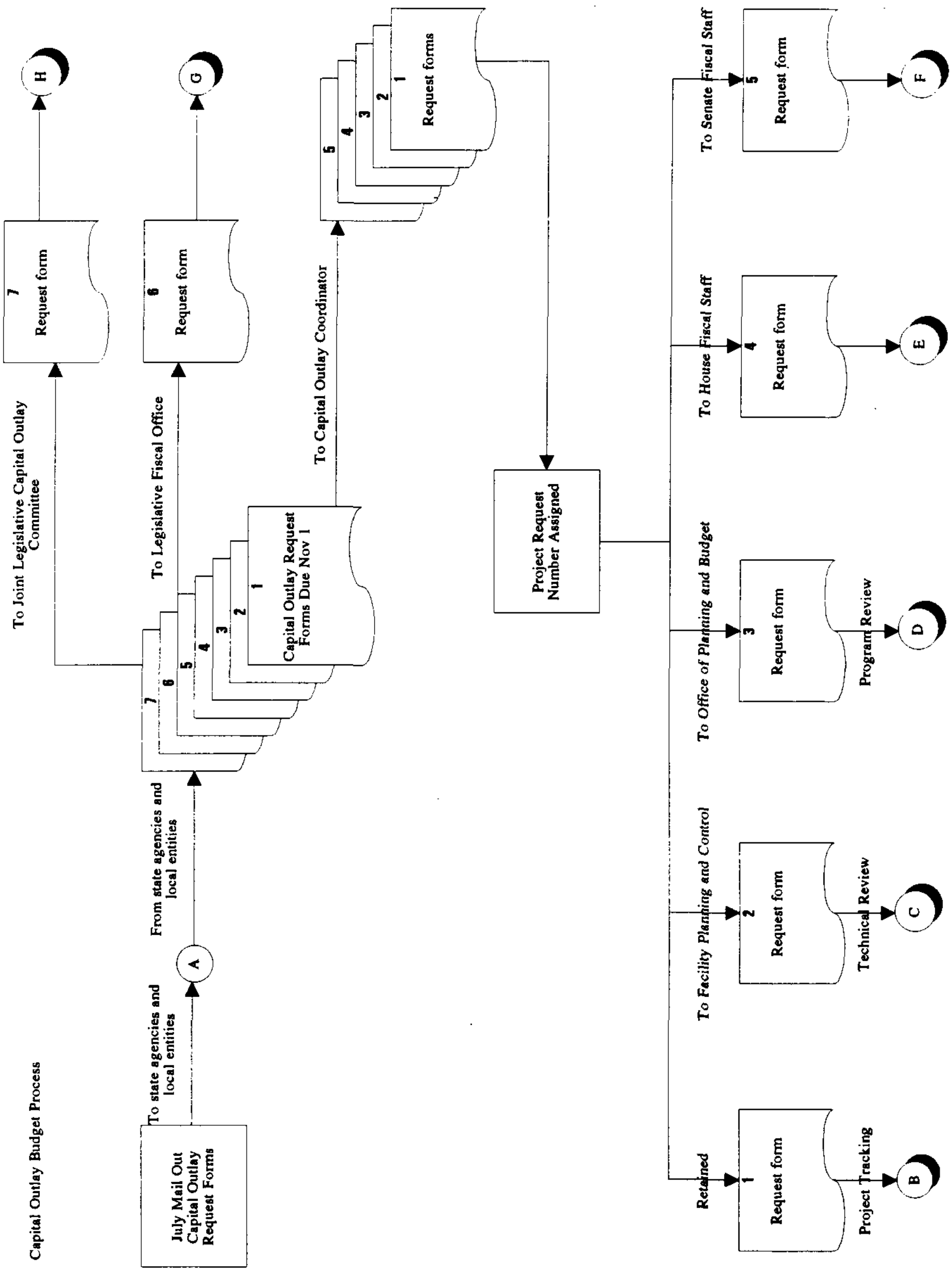
General Obligation Bonds - Funding source is general obligation bonds, but also indicates local match or reimbursement contract stipulations.

NRP - Funding source is bond proceeds from prior year projects not required for the designated project. NRP stands for "Not Requiring Priority."

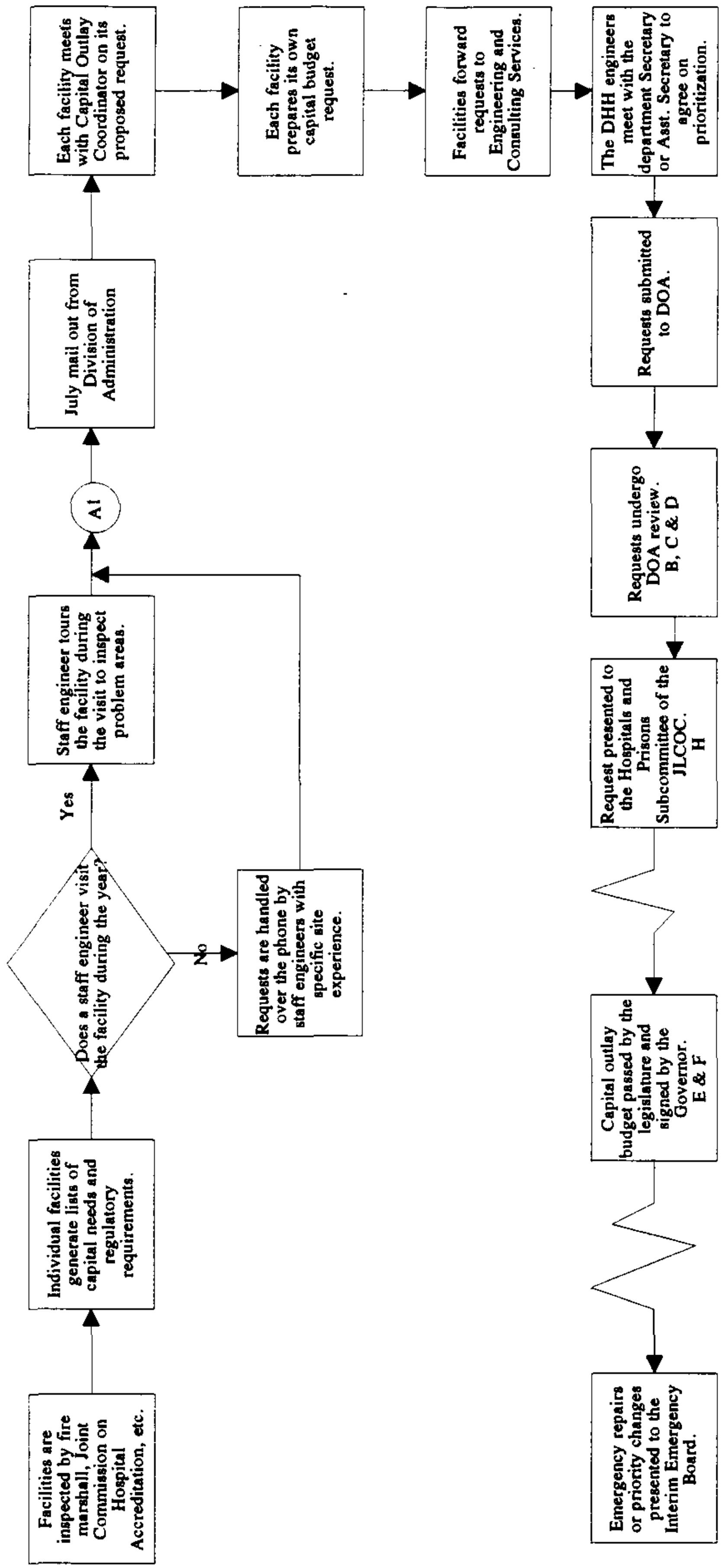
Source: Act 1137 of 1992

The capital outlay bill and Omnibus bond authorization bill are introduced in the House of Representatives. After the bills and accompanying amendments are approved in the House of Representatives, the engrossed bills are sent to the Senate. After Senate consideration, the bills with accompanying amendments are then returned to the House of Representatives for approval. If the House does not approve the Senate amendments, a joint conference committee meets to review both versions and develop an acceptable compromise. Once the legislature passes the capital outlay bill, the enrolled version of the bill is sent to the Governor for his signature. The Governor has the option to veto individual projects in the bill.

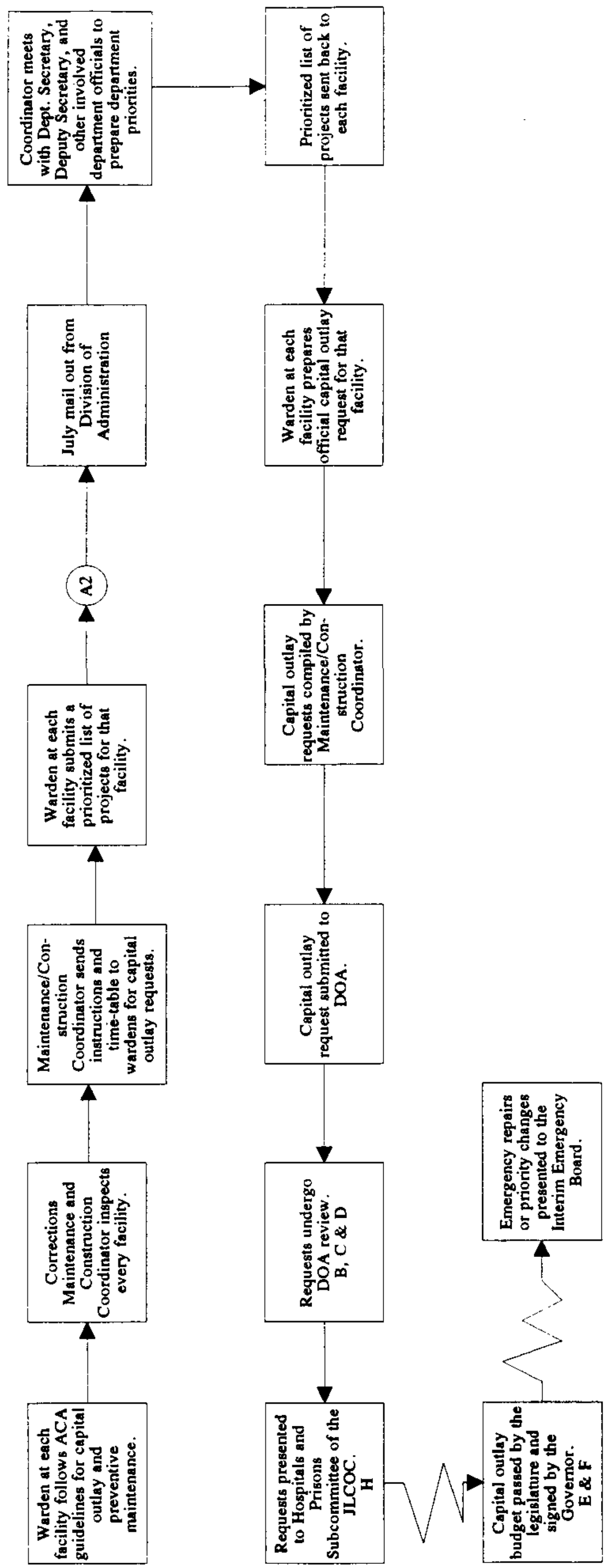
Once the capital outlay budget is enacted, the Division of Administration notifies each political unit which projects are authorized under the act. No bond funded projects in a lower priority can be funded until all projects in higher priorities have been funded or formally withdrawn. Projects in lower priorities can be moved to a higher priority by the Interim Emergency Board. To get funding for an eligible bond funded project, the head of the political unit submits a request to the Commissioner of Administration. The Division of Administration decides which requests will be forwarded to the State Bond Commission. The State Bond Commission can approve lines of credit to fund projects until a bond sale occurs. At the beginning of each fiscal year, the State Bond Commission must reauthorize outstanding lines of credit from the previous fiscal year.

