

BUDGET AND FINANCE COMMITTEE

The Budget and Finance Committee was created and assigned the following responsibilities by the Legislative Council chairman:

- Monitor the status of state revenues and expenditures for the 2007-09 biennium.
- Receive input from major state agencies regarding the status of their budgets and changes in federal funds.
- Receive information from major state agencies regarding anticipated program changes, costs to continue, and other budget needs for the 2009-11 biennium, including elementary and secondary education, higher education, human services, corrections, and transportation.
- Receive information on any deferred maintenance issues relating to facilities and other infrastructure throughout state government.
- Review current budget forms and guidelines, consider any appropriate changes, and provide a recommendation to the Budget Section.
- Receive input from industry and academic representatives on the status of the state's economy, state revenue impact, and expectations for the 2009-11 biennium.
- Receive information from the economic forecasting consultant under contract with the state on the state's economy, including strengths and weaknesses, and provide input to the consultant on the development of the July 2008 revised general fund revenue forecast for the 2007-09 biennium and the preliminary forecast for the 2009-11 biennium.
- Receive the July 2008 revised general fund revenue forecast.
- Review projected revenues, expenditures, and fund balances of major state funds.
- Review preliminary information on 2009-11 biennium estimated revenues and appropriation requirements, including cost-to-continue items.
- Discuss possible legislative initiatives that would affect the budget.
- Discuss possible methods of returning excess revenues to North Dakota taxpayers.
- Identify key budget issues for the 2009 legislative session.
- As appropriate, make recommendations to the Legislative Council.

Committee members were Representatives Al Carlson (Chairman), Ole Aarsvold, Rick Berg, Merle Boucher, Jeff Delzer, Bob Martinson, Bob Skarphol, Ken Svedjan, and Clark Williams and Senators Randel Christmann, Tony Grindberg, Ray Holmberg, Elroy N. Lindaas, David O'Connell, Larry J. Robinson, and Bob Stenehjem.

The committee submitted this report to the Legislative Council at the biennial meeting of the Council in November 2008. The Council accepted the report for submission to the 61st Legislative Assembly.

NORTH DAKOTA'S BUDGETING PROCESS

The committee reviewed North Dakota's budgeting process and constitutional and statutory provisions relating to the state budget, including Article V, Section 7, of the Constitution of North Dakota relating to the powers of the Governor; Article X, Section 12, of the Constitution of North Dakota relating to legislative appropriations; North Dakota Century Code (NDCC) Sections 54-35-12 through 54-35-14 relating to the powers of the legislative budget analyst and auditor; and Chapter 54-44.1 relating to the office of the budget.

The committee learned the budget preparation process begins at the beginning of each even-numbered year by the Governor releasing instructions and guidelines to state agencies for the preparation of their budget requests for the upcoming biennium. Preliminary information is received in April on buildings and infrastructure of state agencies and is used for building and infrastructure formulas. The statutory deadline for agencies to submit their budget requests is July 15; however, the Office of Management and Budget (OMB) often grants extensions to agencies allowing them to include the most current information in the preparation of their budget request. In 2008 most large agencies did not submit their budget requests until the end of October or early November.

After each agency's budget request has been submitted and certified by OMB, a budget hearing may be held on the agency's budget request if the agency requests a hearing.

At the Legislative Assembly's organizational session in December of each even-numbered year, the Governor presents the executive budget recommendation for the next biennium to the Legislative Assembly. The Office of Management and Budget introduces bills to provide for the revenue and appropriation levels recommended in the Governor's budget. Individual legislators may also introduce bills affecting state revenues or an appropriation for an agency. As it develops the legislative budget, the Legislative Assembly considers the Governor's recommendations and information received through public hearings held in each chamber on each appropriation and revenue bill. Each bill having an appropriation of \$5,000 or more, or a bill with a fiscal note indicating a fiscal impact of \$50,000 on an agency's appropriation is by rule required to be referred to the Appropriations Committee. The Legislative Assembly approves the final state budget for the upcoming biennium by the end of the regular session, usually in April of the odd-numbered year.

REVENUE PROJECTION PROCESS

The committee reviewed North Dakota's revenue projection process and learned the executive budget office has primary authority for revenue forecasting in North Dakota. Historically, during each biennium, OMB issues three revenue forecasts:

- June preliminary revenue forecast - Issued in the even-numbered year prior to the start of the legislative session.
- December executive budget revenue forecast - Presented along with the executive budget recommendations to the Budget Section and to the organizational session of the Legislative Assembly.
- February revised revenue forecast - Presented in February prior to crossover during the legislative session at which time the forecast is reviewed by legislative leadership, Appropriations Committee members, and Finance and Taxation Committee members of both houses. The Appropriations Committees by motion approve the revised revenue forecast which is then used as the "official" legislative revenue forecast.