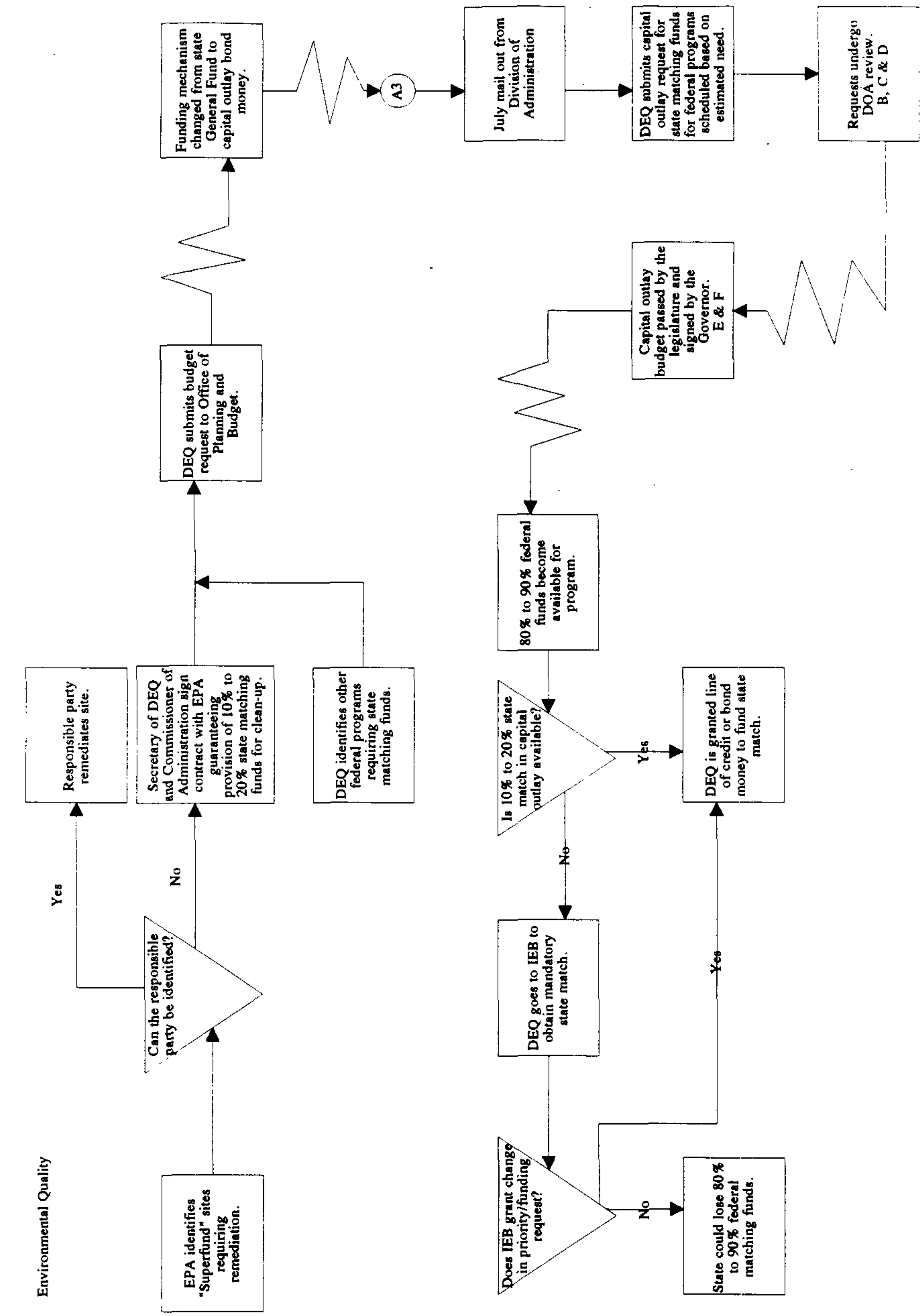

Capital Outlay Budget Process
July Mail Out Capital Outlay Request Forms
To state agencies and local entities
A
From state agencies and local entities
Capital Outlay Request Forms Due Nov 1
1
2
3
4
5
6
7
To Joint Legislative Capital Outlay Committee
7
Request form
H
To Legislative Fiscal Office
6
Request form
G
To Capital Outlay Coordinator
1
2
3
4
5
Request forms
Project Request Number Assigned
Retained
1
Request form
Project Tracking
B
To Facility Planning and Control
2
Request form
Technical Review
C
To Office of Planning and Budget
3
Request form
Program Review
D
To House Fiscal Staff
4
Request form
E
To Senate Fiscal Staff
5
Request form
F

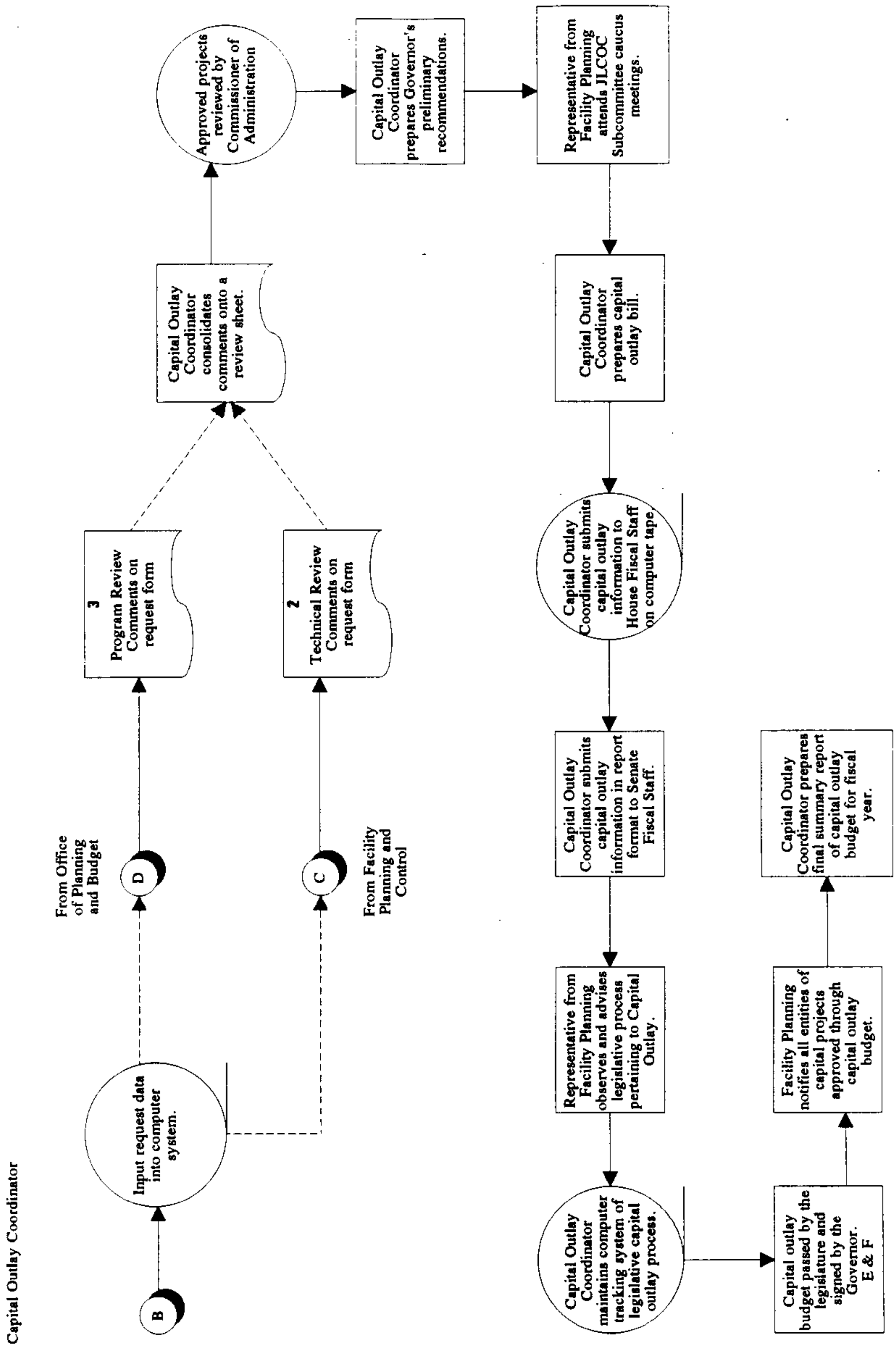
Health and Hospitals

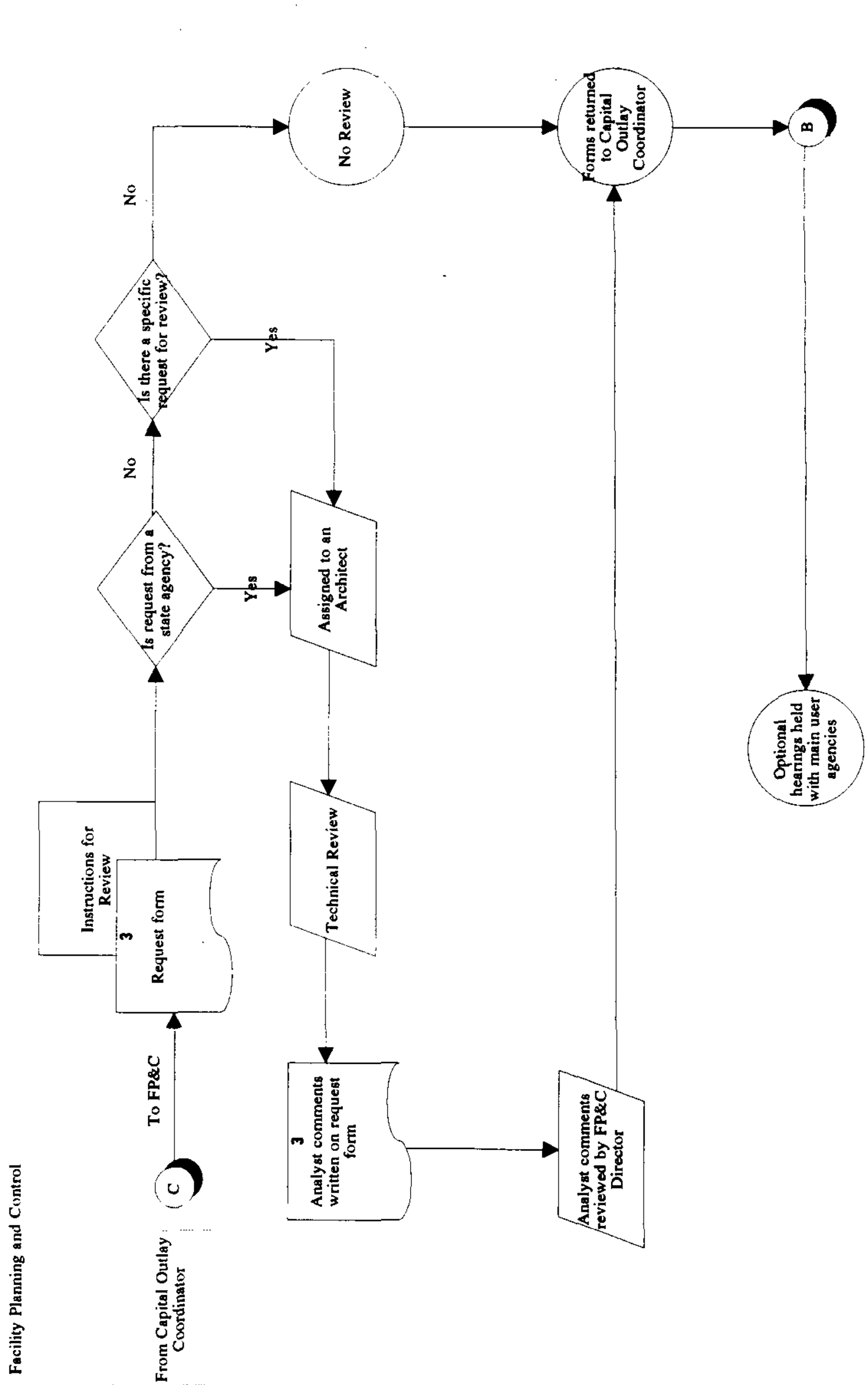


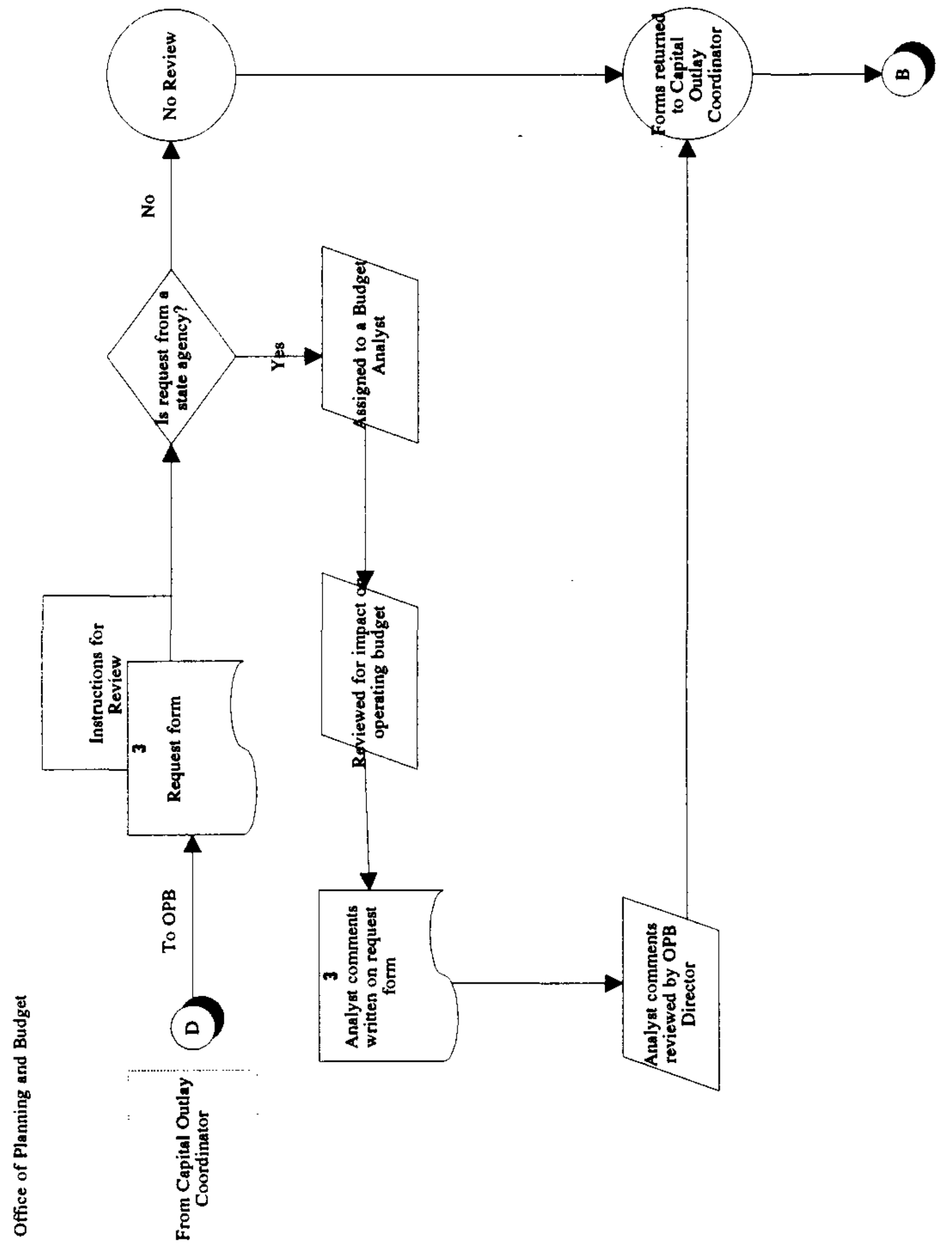
Corrections Services

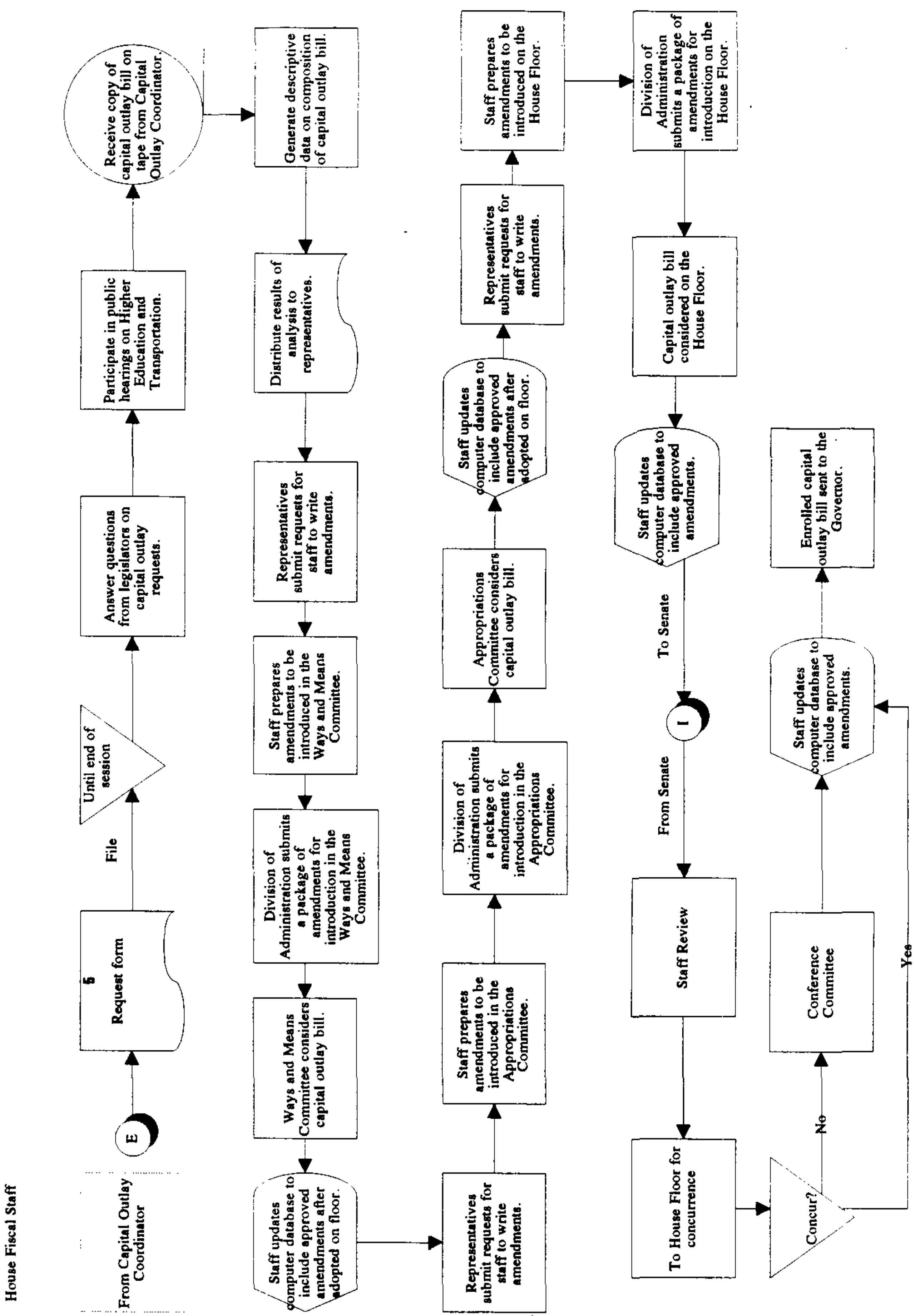


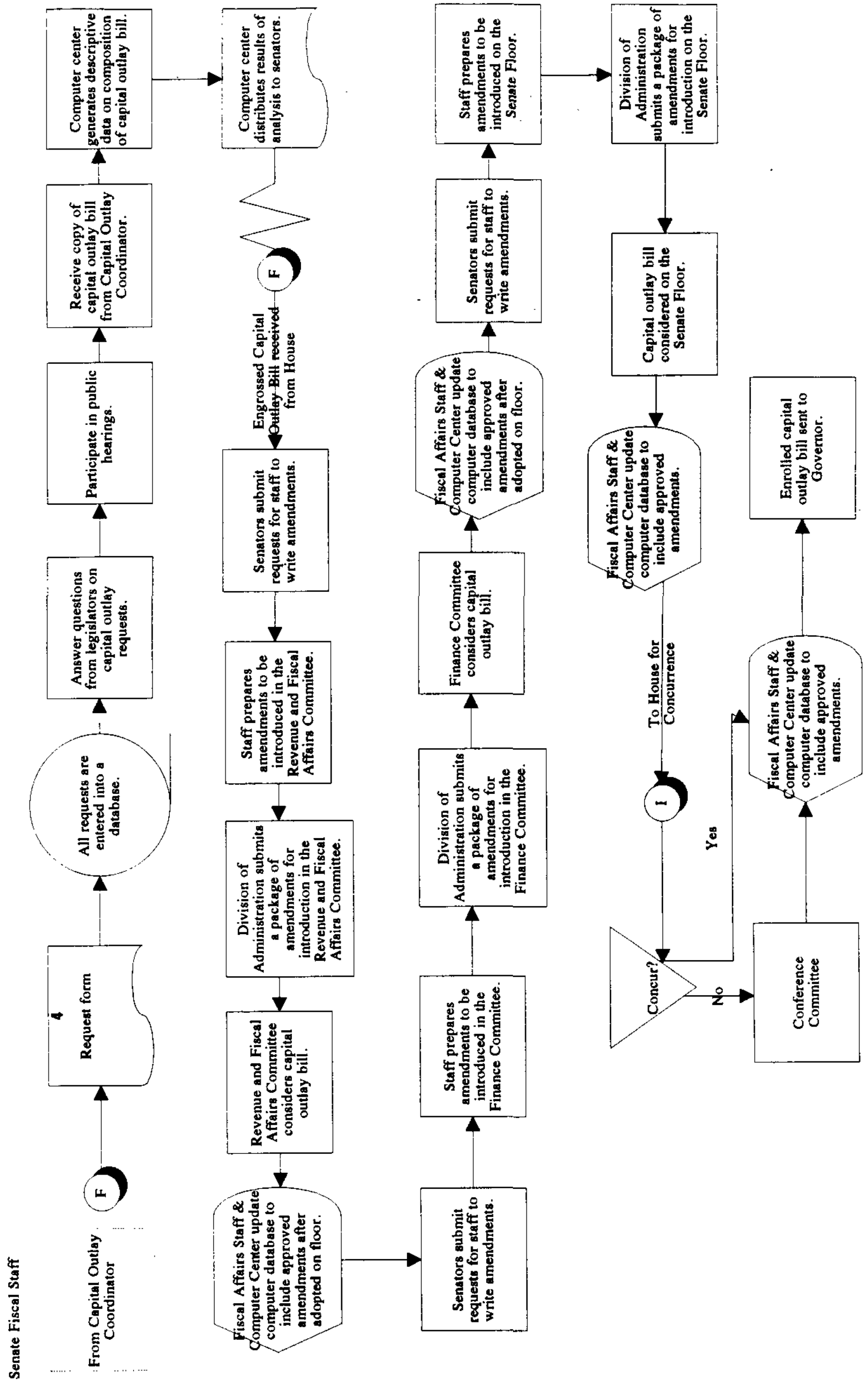

Environmental Quality
EPA identifies "Superfund" sites requiring remediation.
Can the responsible party be identified?
Yes
No
Responsible party remediates site.
Secretary of DEQ and Commissioner of Administration sign contract with EPA guaranteeing provision of 10% to 20% state matching funds for clean-up.
DEQ identifies other federal programs requiring state matching funds.
DEQ submits budget request to Office of Planning and Budget.
Funding mechanism changed from state General Fund to capital outlay bond money.
A3
July mail out from Division of Administration
DEQ submits capital outlay request for state matching funds for federal programs scheduled based on estimated need.
Requests undergo DOA review. B, C & D
Capital outlay budget passed by the legislature and signed by the Governor. E & F
80% to 90% federal funds become available for program.
Is 10% to 20% state match in capital outlay available?
Yes
No
DEQ is granted line of credit or bond money to fund state match.
DEQ goes to IEB to obtain mandatory state match.
Does IEB grant change in priority/funding request?
Yes
No
State could lose 80% to 90% federal matching funds.