The Office of Management and Budget contracts with Moody's Economy.com to provide economic projections for the state of North Dakota.

Moody's Economy.com provides tax-based forecasts for each of the major taxable sectors. Reports prepared by Moody's Economy.com include analyses and forecasts of sweet crude oil prices and North Dakota's major crops and livestock, including farm income and cash receipts for livestock and products.

The Tax Department is responsible for the basic methodology for forecasting the following general fund tax types--sales, motor vehicle excise, individual income, corporation income, financial institution, oil extraction, oil and gas production, cigarette and tobacco, coal conversion, and wholesale liquor taxes. The Office of Management and Budget projects interest income and departmental collections categories of the revenue forecast. The revenue forecasting process includes the following steps:

- At the start of each of the three forecasts, the Tax Department updates the historical tax base statistics and provides the results to Moody's Economy.com.
- Moody's Economy.com processes the historical data through forecasting models, adjusting and updating forecast equations or "drivers" as needed.
- The Tax Department and OMB participate in conference calls with Moody's Economy.com to discuss views on the United States and North Dakota economies.
- Moody's Economy.com creates North Dakota's tax-based forecasts for each of the next three fiscal years.
- The Office of Management and Budget schedules a meeting of its Revenue Advisory Committee to review the tax-based forecasts and make any modifications as determined by the committee. The Revenue Advisory Committee includes representatives of the major economic sectors and two legislators.
- The Tax Department applies the appropriate tax rates and statutory distributions through the use of in-house tax revenue models to produce the tax revenue forecast, which is supplied to OMB.

2007-09 BIENNIUM BUDGET INFORMATION

Status of the General Fund and Selected Other Funds

The committee received the following schedule regarding the actual July 1, 2007, beginning balance of selected funds compared to estimates made at the close of the 2007 Legislative Assembly:

	April 2007 Forecast	Actual Balance	Additional Funds Available
Beginning balance - July 1, 2007			
General fund	\$218,350,170	\$295,541,176	\$77,191,006
Budget stabilization fund	200,000,000	200,000,000	0
Permanent oil tax trust fund	136,666,681	143,270,662	6,603,981
Total	\$555,016,851	\$638,811,838	\$83,794,987

The committee learned that the \$77 million of additional general fund money available on July 1, 2007, was the result of revenues exceeding projections by \$74 million and 2005-07 general fund unspent appropriation authority (turnback) being approximately \$3.1 million more than the \$10 million anticipated during the legislative session.

At each meeting, the committee received information on the status of the general fund and permanent oil tax trust fund. The following schedule shows the status of the **general fund** for the 2007-09 biennium as of September 30, 2008:

July 1, 2007, balance	\$295,541,176
Estimated revenues	2,634,848,870
Estimated available funds	\$2,930,390,046
Appropriations	(2,461,973,956)
Estimated June 30, 2009, balance	\$468,416,090

The committee learned that through September 2008 general fund revenues exceeded the legislative forecast by \$247.8 million or 17.9 percent. Major variances related to sales tax and individual and corporate income tax categories. Compared to the July 2008 forecast, revenues through September 2008 exceeded estimates by approximately \$14.5 million.

The committee received the July 2008 revised general fund revenue forecast for the 2007-09 biennium. The committee learned that 2007-09 general fund ongoing revenues, excluding transfers, are anticipated to total \$2.421 billion, \$363 million or 17.6 percent more than the \$2.058 billion anticipated by the 2007 Legislative Assembly.

The following schedule shows the status of the **permanent oil tax trust fund** for the 2007-09 biennium as of September 30, 2008:

July 1, 2007, balance	\$143,270,662
Estimated revenues	634,601,015
Estimated available funds	\$777,871,677
Appropriations	(145,716,541)
Estimated June 30, 2009, balance	\$632,155,136

The committee received information on the **budget stabilization fund**. The committee learned at the end of the 2003-05 biennium, \$99,472,631 was transferred to the budget stabilization fund from the general fund and at the end of the 2005-07 biennium, \$100,527,369 was transferred to the budget stabilization fund. The current balance in the budget stabilization fund is \$200 million.