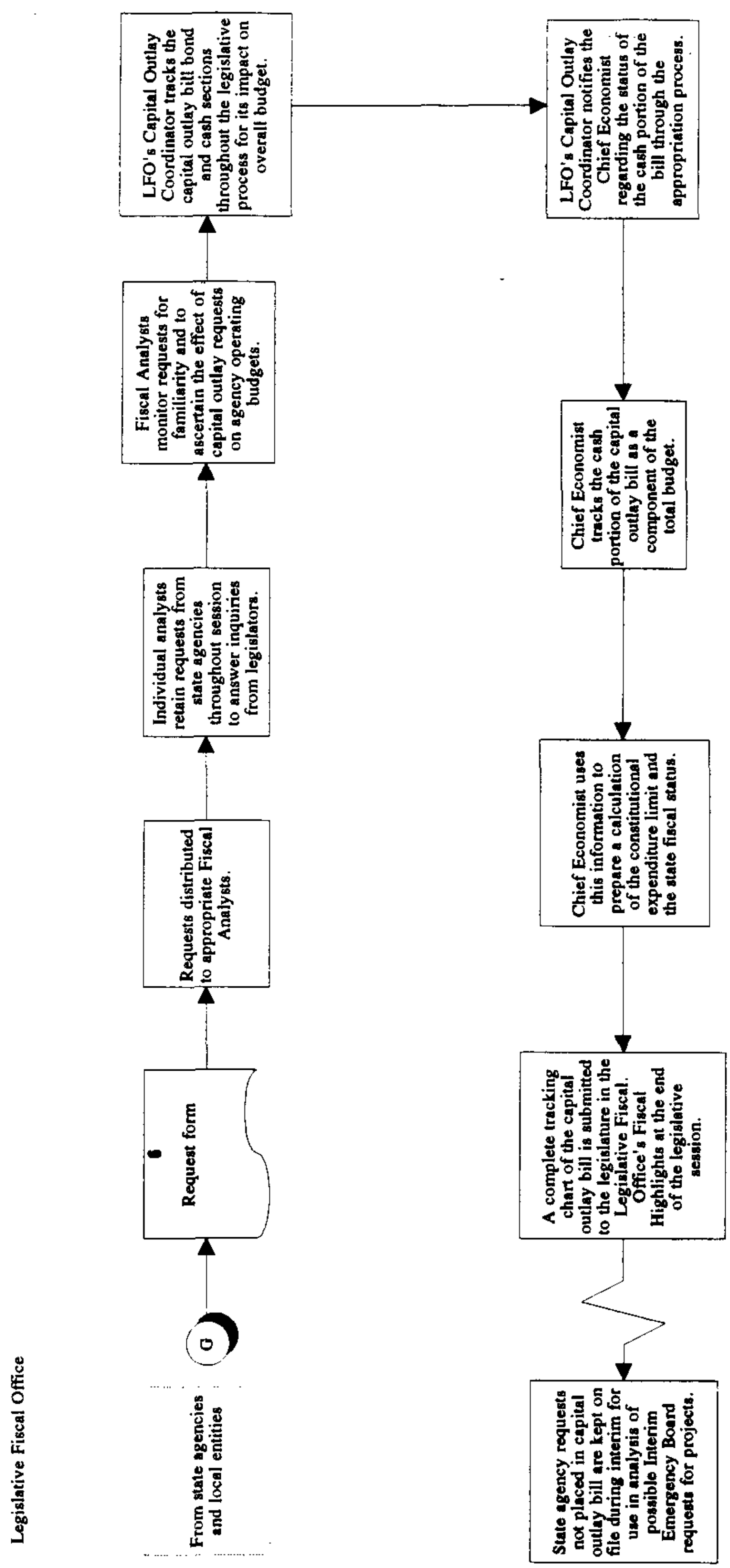

Capital Outlay Coordinator
B
Input request data into computer system.
D
From Office of Planning and Budget
C
From Facility Planning and Control
3
Program Review Comments on request form
2
Technical Review Comments on request form
Capital Outlay Coordinator consolidates comments onto a review sheet.
Approved projects reviewed by Commissioner of Administration
Capital Outlay Coordinator prepares Governor's preliminary recommendations.
Representative from Facility Planning attends JLCOC Subcommittee caucus meetings.
Capital Outlay Coordinator prepares capital outlay bill.
Capital Outlay Coordinator submits capital outlay information to House Fiscal Staff on computer tape.
Capital Outlay Coordinator submits capital outlay information in report format to Senate Fiscal Staff.
Representative from Facility Planning observes and advises legislative process pertaining to Capital Outlay.
Capital Outlay Coordinator maintains computer tracking system of legislative capital outlay process.
Capital outlay budget passed by the legislature and signed by the Governor.
E & F
Facility Planning notifies all entities of capital projects approved through capital outlay budget.
Capital Outlay Coordinator prepares final summary report of capital outlay budget for fiscal year.

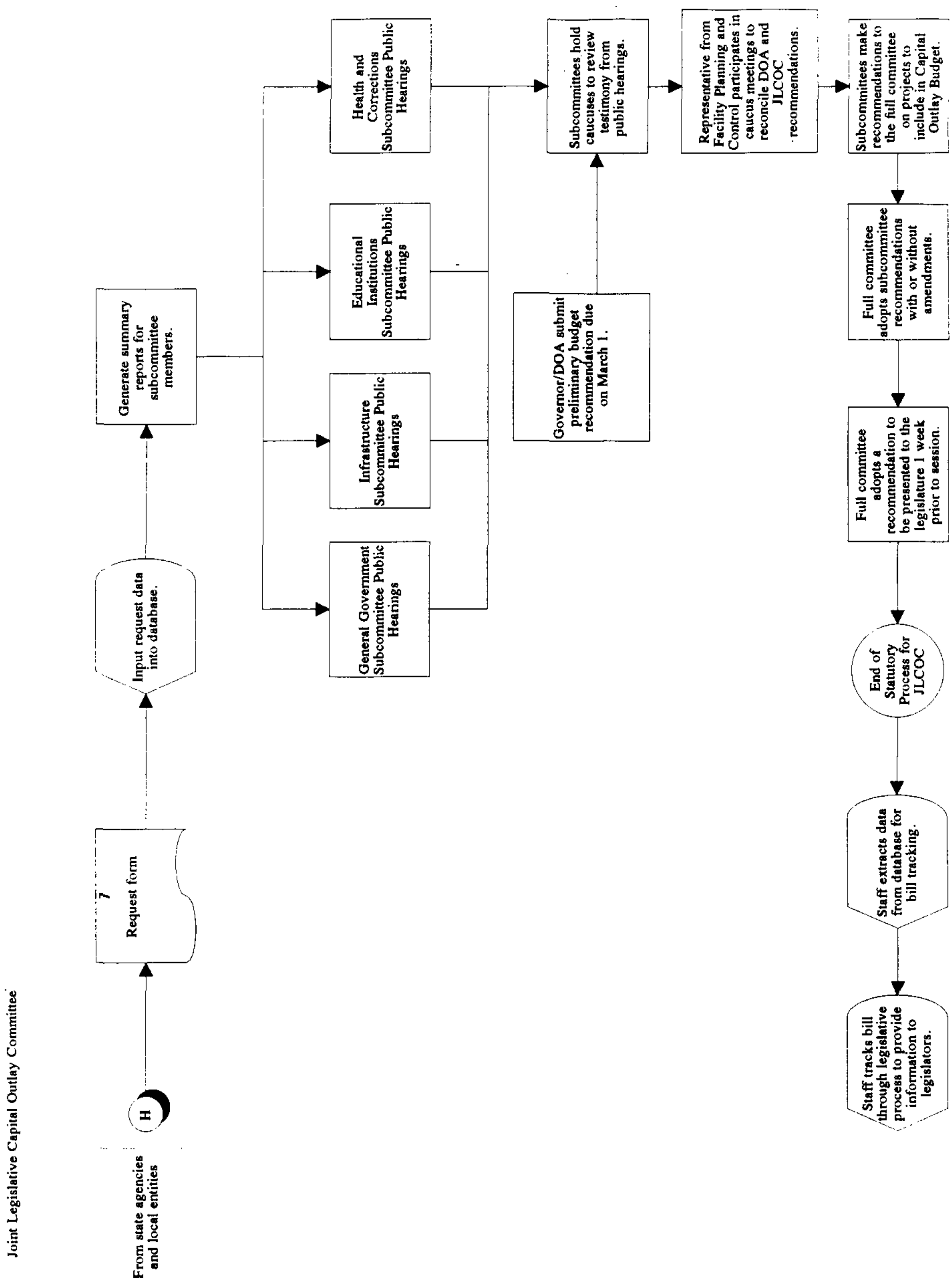

Facility Planning and Control
From Capital Outlay Coordinator
C
To FP&C
Instructions for Review
3
Request form
Is request from a state agency?
Yes
No
Is there a specific request for review?
Yes
No
No Review
Forms returned to Capital Outlay Coordinator
B
Assigned to an Architect
Technical Review
3
Analyst comments written on request form
Analyst comments reviewed by FP&C Director
Optional hearings held with main user agencies


Office of Planning and Budget
From Capital Outlay Coordinator
D
To OPB
3
Request form
Instructions for Review
Is request from a state agency?
No
No Review
Yes
Assigned to a Budget Analyst
Reviewed for impact on operating budget
3
Analyst comments written on request form
Analyst comments reviewed by OPB Director
Forms returned to Capital Outlay Coordinator
B


House Fiscal Staff
From Capital Outlay Coordinator
E
5
Request form
File
Until end of session
Answer questions from legislators on capital outlay requests.
Participate in public hearings on Higher Education and Transportation.
Receive copy of capital outlay bill on tape from Capital Outlay Coordinator.
Generate descriptive data on composition of capital outlay bill.
Distribute results of analysis to representatives.
Representatives submit requests for staff to write amendments.
Staff prepares amendments to be introduced in the Ways and Means Committee.
Division of Administration submits a package of amendments for introduction in the Ways and Means Committee.
Ways and Means Committee considers capital outlay bill.
Staff updates computer database to include approved amendments after adopted on floor.
Representatives submit requests for staff to write amendments.
Staff prepares amendments to be introduced in the Appropriations Committee.
Division of Administration submits a package of amendments for introduction in the Appropriations Committee.
Appropriations Committee considers capital outlay bill.
Staff updates computer database to include approved amendments after adopted on floor.
Representatives submit requests for staff to write amendments.
Staff prepares amendments to be introduced on the House Floor.
Division of Administration submits a package of amendments for introduction on the House Floor.
Capital outlay bill considered on the House Floor.
Staff updates computer database to include approved amendments.
To Senate
I
From Senate
Staff Review
To House Floor for concurrence
Concur?
No
Yes
Conference Committee
Staff updates computer database to include approved amendments.
Enrolled capital outlay bill sent to the Governor.


Senate Fiscal Staff
From Capital Outlay Coordinator
F
4
Request form
All requests are entered into a database.
Answer questions from legislators on capital outlay requests.
Participate in public hearings.
Receive copy of capital outlay bill from Capital Outlay Coordinator.
Computer center generates descriptive data on composition of capital outlay bill.
Computer center distributes results of analysis to senators.
F
Engrossed Capital ~~Outlay Bill received~~ from House
Senators submit requests for staff to write amendments.
Staff prepares amendments to be introduced in the Revenue and Fiscal Affairs Committee.
Division of Administration submits a package of amendments for introduction in the Revenue and Fiscal Affairs Committee.
Revenue and Fiscal Affairs Committee considers capital outlay bill.
Fiscal Affairs Staff & Computer Center update computer database to include approved amendments after adopted on floor.
Senators submit requests for staff to write amendments.
Staff prepares amendments to be introduced in the Finance Committee.
Division of Administration submits a package of amendments for introduction in the Finance Committee.
Finance Committee considers capital outlay bill.
Fiscal Affairs Staff & Computer Center update computer database to include approved amendments after adopted on floor.
Senators submit requests for staff to write amendments.
Staff prepares amendments to be introduced on the Senate Floor.
Division of Administration submits a package of amendments for introduction on the Senate Floor.
Capital outlay bill considered on the Senate Floor.
Fiscal Affairs Staff & Computer Center update computer database to include approved amendments.
To House for Concurrence
I
Concur?
Yes
No
Conference Committee
Fiscal Affairs Staff & Computer Center update computer database to include approved amendments.
Enrolled capital outlay bill sent to Governor.


Legislative Fiscal Office
From state agencies and local entities
G
Request form
Requests distributed to appropriate Fiscal Analysts.
Individual analysts retain requests from state agencies throughout session to answer inquiries from legislators.
Fiscal Analysts monitor requests for familiarity and to ascertain the effect of capital outlay requests on agency operating budgets.
LFO's Capital Outlay Coordinator tracks the capital outlay bill bond and cash sections throughout the legislative process for its impact on overall budget.
LFO's Capital Outlay Coordinator notifies the Chief Economist regarding the status of the cash portion of the bill through the appropriation process.
Chief Economist tracks the cash portion of the capital outlay bill as a component of the total budget.
Chief Economist uses this information to prepare a calculation of the constitutional expenditure limit and the state fiscal status.
A complete tracking chart of the capital outlay bill is submitted to the legislature in the Legislative Fiscal Office's Fiscal Highlights at the end of the legislative session.
State agency requests not placed in capital outlay bill are kept on file during interim for use in analysis of possible Interim Emergency Board requests for projects.


Joint Legislative Capital Outlay Committee
From state agencies and local entities
H
Request form
Input request data into database.
Generate summary reports for subcommittee members.
General Government Subcommittee Public Hearings
Infrastructure Subcommittee Public Hearings
Educational Institutions Subcommittee Public Hearings
Health and Corrections Subcommittee Public Hearings
Governor/DOA submit preliminary budget recommendation due on March 1.
Subcommittees hold caucuses to review testimony from public hearings.
Representative from Facility Planning and Control participates in caucus meetings to reconcile DOA and JLCOC recommendations.
Subcommittees make recommendations to the full committee on projects to include in Capital Outlay Budget.
Full committee adopts subcommittee recommendations with or without amendments.
Full committee adopts a recommendation to be presented to the legislature 1 week prior to session.
End of Statutory Process for JLCOC
Staff extracts data from database for bill tracking.
Staff tracks bill through legislative process to provide information to legislators.

Appendix C: State Tax-Supported Bonded Debt Outstanding and Debt Service

State Tax-Supported Bonded Debt Outstanding
As of June 30, 1992
(in Thousands)

General Obligation Debt Equivalents		$2,605,917
General Obligation	$2,520,732	
Highway Construction	13,795	
Capital Improvement	4,455	
Vietnam Veterans	600	
Louisiana Superdome	59,680	
Charity Hospital at New Orleans	3,135	
Higher Education	3,285	
Louisiana Highway	235	
Dedicated Tax Debt		968,208
Louisiana Recovery District	704,305	
Transportation Trust Fund	263,903	
Long-Term Lease Obligations		243,180
Louisiana Correctional Facilities Corporation	132,460	
Office Facilities Corporation	17,000	
LPFA - Equipment Leasing 1985	13,070	
LPFA - Equipment Leasing 1991	77,370	
Louisiana Office Building Corporation	3,280	
Other Revenue Debt		67,893
Ascension-St. James Bridge Authority	14,041	
Lake Charles Harbor Authority	2,185	
Crescent City Connection	34,033	
New Orleans Port Commission	17,634	
Total State Tax-Supported Bonded Debt		$3,885,198

Source: Louisiana Comprehensive Annual Financial Report for the fiscal year ended June 30, 1992; Louisiana Division of Administration; and Moody's Investors Service, Inc.

Bonded Debt for Financial Reporting Purpose Outstanding
As of June 30, 1992
(in Thousands)

Significant Oversight Revenue Bonds		$585,645
Colleges and Universities	$104,007	
Louisiana Department of Agriculture and Forestry	5,100	
Greater Baton Rouge Port Commission	5,460	
Greater New Orleans Expressway	60,015	
South Louisiana Port Commission	120,744	
Parish Road Fund	5,800	
Levee Districts	160,635	
Orleans Levee District	75,568	
Health Education Authority	28,316	
Louisiana Opportunity Loan Fund	20,000	
Unemployment Compensation Bonds		691,850
Long-Term Lease Obligations Counted as Capital Leases in the CAFR		(90,440)
LPFA - Equipment Leasing 1985	(13,070)	
LPFA - Equipment Leasing 1991	(77,370)	
Reimbursement Contracts With Political Subdivisions		(94,971)
Total State Bonded Debt as Shown in the CAFR		$4,977,282

Source: Louisiana Comprehensive Annual Financial Report for the fiscal year ended June 30, 1992; Louisiana Division of Administration; and Moody's Investors Service, Inc.

State Tax-Supported Bonded Debt Service Requirements
Debt Outstanding as of June 30, 1992
Beginning in Fiscal Year 1992-93

Type	Fiscal Year	Principal and Interest	% Projected General Revenues
General Obligation Equivalents			
	1992-1993	$359,728	6.7
	1993-1994	359,991	6.6
	1994-1995	358,807	6.3
	1995-1996	353,768	6
	Thereafter	2,433,863	N/A
Dedicated Tax Debt			
	1992-1993	39,316	0.7
	1993-1994	174,911	3.2
	1994-1995	175,567	3.1
	1995-1996	182,506	3.1
	Thereafter	712,379	N/A
Long-Term Lease Obligations			
	1992-1993	45,041	0.8
	1993-1994	43,855	0.8
	1994-1995	43,890	0.8
	1995-1996	39,238	0.7
	Thereafter	172,730	N/A
Other Revenue Bonds			
	1992-1993	9,250	0.2
	1993-1994	11,530	0.2
	1994-1995	14,506	0.3
	1995-1996	10,659	0.2
	Thereafter	77,293	N/A

(Continued)

Type	Fiscal Year	Principal and Interest	% Projected General Revenues
Total Tax-Supported Debt	1992-1993	$453,335	8.4
	1993-1994	590,287	10.8
	1994-1995	592,770	10.5
	1995-1996	586,171	10
	Thereafter	$3,396,265	N/A

Source: Louisiana Comprehensive Annual Financial Report for the year ended June 30, 1992; Louisiana Division of Administration; Revenue Estimating Conference; and Moody's Investors Service, Inc.

(Concluded)

State Tax-Supported Bonded Debt Service Requirements
Debt Outstanding as of June 30, 1992
Beginning in Fiscal Year 1992-93

Type	Fiscal Year	Principal and Interest	% Projected General Revenues
General Obligation Equivalents			
	1992-1993	$359,728	6.7
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	1992-1993	9,250	0.2
	1993-1994	11,530	0.2
	1994-1995	14,506	0.3
	1995-1996	10,659	0.2
	Thereafter	77,293	N/A

(Continued)

Appendix D

Agency Responses

Division of Administration's Responses

State of Louisiana
DIVISION OF ADMINISTRATION
OFFICE OF THE COMMISSIONER

EDWIN W. EDWARDS
GOVERNOR

RAYMOND J. LABORDE
COMMISSIONER OF ADMINISTRATION

April 8, 1993

Daniel G. Kyle, PhD., CPA
Legislative Auditor
P. O. Box 94397
Baton Rouge, LA 70804

Dear Dr. Kyle:

RE: Performance Audit-State Debt

The following are our management responses to the aforementioned report.

It is our position that information contained on pages 2 and 3 of the report requires clarification namely that: Exhibit 1 was compiled by the Legislative Auditor's Office, utilizing state tax supported debt parameters defined by the 1/1/93 Moody's Investors Services report, and information contained in the state's 1992 Comprehensive Annual Financial Report (CAFR). Part 1 of the exhibit shows outstanding bond obligations which are considered state tax supported debt by the financial community and the state and reflected in the CAFR under the debt unit. Part 2 adds certain other bonded debt which is considered state bonded debt obligations for financial reporting purposes and financial community purposes which is also contained within the CAFR under the debt unit. Also, Part 2 subtracts other type of debt both the financial community and the CAFR consider as state tax supported debt, which is reflected under the Capital Leases unit, rather than the Debt unit, of the CAFR.

Regarding information presented on page 3, it is the Division of Administration's position that certain debt of the state and its instrumentalities which should be considered as net tax supported debt and which is contained in the CAFR and recent Official Statements, is not included in the 1/1/93 Moody's listing. Those debt items include the debt of the Greater New Orleans Expressway Commission, pre-1974 debt of the colleges and universities, and the non-loan program debt of the Louisiana Agricultural and Finance Authority.

It is our position that clarification on information on pages 33 and 35 regarding the Use of Lines of Credit is required. The Division of Administration has

a mechanism to insure that projects with outstanding lines of credit are addressed in subsequent budgets, in the introduction of the Capital Outlay Bill (the Original Bill); however this does not guarantee that the legislative process will not make changes which affect the reauthorization of these lines of credit. These lines of credit are also subject to reauthorization approval by the State Bond Commission.

It is our position that clarification of the conclusions and comments made in Chapter 3 must be delineated. Several references to a breakdown in the process occur, yet in no section does it indicate where, or what entity was responsible for the breakdown (the faulty party is implied, but not stated). As stated in the exit conference, it is my belief that failure to indicate specific responsibility results in an implication that all parties are responsible and share equivalent fault. **It is my belief that this is not the case. The Division fulfilled its responsibilities under the law and is willing to accept responsibility when and if it has failed, however, we should not be held responsible, either directly or by implication, for failures outside that responsibility scope.**

Should you have any questions regarding our requested changes, please contact Mr. Whitman Kling at 504/342-7058.

Sincerely,

Raymond J. Laborde

Raymond J. Laborde
Commissioner of Administration

RJL/WJK/sm

Department of Treasury's Responses

TREASURER OF THE STATE OF LOUISIANA

MARY L. LANDRIEU
TREASURER

P. O. BOX 44154
BATON ROUGE 70804
(504) 342-0010

HAND DELIVERY

MEMORANDUM

To: Dan Kyle, Legislative Auditor

From: Mary L. Landrieu, State Treasurer

Re: Management Response of the Office of the State Bond Commission to Performance Audit Entitled: The State of Louisiana's Planning, Use and Oversight of Long-Term Bonded Debt

Date: April 13, 1993

Attached for your review and consideration is our response to the captioned audit report. As you will note, we have taken strong exception to the methodology and conclusions of the report, particularly in light of the stated purpose of the audit. The response is much lengthier than I would have liked, but given the magnitude of the misunderstandings reflected in the audit report, it was necessary to address in great detail many of the points in the report which were set out as fact and/or supported conclusions. Given additional time, however, our response would have been even lengthier--tantamount to a line-by-line refutation of the material contained in the report.

I am, as I told you in our telephone conversation, available at your convenience to discuss the issues involved here.

Attachment

cc: Judith Brown (with attachment)

STATE BOND COMMISSION
DEPARTMENT OF TREASURY

Mary L. Landrieu
State Treasurer
& Chairperson

Rae W. Logan
Director

MANAGEMENT RESPONSE OF THE OFFICE OF THE STATE BOND COMMISSION TO THE PERFORMANCE AUDIT ENTITLED: THE STATE OF LOUISIANA'S PLANNING, USE AND OVERSIGHT OF LONG-TERM BONDED DEBT

After a thorough review of the above-captioned report, including an in-depth study of the background material used to produce it, the Office of the State Bond Commission registers objection to and disputes both the general and specific findings. These objections can be summarized in three basic statements: (1) the report is not on-point in the sense that it does not address issuance and management of state debt, but instead veers off into a detailed (but still flawed) analysis of the oversight of several discrete (and unrepresentative) applications for issuance of local government debt; (2) the audit fails, indeed refuses, to recognize the significant strides the State Bond Commission and the staff of the Office of the State Bond Commission have made in the recent past in the area of debt oversight and management, instead implying that there has been a failure to perform up to normal levels; and (3) the methodology employed in the preparation of the audit is not in accordance with standard accounting sampling practices and procedures, and the resulting report misinterprets and mischaracterizes both financial data given to the Commission and the nature of agenda items presented to the Commission. The end result is a report which could be construed to cast the State Bond Commission and the Staff of the Office of the State Bond Commission in an unfavorable light, but which, as this response will show, was prepared without data which fairly supports such a conclusion.

The Office of the State Bond Commission was told at the inception of the work on this report that the purpose of the audit was to review how debt of the state was issued and managed. Although indeed this purpose is still reflected as the resulting report's subject, there is little about the content of the auditor's work product which reflects this purpose. Most of the analyses in the report deal with local and private debt issues, and nothing is said in the report about the extensive work which the Office of the State Bond Commission does as a part of assisting in the issuance of state general obligation and revenue debt. This perhaps is not surprising given the fact that, although invited several times to observe, the auditor did not attend any meetings with ratings agencies, the state's financial advisor, the underwriters, and other persons and entities which lead up to the recent issuance of $600 million in state general obligation refunding and new money bonds.

While the audit findings are specifically called into question in the coming pages, it is also a function of this response to make it clear from the outset the significant positive role the Commission and its staff have played in the issuance and management of state debt, including the Bond Commission's self imposed debt limitation. This self-imposed limitation has been rewarded by the marketplace with greater investor acceptance of State of Louisiana debt and recognized by the rating agencies as a positive factor in reducing the overall debt burden of the state. In addition, the current legislative debate concerning the imposition of a constitutionally mandated debt management plan can be directly traced to the ongoing and unyielding effort of the State Bond Commission to reduce the state's overall indebtedness. The office of the State Bond Commission submits that this debate and possible reform would not be at the forefront of public debate absent the increased oversight and meaningful review of debt applications the Commission has undertaken over the last several years.

What is also disturbing and misleading about the audit report is that a reader without an historical perspective of the State Bond Commission could be left with the erroneous impression that the Office of the Commission is a static entity lacking energy and commitment to progress and improve in carrying out its tasks and mission. The historical facts, when stated accurately, on their face compel the opposite conclusion. Prior to 1988, the Bond Commission members were not even provided written analysis of Commission agenda items. In fact, it was not uncommon prior to 1987 for the Bond Commission members to receive nothing more than an oral representation from the Director of the Bond Commission recommending approval of agenda items. The Bond Commission has made significant and laudable strides in creating a staffing environment that includes the resources necessary to apply meaningful and significant analysis of applications for borrowings made to the Commission. Besides the introduction of the labor intensive analysis sheets produced for the Bond Commission members for each application, the audit report fails to mention the legislative auditor's own in-depth report presented to the Bond Commission on a monthly basis, fails to mention the creation of the Fiscal Review Committee which has been designed to assist and rehabilitate local governmental borrowers in distress, fails to mention that the Commission has on contract a leading national financial advisory firm that is on call to assist the Commission with any financing it deems appropriate, fails to mention the financial data base now being established by the staff, and, finally, fails to mention the Staff's current ongoing project to implement an automated analysis support system to augment the approval process.

Notwithstanding these objections to the present report, the Office of the State Bond Commission stands ready to work with the legislative auditor to perform any additional analysis requirements that the auditor deems appropriate. The Office of the Commission would welcome the legislative auditor's input and suggestion on specific policy and procedure improvements to further refine the staff review process.

<u>RESPONSE AND REVIEW TO SPECIFIC SECTIONS OF THE AUDIT REPORT</u>

(NOTE: All references to page numbers in the sections below refer to the version of the audit report attached hereto as Exhibit A.) [NOTE: Exhibit A refers to a draft version of Chapter 4 of the audit report. It is not attached as an exhibit in this appendix. Page numbers in this response may not always match those of the final report.]

CHAPTER FOUR: OFFICE OF THE STATE BOND COMMISSION

<u>BOND COMMISSION STAFF OVERSIGHT (p. 39-41 of Report)</u>

This section of the report fails to outline the administrative reforms and advances that have been made in the Commission over the past several years. For example, while the report in this section mentions the format of the analysis sheets, the report does not state that prior to 1989, Bond Commission members considered applications based only upon limited <u>oral</u> information presented by the staff. In 1989, the analysis sheet format was initiated for the first time in the history of the State Bond Commission.

While this section of the report provides an organizational chart of the staff of the commission, the report fails to mention that the office of the State Bond Commission was significantly reorganized in 1990. At that time, the professional classification of debt analysts was requested of Civil Service by the State Treasurer in order to facilitate a thorough review of debt applications. The classified position of Assistant Director was also introduced by the State Treasurer to ensure continuity through changes in the department's elected Treasurer. The mission of the State Debt section of the State Bond Commission was enhanced to assume the responsibilities of the statutory mandate of a State Debt Management section thus eliminating duplication of duties.

While the report outlines the budget of the Commission, it fails to mention that prior to 1989, the State Bond Commission relied mainly on general fund revenues for its operating budget. Responding to a mandate that the Commission become self-supportive, in 1989 the Commission through statutory authority imposed a modest closing fee on local government issues. In 1990, the State Treasurer initiated legislation to lower the fees and to permit the rebate any excess closing fees. Since the effective date of this legislation, the State Bond Commission has rebated close to a million dollars to local governments and other entities paying closing fees to the Commission.

This section of the report also appears to suggest the duties of the staff are limited to oversight responsibilities, leaving the reader with the impression that the staff has a more limited role than is actually the case. For instance, the staff of the Commission is actively engaged in the actual issuance of the state's debt, both general obligation and revenue debt. This active involvement includes: (1) coordinating the disclosure requirements of the state culminating in the production of the official statement of the state's financial condition which must be attested to as correct and complete by the State Treasurer; (2) structuring the payment schedule of the Bonds to be sold; (3) ensuring that all aspects of the sale of the state's debt is done in the most competitive environment possible which requires the staff to: (a) create, mail and review solicitations and requests for proposals for bond counsel, underwriters, bond insurance and the like; and (4) actually pricing the bonds to ensure favorable market participation by the states. In addition to the role of the Commission staff in coordinating the issuance of state debt, the staff is also required to track the existing state debt and in conjunction with the staff of the Treasury Department staff, must ensure the timely and correct payment of state debt. The state's current debt service schedule requires the repayment of hundreds of millions of dollars each year. The administrative task of accomplishing this repayment is significant.

Finally, this section of the report fails to mention that in 1990, the Treasurer as Chair of the Bond Commission, requested and received an expanded role for the Legislative Auditor and instituted the Legislative Auditor's report. This important report is presented as a separate item at each Commission meeting and is designed to highlight deficit fund balances or other pertinent information to the Commission. It is this report which should call to the members' attention deficit fund balances and problems with the creditworthiness of applicants.

STAFF FINANCIAL REVIEW (p. 43-45 of Report)

The office of the State Bond Commission, with a staff of five analysts and two debt managers, analyzes and reviews between 600 - 1000 applications annually. This report based its conclusions upon a sample of only 43 files (both state and local debt) which does not constitute adequate statistical analysis. Furthermore, in most cases the audit staff incorrectly interprets the information contained in the files which were actually reviewed. Even further, the report seems to impose review requirements upon the staff that do not exist in either statute or the administrative rules of the Bond Commission.

For example, for the purposes of reviewing loans, the following is routinely expected to be contained in the analysts files:

For Budgetary Loans:

- Current adopted budget of the entity showing sufficient budgeted revenues. Municipalities and police juries are allowed to incur debt up to 100% of their budgeted revenues, and school board up to 50% with some up to 75% of their revenues.

- Certified resolution adopted by the entity.

- Audited financial statements are also examined, **although not required by law.**

For anticipation of avails of special taxes:

- Certified resolution adopted by the entity.

- Amount of anticipated annual avails of the tax that is to be pledged.

- Analyst also checks the tax proposition which was voted on the make sure the purpose is the same for which the loan is being made.

- Audited financial statements are also examined **although not required by law**.

For excess revenue loans:

- Certified resolution adopted by the entity.

- Current adopted budget of the entity showing sufficient excess revenues (including taking into consideration fund balances) to cover the **first year's** debt service.

- Audited financial statements are also examined **although not required by law**.

The report states that several of the 43 application files contained "insufficient financial information" with which to evaluate an applicant's repayment capability. The report fails to mention what standard for financial information had been violated. The notion that several files contained insufficient financial analysis is particularly curious considering the active involvement of the Legislative Auditor in the pre-Commission meeting process. Prior to any item being included on the Commission's agenda, each local governmental item is reviewed by the Department of Justice public finance section for statutory compliance and by the Legislative Auditor for adequate financial analysis. Certainly the auditor has adequate pre-commission meeting input regarding particular agenda items. While the audit report in this section does not specify what files contained inadequate information, the Local Debt Officer obtained from the representative of the Legislative Auditor's Office, a list of the 14 local debt files the auditor deemed deficient. Below is the Staff's file-by-file response to the 14 local debt files the auditor advises were reviewed:

(1) L91-463 - St. Helena Parish Police Jury:

Budgetary Loan request. The **financial** information required is contained in the file, including current adopted budget showing sufficient revenues. What is missing is a "certified" resolution of the entity. The audit report should **not** contain a statement that this file contained insufficient financial information.

(2) L92-183 - Town of Church Point:

Excess Revenue loan request. The **financial** information required is contained in the file. What [the auditor] did not take into consideration was the "transfers in" from the sales tax fund in order to produce sufficient revenues to cover the debt service.

(3) L92-263 - Caddo Parish Law Enforcement District:

Budgetary Loan request. The **financial** information required is contained in the file, including the current adopted budget as well as a fiscal agency agreement, which is **not** required by law to be submitted.

(4) L92-352 - Water Service Commission of St. Tammany Parish:

This was a request to issue Bond Anticipation Notes. These notes were being issued to acquire certain existing small sewerage and water facilities owned by private utility companies. What the auditor failed to note was that the DEQ had not granted a permit for one of the plants because of owner/operator problems. The DEQ stated that no permit would be issued until this *facility was acquired by an acceptable owner/operator. The file contains sufficient information* to analyze this request. Bond Anticipation Notes are payable from the proceeds of the long term bonds when they are issued.

(5) L91-406 - Village of Rosedale:

This was an excess revenue loan request. The **financial** information required is contained in the file, including a current adopted budget showing sufficient excess revenues to cover the annual debt service. What is **not** shown on the analysis sheet is the **outstanding** excess revenue loan of $36,500, although the excess revenues, including fund balances, are more than sufficient to cover the current loan debt service, as well as the outstanding loan debt service. The system is not foolproof, and the Staff is currently seeking ways to address the problem of information regarding prior loans. However, in this instance, the lack of information created no adverse result, and had the information been in the file approval would have been granted anyway.

(6) L91-402 - Town of Vivian:

This was a request to hold a general Obligation Bond Election. The file contains everything that is required, (a) certified resolution as well as (b) the assessed valuation, (c) the current millage and (d) the projected new millage. The legal debt limit on the general obligation bonds was actually $2,069,490, and this request was for $2,200,000; **but** the analyst **noted** in the problem area of the analysis sheet that approval be conditioned that the legal debt limit not be exceeded at issuance. Furthermore, this request was for the acquisition of an industrial plant building within the Town for Vivian Industries, and the bonds were actually payable from the revenues of the lease of the facility to the extent that they were available, as was noted by the analyst. The ad valorem tax security (the g. o. election) was secondary security for repayment.

(7) L92-58 - Industrial Development Board of the City of La., Inc. (International Paper Company, Inc.):

This was a request to issue revenue refunding bonds. Everything that is required to analyze this request **is** contained in the file. As is stated in other portions of this response, industrial development bond issues are secured by payments made by a private company (in this case, International Paper) under a refunding agreement. **The bonds are not secured by payment of a governmental entity or political subdivision. This is a business decision by International Paper to refund these bonds.**

(8) L92-137 - Memorial Hospital Service District, St. Charles Parish (Lake Charles Memorial Hospital):

This was a request to issue hospital revenue refunding bonds. Everything that is required to analyze this refunding request, including financial schedules, was provided and is contained in the file. The auditor failed to note that this is a **private not-for-profit** hospital, and, as noted on the analysis sheet, **the financing will not be secured by the full faith and credit of this issuer or any other political subdivision of the State.**

(9) L92-221 - Beauregard Parish Police Jury (Road Districts 4,7,8):

This was a request to hold general obligation bond elections in three districts. Everything that is required for bond elections is contained in the file, including the certified resolution as well as the assessed valuation of each district, the outstanding debt and the current and projected millage.

(10) L92-58 - Industrial Development Board of the Parish of East Baton Rouge, La., Inc. (La Quinta Motor Inns):

This was a request to issue revenue refunding bonds. Everything that is required to analyze this request **is** contained in the file. As stated in other portions of this response, industrial development bond issues are secured by payments made by a private company (in this case, La Quinta) under a refunding agreement. **The bonds are not secured by payment of a**

governmental entity or political subdivision. This is a business decision by La Quinta to issue these refunding bonds.

(11) L92-285 - St. Tammany Parish School Board:

This was a request to issue sales tax bonds. Everything that is required to analyze this request is contained in the file, including the certified resolution and projected annual sales tax avails.

(12) L92-331 - Tangipahoa Parish School Board:

This was a request to issue general obligation school refunding bonds. The refunding schedules, certified resolution, current and projected millage reduction and everything else required is contained in the file. This restructuring, as shown on the analysis sheet, was done to free up sales tax revenues for capital improvements, **not for present value savings.**

(13) L92-350 - Morehouse Parish Law Enforcement District:

This was a request to issue jail revenue bonds. This **is one of the most documented files and most talked about issues that the local debt section reviewed in 1992**. These are jail revenue bonds secured by revenues derived by the District and are dependant upon an annual appropriation by the State through the Department of Corrections (DOC). The District entered into a cooperative endeavor agreement with the DOC whereby the DOC agreed to house a minimum of 40%, or 96 inmates, of the total capacity of 240 inmates in the jail facility at all times during the period when the bonds are outstanding. The staff expressed concerns over a contract involving an annual appropriation of debt of the state and with a guarantee of a certain number of inmates as long as any bonds were outstanding. The Treasurer appointed a Jail Subcommittee of the Bond Commission to look into and take testimony from DOC. As a result of the Staff's bringing this matter to the attention of the Commission, the Commission decided that after this application an unofficial moratorium would be placed in effect, with no more than two such applications being approved in any one year. This application, then, caused the Staff and the Commission to make policies to protect and preserve the integrity of the local debt issuance process as it related to jail revenue bonds.

(14) L92-398 - Vernon Parish Police Jury:

This was a request for General Obligation Bond Election. The file contains everything that is required, certified resolution as well as the assessed valuation, the current millage and the projected new millage. The estimated debt service requirement, which is **not** required, as the letter indicated, was not contained in the file, but the analyst called and obtained the information, as is shown on the analysis sheet.

In conclusion to our response to this section of the audit report, it is particularly disturbing that the report suggests that the staff should generate its own "schedules for financial analysis". It is obviously not feasible under present staffing levels for the Office of the Commission to prepare payment schedules for each of the 600 - 1000 applications it receives annually. Further, the constitutional mandate of the Commission and the statutory framework to fulfill the constitutional mandate do not call upon the office of the Commission to structure debt for local entities, public trusts and agencies. To some extent, the staff must be able to rely on credibility and the integrity of the applicant entity in its presentation of data to the Commission's staff. When deemed necessary, the staff will run alternative payment schedules and will on occasion consult with the State's Financial Advisor on particular applications.

Lack of Consideration of Key Financial Information (p.43)

This section of the report also discusses at length the Office of the Commission's policy regarding refundings. In order for the staff to have some guidance in their review of refunding applications, the Director issued guidelines in 1991. In January, 1992, the staff asked the Commission to establish a rule of the Commission codifying the refunding guidelines. The rule would have required a 5% present value savings for all refundings except in extenuating circumstances. The proposed rule was rejected by the Commission as too restrictive; clearly, the Staff desired guidelines which were more definite and more stringent than the members of the Commission were willing to impose.

Currently the guidelines are in use to assess refunding bond issues, and the guidelines recognize that refunding's may be done for other than economic savings. The guidelines give the staff a rule-of-thumb against which to make a refunding analysis and provide a starting point for Commission review.

The Office of the State Bond Commission takes particular exception to the two refunding analysis discussed in this section of the report. The two refunding examples cited by the audit report on page 44 concern private activity bonds (as opposed to refundings of public debt) where no public funds were used for debt repayment nor were public funds at risk by virtue of a pledge against the debt. In the first instance, the bond issue was for a major hotel/motel chain. (This file is reviewed as number 10 in the file-by-file analysis.) Undoubtedly, a major hotel/motel chain is capable of making and moreover expects to make prudent business decisions based on the analysis of the Corporation's financial advisors. The second example cited consisted of a private university issuer which was using the Louisiana Public Facilities Authority as a conduit issuer to access the tax-exempt markets. Again, the staff recognized that public funds were not at risk and that the University possessed the necessary business acumen to successfully restructure their debt with a "bullet payment". Some judgment is necessary on the part of the staff to differentiate between private issuers accessing the public market through a conduit issuer and a public issuer pledging public funds under strict statutory provisions.

Recommendation 1 (p. 48)

Response:

In 1988, the State Treasurer, as chair of the State Bond Commission recognized the lack of in-depth analysis by the staff of the commission and instituted several reforms. The first was the introduction of the analysis sheet referenced earlier in this response statement. The Treasurer also worked out with the Bond Commission staff and the Legislative Auditor a greater role for the Legislative Auditor's staff and instituted a written Auditor's report with a much expanded scope and mission. The Staff of the Bond Commission now receives ongoing training in public finance. All efforts are made to do a uniform financial analysis on all applications but the staff does recognize unique situations.

Recommendation 2 (p. 48)

Response:

The Bond Commission rules for non-traditional debt were adopted in 1979 and revised in 1982. The Treasurer appointed a Rules Subcommittee in 1992 creating a mechanism for the revision and updating of State Bond Commission Rules. However, it should be noted that the staff strictly follows statutory and administrative rule guidelines for the review of different forms of debt.

Insufficient Financial Information (p. 48)

This section of the report attempts to suggest that the staff of the Commission permitted approval of applications based upon insufficient data. In particular this section of the report cites a commercial venture in New Orleans that sought approval for $3.5 million in revenue bonds where the file supposedly contained no financial analysis whatsoever regarding repayment. What the audit report does not state is the file was opened for preliminary approval consideration by the Commission. Preliminary approval is designed to notify the Commission of a project and is intended to establish the public purpose of the issue. The financial analysis would have been completed upon request for final approval which was never made by the applicant. HOWEVER, THE MATTER NEVER CAME BEFORE THE COMMISSION FOR FINAL APPROVAL AND THE COMMISSION NEVER APPROVED THE BOND ISSUE.

In the audit report, there is a reference on page 48 to $7.5 million of bond anticipation notes, critically noting lack of information in the supporting file. This criticism deserves specific response because it is indicative of the methodology and incomplete information on which the report is based. In 1992, St. Tammany Parish was permitted by the Legislature to form a parishwide water and sewerage district to consolidate and purchase existing facilities. (This file is reviewed above as number 4 in the file-by-file analysis.) The $7.5 million bond anticipation note application was actually only one part of a two-part request. The newly formed entity was seeking to purchase an existing facility for which the Dept. of Environmental Quality would not issue a permit until the purchase had been made. An initial issuance of $1,000,000 in Bond Anticipation Notes to effect the purchase was requested and permission was granted to hold a public hearing for the full $7.5 million. If no objections were received, permission was given to go forward with the full amount of bond anticipation notes. It should be noted here that bond anticipation notes are paid by the issuance of bonds. The intent for the issuance of the bond anticipation notes was to acquire the facility, and generate revenues from which the subsequent bonds would be paid.

In response to the criticism of the file contents of another specifically-referenced application at page 48 of the report, the application for $600,000 excess revenue certificates of indebtedness payable over a ten-year period (this file is addressed above as number 2), La. R.S. 33:2921 allows parishes and municipalities to incur debt, and pledge their excess of annual revenues, above statutory, necessary and usual charges for the **current** year. In other words the current year's excess revenues are compared to the annual debt service. Future years' excess revenues are not considered. This is a matter that should be addressed with legislation. Additionally, it has been determined that local governments can use their "fund balances" in determining excess revenues. The staff computes debt service using "level debt" and computes this themselves. The fact that the debt service schedule was not enclosed was not a factor, since the **staff** determined what the debt service would be and compared it to excess revenues.

Recommendation 3 (p. 49)

A desired time frame for the submission of information is in place, but the Staff is often unable to enforce the rule because of the realities of local debt management and the practical problems Bond Commission members are presented with by the applicants. Bond Commission rules would generally require that applications be submitted 20 working days prior to the regular meeting. In addition, the Bond Commission adopted a policy which sets the parameters for submission of additional data. The current requirements included in the Bond Commission rules can be amended to set specific guidelines delineating minimum financial information. However, the current rules of the Commission do impose certain requirements. The Office of the Commission welcomes the input of the Legislative Auditor with regard to certain enhancements to the Commission rules. The staff, absent enhanced reporting requirements, has operated under the "prudent business person" rule of business in that the required information would be that which would be required by a prudent business person making informed decisions.

Recommendation 4 (p. 49)

We agree that this policy needs to be adopted. Currently, if the staff finds an application lacking sufficient data, the item is withheld from the agenda. However, the State Bond Commission operates under Roberts Rules of Order which allows items not on the agenda to be brought up under other business with 2/3 vote of members present and voting. On occasion, an entity that has not presented sufficient information for a recommendation will lobby the Bond Commission to have the item placed on the agenda for consideration and approval.

Not All Relevant Facts Presented to the Commission (p. 49-51)

We strongly disagree with the Audit Report's overall assertion that pertinent information is not provided to the Commission members. While we will continue to strive to enhance the presentations made to the Commission, we must note that this Audit Report fails to mention, directly or indirectly, the substantive improvements that have been made in the last few years.

As for the examples cited in this section of the report, a review of the analysis sheet prepared for the refunding in question (referred to above in this response as number 12) shows that the analyst clearly stated in the section entitled "Present Value/Future Value Savings" that there would be a negative total net debt service savings of ($209,000). The analyst did not state that the present value savings was less than 5% because such is obvious in light of the statement there would be a negative total debt service savings. As stated by the Bond Commission analyst and repeated in your report, this refunding was done to restructure debt which was originally issued in 1982 and 1984. A further review of the file shows that the original debt was structured as 15 year debt with a 20 year life expectancy of the financed items. This type of structure was typical in the high interest rate environment of the early 1980's. The analyst clearly stated on the analysis sheet that this application was a request to refund and restructure the outstanding debt.

On page 51 of this section of the report (referred to above as number 9 in this response), the staff is also called to task for not advising the Commission that an application was technically deficient because a proposed debt issuance called for in an election request would exceed the local debt limit. However, the Attorney General has repeatedly stated that a if proposed bond issuance exceeds the statutory limitation, AN ELECTION FOR THE BOND ISSUE CAN BE HELD BUT THE BONDS CANNOT BE ISSUED. It is therefore our opinion that the analyst having relied on the Attorney General's ruling had no need to cite any technical problems with this election. Until the Attorney General rules otherwise, or until legislation is enacted to clarify this rule, we will continue to advocate support and assistance of local government issuers without making arbitrary and subjective interpretations of the Constitution.

Recommendation 5 (p. 51)

Response:

This recommendation suggests the Commission members are given inadequate information by the analysts. The analysis sheet was first introduced by the Treasurer in 1989. Prior to 1989, no formal format or presentation was made to the Bond Commission in consideration of applications. There is an ongoing effort to improve the format of the analysis sheet. Most notably, the staff of the Commission is currently developing an automated support system for the approval process. This integrated computer program will include the analytical framework for the various types of approval processes. Not only will the automated support system help to enhance the analysis sheet, but will also assist in developing a database on all state and local debt analysis.

Recommendation 6 (p. 52)

Response:

Officewide use of computers were first implemented in the Commission offices in 1989. For the past two years, the staff has been actively engaged in the process of developing a database which will assist the staff, the Commission and the Legislature in closely monitoring outstanding indebtedness. In order to develop this database, a complete internal study of the operations of the office and records has just been completed to ensure that the database will include all pertinent data.

Possibilities for Efficiency (p. 53)

Matter for Efficiency

The Treasurer has requested this legislation to be filed. In 1974, there were few Home Rule Charter cities. We agree that such elections should be at the option of local government.

Recommendation 7 (p.54)

The staff has initiated discussions with the Secretary of State's office to more efficiently handle election requests.

Preliminary Approval

Matter for Legislative Consideration 10 (p. 55)
(Consideration of elimination of State Bond Commission preliminary approval)

The office of the Commission strongly disagrees with the reports suggestion that the preliminary approval process of the State Bond Commission is of limited value. On the contrary, the preliminary approval process provides great benefit to both the Commission members and the entity requesting the issuance of the bonds. First, as a legal requirement, preliminary approval authorizes the publication of the notice of intention to issue the bonds. This publication provides true notification to the public of a governmental entity's desire to finance a specific project involving taxpayer's dollars. The result of this process is if the public purpose of the project is not justified, or if other legal questions arise, further cost of the issuing entity is avoided until such problems are resolved.

Further, from the practical point of view, the preliminary process allows the staff, the Commission members and the affected public to become more familiar with the project and to request additional information. The rules require that information should be submitted to the Bond Commission twenty days prior to the next meeting. With sometimes over sixty applications pending, the Bond Commission has come to expect a general preliminary discussion of the nature of the project the beneficiary of the project and the source of payment at the preliminary approval stage of review. If there is public opposition, it will usually surface between preliminary and final approval. As a general policy matter, the more scrutiny a public borrowing request is given, the better the taxpayers are served.

Budgetary Loans

Recommendation 8 (p.56)

The Treasurer established the Rules Subcommittee of the Bond Commission to review ways to assist local government's which have established good financial practices and have sound credit ratings. The lease rule for local government which takes effect in April of this year establishes an expeditious review process for leases for movable equipment. A local government advisory panel is being created to review more thoroughly how the State Bond Commission may properly consider local government matters.

Elections

Recommendation 9

The Bond Commission currently takes all election requests in one combined motion at Commission meetings unless there are distinguishing technical or financial issues which merit the Commission's individual attention to an election items. The analysis sheets are prepared during the review process which documents that each application contains the prerequisite information for approval.

Appendix E: Supplemental Information on the Review of the State Bond Commission Staff's Files

In its formal response to the audit report, the Department of Treasury questioned the validity of certain report conclusions. One key area of concern was the review of State Bond Commission files. The auditor would like to address these concerns by disclosing additional facts and details of the file review. So not to detract from the responses of the Department of Treasury (included verbatim in Appendix D of this report), our comments have been included in this separate appendix, with applicable excerpts from the Department of Treasury response inserted where needed.

General Comments on File Review

Excerpt from Department of Treasury Response

"The report states that several of the 43 application files contained "insufficient financial information" with which to evaluate an applicant's repayment capability. The report fails to mention what standard for financial information had been violated. The notion that several files contained insufficient financial analysis is particularly curious considering the active involvement of the Legislative Auditor in the pre-Commission meeting process. Prior to any item being included on the Commission's agenda, each local governmental item is reviewed by the Department of Justice public finance section for statutory compliance ***and by the Legislative Auditor for adequate financial analysis.*** *Certainly the auditor has adequate pre-commission meeting input regarding particular agenda items. While the audit report in this section does not specify what files contained inadequate information, the Local Debt Officer obtained from the representative of the Legislative Auditor's Office, a list of the 14 local debt files the auditor deemed deficient. Below is the Staff's file-by-file response to the 14 local debt files the auditor advises were reviewed:"*

Legislative Auditor's Comments

It is not the responsibility of the Office of Legislative Auditor to perform financial analysis on applications submitted to the staff of the State Bond Commission. The Department of Treasury, in its response, implies that the Office of Legislative Auditor reviews the financial analysis contained in local governmental debt applications. In fact, the Office of Legislative Auditor reviews historical audited and unaudited financial statements of political subdivision applicants and advises the State Bond Commission (and its staff) if an applicant has deficits and if, in the representative's opinion, the deficits would adversely impact an applicant's ability to repay requested indebtedness. The Office of Legislative Auditor does not review the financial analysis either submitted with local governmental debt applications or performed by the staff of the State Bond Commission.

Excerpts from the Office of Legislative Auditor's report are as follows:

"We reviewed 43 randomly selected files from both the state and local debt sections. There was no indication from some files we reviewed that staff considered key financial information and assumptions. <u>Six</u> of the <u>files contained insufficient financial information</u> with which to evaluate an applicant's repayment capability (emphasis added). . . . Nineteen out of 43 sample files we reviewed (44%) contained inadequate financial analyses and/or data."

The Department of Treasury/staff of State Bond Commission's individual responses concerning 14 files are focused on whether the file contained sufficient financial information. The legislative auditor concluded that only six files contained insufficient information, and the remaining 13 files (of 19 total) contained inadequate <u>financial analysis</u> for one of several possible reasons. The responses of the Department of Treasury/State Bond Commission staff for 14 files are provided on the following pages. Following each response is a brief statement by the legislative auditor concerning why the file was determined to contain inadequate financial analysis.

(1) L91-463 St. Helena Parish Police Jury

Excerpt from Department of Treasury Response

*Budgetary loan request. The **financial** information required is contained in the file, including current adopted budget showing sufficient revenues. What is missing is a "certified" resolution of the entity. The audit report should **not** contain a statement that this file contained insufficient financial information.*

Legislative Auditor's Comments

Insufficient financial information is not the point of this example. This application was for $157,600 to pay for industrial park improvements and a $150,000 budgetary loan was already outstanding. The budgeted revenues for 1991 were $696,500 showing an excess of $45,557 over expenditures. This police jury had operating deficits for two out of the previous five years. It was not demonstrated how $307,600 would be repaid by March 1, 1992 (within 3 1/2 months of the date this item was on the State Bond Commission's agenda). The analysis sheet states that a grant from the Economic Development Authority to provide permanent financing was anticipated in the near future. What would happen if this grant were not received? How would the loan be repaid? These questions were not addressed.

(2) L92-183 Town of Church Point

Excerpt from Department of Treasury Response

*Excess Revenue loan request. The **financial** information required is contained in the file. What* [the auditor] *did not take into consideration was the "transfers in" from the sales tax fund in order to produce sufficient revenues to cover the debt service.*

Legislative Auditor's Comments

There was no debt service schedule contained in this file. The auditor did take into account "transfers in" of $111,910 in sales tax and other funds. The excess revenues budgeted for 1992 were roughly $25,000 and the actual excess for 1991 was $34,932. This loan is $600,000 repaid over a 10-year period. Thus, an average of $30,000 per year of excess revenues for 10 years plus roughly $112,000 in reserve funds equals $412,000.

This cash flow cannot adequately service a $600,000 loan plus interest.

(3) L92-263 Caddo Parish Law Enforcement District

Excerpt from Department of Treasury Response

Budgetary Loan request. The financial information required is contained in the file, including the current adopted budget as well as a fiscal agency agreement, which is not required by law to be submitted.

Legislative Auditor's Comments

Insufficient financial information is not the point of this example. This was a request for a budgetary loan not to exceed $2.5 million. This district had an operating deficit of $1,198,310 for the fiscal year ended June 30, 1991, and a budgeted deficit of $441,416 for the year ending June 30, 1992. Whether this district will continue to operate at a deficit and whether it has a plan to operate "in the black" are questions that need answering. Although this district had a reserve to finance the operating deficits, there was no evidence in this file that the two years of deficits were discussed with the applicant.

(4) L92-352 Water Service Commission of St. Tammany Parish

Excerpt from Department of Treasury Response

This was a request to issue Bond Anticipation Notes. These notes were being issued to acquire certain existing small sewerage and water facilities owned by private utility companies. What the auditor failed to note was that the DEQ had not granted a permit for one of the plants because of owner/operator problems. The DEQ stated that no permit would be issued until this facility was acquired by an acceptable owner/operator. The file contains sufficient information to analyze this request. Bond Anticipation Notes are payable from the proceeds of the long term bonds when they are issued.

Legislative Auditor's Comments

This file contained no financial statements showing the actual past results of the facilities to be purchased and also contained no debt service schedule. The only financial schedule in the file was a projected annual cash flow for the Northpark Facility which showed annual cash flow of $40,000 expected from this facility. It was not clear whether any payroll costs were reflected on this schedule. The amount of indebtedness was $7.5 million, and $40,000 annually is insufficient to service this amount of indebtedness. The auditor does not agree with the Department of Treasury's statement that "The file contains sufficient information to analyze this request."

(5) L91-406 Village of Rosedale

Excerpt from Department of Treasury Response

This was an excess revenue loan request. The ***financial*** *information required is contained in the file, including a current adopted budget showing sufficient excess revenues to cover the annual debt service. What is* ***not*** *shown on the analysis sheet is the* ***outstanding*** *excess revenue loan of $36,500, although the excess revenues, including fund balances, are more than sufficient to cover the current loan debt service, as well as the outstanding loan debt service. The system is not foolproof, and the Staff is currently seeking ways to address the problem of information regarding prior loans. However, in this instance, the lack of information created no adverse result, and had the information been in the file approval would have been granted anyway.*

Legislative Auditor's Comments

Insufficient financial information is not the point of this example. This loan request was for $50,000 to be repaid in two years or less. A loan of $36,500 was already outstanding. The analysis sheet shows $0 of actual excess revenues for calendar year 1990 and $0 of budgeted excess revenues for 1991. The analysis sheet shows a fund balance of $190,239. The unaudited financial statements in this file show that this fund balance on December 31, 1990, was composed of $18,078 of cash equivalent assets with the balance composed of fixed assets - a water system. In short, there was $18,078 of fund balances and $0 of excess revenues shown in this file to service $86,500 of indebtedness. The auditor does not agree with the Department of Treasury's statement that ". . . the excess revenues, including fund balances, are more than sufficient to cover the current loan service, as well as the outstanding loan debt service."

(6) L91-402 Town of Vivian

Excerpt from Department of Treasury Response

This was a request to hold a general Obligation Bond Election. The file contains everything that is required, (a) certified resolution as well as (b) the assessed valuation, (c) the current millage and (d) the projected new millage. The legal debt limit on the general obligation bonds was actually $2,069,490, and this request was for $2,200,000; but the analyst noted in the problem area of the analysis sheet that approval be conditioned that the legal debt limit not be exceeded at issuance. Furthermore, this request was for the acquisition of an industrial plant building within the Town for Vivian Industries, and the bonds were actually payable from the revenues of the lease of the facility to the extent that they were available, as was noted by the analyst. The ad valorem tax security (the g. o. election) was secondary security for repayment.

Legislative Auditor's Comments

The proceeds of these bonds were to be used to acquire or construct an industrial building. The Town of Vivian would lease this building to a private company and the lease payments received would pay the debt service on the bonds. Ad valorem taxes were to be a secondary source of repayment. There was no signed lease agreement in this file and no financial schedule showing the dollar amount of the lease payments and how the proposed debt would be serviced.

(7) L92-58 Industrial Development Board of the City of Bastrop, La., Inc.

Excerpt from Department of Treasury Response

This was a request to issue revenue refunding bonds. Everything that is required to analyze this request is contained in the file. As is stated in other portions of this response, industrial development bond issues are secured by payments made by a private company (in this case, International Paper) under a refunding agreement. ***The bonds are not secured by payment of a governmental entity or political subdivision. This is a business decision by International Paper to refund these bonds.***

Legislative Auditor's Comments

Insufficient financial information is not the point of this example. The financial analysis done on these refunding bonds overstated the net present value savings. The staff of the State Bond Commission did not appear to question the financial analysis submitted by International Paper.

(8) L92-137 Memorial Hospital Service District

Excerpt from Department of Treasury Response

This was a request to issue hospital revenue refunding bonds. Everything that is required to analyze this refunding request, including financial schedules, was provided and is contained in the file. The auditor failed to note that this is a ***private not-for-profit*** *hospital, and, as noted on the analysis sheet,* ***the financing will not be secured by the full faith and credit of this issuer or any other political subdivision of the State.***

Legislative Auditor's Comments

Insufficient financial information is not the point of this example, and during the review, the auditor noted that this was a private hospital with financing not secured by any political subdivision of the state. The issue in this file was the adequacy of the financial analysis. The discount rate used to compute the savings produced by the refunding was not stated. Also, the net present value savings numbers furnished by the applicant did not match those listed on the analysis sheet by the staff of the State Bond Commission.

(9) L92-221 Beauregard Parish Police Jury

Excerpt from Department of Treasury Response

This was a request to hold general obligation bond elections in three districts. Everything that is required for bond elections is contained in the file, including the certified resolution as well as the assessed valuation of each district, the outstanding debt and the current and projected millage.

Legislative Auditor's Comments

Insufficient financial information is not the point of this example. The analysis sheet for this file contained conflicting information. In Road District 4, the total bonds proposed and outstanding (10.64%) of assessed valuation exceeds the legal debt limit (10%) of assessed valuation. These values are mentioned in the Summary of Request section of the analysis sheet. However, in the Problem Areas and State Bond Commission Recommendation section of the analysis sheet, it is stated that "The staff finds no technical problems with this election request and recommends this proposition be presented to the voters."

(10) L92-58 Industrial Development Board of the Parish of East Baton Rouge, La., Inc.

Excerpt from Department of Treasury Response

This was a request to issue revenue refunding bonds. Everything that is required to analyze this request is contained in the file. As stated in other portions of this response, industrial development bond issues are secured by payments made by a private company (in this case, La Quinta) under a refunding agreement. ***The bonds are not secured by payment of a governmental entity or political subdivision. This was a business decision by La Quinta to issue these refunding bonds.***

Legislative Auditor's Comments

Insufficient financial information is not the point of this example. The issue is that a weekly interest rate of 3.85 percent is being used to calculate the net present value savings for a 10-year bond issue (the interest rate for a 10-year bond would be higher than 3.85 percent); thus, the savings generated by this refunding are overstated. This issue was not addressed by the staff of the State Bond Commission; thus, the auditor concluded that the staff's financial analysis was inadequate.

(11) L92-285
St. Tammany Parish School Board

Excerpt from Department of Treasury Response

This was a request to issue sales tax bonds. Everything that is required to analyze this request is contained in the file, including the certified resolution and projected annual sales tax avails.

Legislative Auditor's Comments

A certified resolution and debt service schedule are included in this file. The problem with this file is that the principal payment schedule used in the debt service schedule differs from that of the certified resolution for 6 of the 15 years the bonds are to be outstanding. The file contains no evidence that the staff of the State Bond Commission questioned these differences.

(12) L92-331
Tangipahoa Parish School Board

Excerpt from Department of Treasury Response

This was a request to issue general obligation school refunding bonds. The refunding schedule, certified resolution, current and projected millage reduction and everything else required is contained in the file. This restructuring, as shown on the analysis sheet, was done to free up sales tax revenues for capital improvements, ***not for present value savings.***

Legislative Auditor's Comments

Insufficient financial information is not the point of this example. This refunding bond will cost this school board money. While the refunding bond may have provided short-term cash flow benefits, the staff did not analyze the potential for a harmful long-term effect on cash flow. Nor did the staff indicate on the analysis sheet that this refunding did not meet refunding rule guidelines promulgated by staff. The analysis sheet states, "There are no problems with this request." Therefore, the State Bond Commission did not have all relevant information for its decision making.

(13) L92-350 Morehouse Parish Law Enforcement District

Excerpt from Department of Treasury Response

This was a request to issue jail revenue bonds. This is one ***of the most documented files and most talked about issues that the local debt section reviewed in 1992.*** *These are jail revenue bonds secured by revenues derived by the District and are dependant upon an annual appropriation by the State through the Department of Corrections (DOC). The District entered into a cooperative endeavor agreement with the DOC whereby the DOC agreed to house a minimum of 40%, or 96 inmates, of the total capacity of 240 inmates in the jail facility at all times during the period when the bonds are outstanding. The staff expressed concerns over a contract involving an annual appropriation of debt of the state and with a guarantee of a certain number of inmates as long as any bonds were outstanding. The Treasurer appointed a Jail Subcommittee of the Bond Commission to look into and take testimony from DOC. As a result of the Staff's bringing this matter to the attention of the Commission, the Commission decided that after this application an unofficial moratorium would be placed in effect, with no more than two such applications being approved in any one year. This application, then, caused the Staff and the Commission to make policies to protect and preserve the integrity of the local debt issuance process as it related to jail revenue bonds.*

Legislative Auditor's Comments

The only financial information contained in this file was an undetailed one year pro-forma cash flow statement. There should have been more analysis of what appropriation risk the <u>state</u> was assuming for 20 years, especially since this District had operated at a deficit in fiscal years ending June 30, 1989 and 1990.

(14) L92-398 Vernon Parish Police Jury

Excerpt from Department of Treasury Response

This was a request for General Obligation Bond Election. The file contains everything that is required, certified resolution as well as the assessed valuation, the current millage and the projected new millage. The estimated debt service requirement, which is not required, as the letter indicated, was not contained in the file, but the analyst called and obtained the information, as is shown on the analysis sheet.

Legislative Auditor's Comments

There is no debt service schedule in this file. Even if the analyst telephoned and obtained a debt service number, debt service does not necessarily remain constant over time. There is also no evidence in the file that the analyst checked how much tax revenue would be generated by the proposed ad valorem tax and whether it would cover debt service.