The committee learned that House Bill No. 1429 (2007) increased effective July 1, 2009, the maximum balance allowed in the budget stabilization fund from 5 percent to 10 percent of the general fund budget approved by the most recent session of the Legislative Assembly. Pursuant to NDCC Section 54-27.2-02, the budget stabilization fund transfer occurs at the end of the biennium after cancellation of unexpended appropriations under Section 54-44.1-11. Section 54-44.1-11 states that appropriations cancel 30 days after the close of each biennial period. The close of the 2007-09 biennium is June 30, 2009; therefore, 30 days later is July 30, 2009. Because Section 2 of House Bill No. 1429 becomes effective on July 1, 2009, the provisions of the bill will affect the budget stabilization fund transfers occurring at the end of the 2007-09 biennium. The committee learned that if 2009-11 biennium general fund appropriations increase by 10.8 percent, which is the average biennial percentage increase for the last 10 years, an additional \$72.8 million would be transferred to the budget stabilization fund at the end of the 2007-09 biennium under current law resulting in a June 30, 2009, balance of \$272.8 million in the fund.

North Dakota Economy

The committee reviewed economic statistics and economic projections for North Dakota. The committee received information from the University of North Dakota Bureau of Business and Economics Research, North Dakota State University Department of Agriculture and Applied Economics, Job Service North Dakota, Department of Mineral Resources of the Industrial Commission, Department of Financial Institutions, Wheat Commission, and the Stockmen's Association. The committee also reviewed a history of state revenues and appropriations compared to selected economic indicators since 1971.

The committee learned that:

- The economic indicators that most closely predict general fund revenue collections include gross state product and personal income.
- North Dakota nonfarm personal income is anticipated to increase by approximately 3 percent each year for the next three years.
- Wheat prices are anticipated to decrease from \$8.57 per bushel for the 2007-08 crop year to \$6.74 for the 2010-11 crop year.
- Italy imported the most United States durum and Japan imported the most United States spring wheat for the 2007-08 marketing year.
- The United States feed grain cost per steer in 2008 exceeds \$280 compared to approximately \$130 in 2006.

- Employment in the state increased by 27,433 jobs or 8.7 percent during the past five years.
- North Dakota ranks 49th in the number of home foreclosures nationwide.

Oil-Related Information

The committee received information on oil production and prices during the 2007-09 biennium. North Dakota oil prices ranged from \$61 per barrel in July 2007 to a high of \$136 per barrel in July 2008 to \$52 on October 31, 2008. Oil production began the biennium at 124,000 barrels per day and has steadily increased to 185,000 barrels per day in October 2008.

In August 2008 North Dakota had 80 oil rigs operating within the state. Each oil rig can drill approximately 10 wells per year, and the cost of each well drilled averages \$5.8 million.

The committee learned that North Dakota had been experiencing oil pipeline capacity limitations resulting in price discounts for North Dakota-produced oil. For the period December 2005 through June 2008, the committee learned that oil discounts had resulted in the loss of an estimated \$19.1 million of oil-related tax revenue and that the estimated average discounts ranged from no discount to discounts of over \$11 per barrel. The Industrial Commission anticipates any North Dakota oil production over 160,000 barrels per day will be discounted due to oil pipeline capacity limitations. Because of pipeline capacity limitations, more oil is now being transported by rail. The committee learned it costs approximately \$1 to \$2 per barrel to transport oil by pipeline to Minnesota compared to a cost of approximately \$13 per barrel to transfer oil by rail to Oklahoma. The committee learned approximately five years is needed to plan and construct an oil pipeline.

The committee received schedules of oil and gas tax and mineral royalty allocations to cities and counties for fiscal years 2004 through 2008 and through October 20, 2008, for fiscal year 2009. Total allocations for each fiscal year (FY) have been:

FY 2004	\$16,617,551
FY 2005	\$22,317,470
FY 2006	\$25,251,238
FY 2007	\$27,634,797
FY 2008	\$40,838,421

The committee received information on the actual fiscal effect of provisions of Senate Bill No. 2178 (2007) and House Bill No. 1044 (2007) relating to oil tax distributions. The committee learned Senate Bill No. 2178, which increased maximum county oil and gas tax allocations by \$1 million, is currently anticipated to increase the counties' share and reduce state revenues by \$10.8 million for the 2007-09 biennium. House Bill No. 1044, which increases the counties' share of oil and gas tax collections beginning the second year of the 2007-09 biennium is currently anticipated to increase the counties' share and reduce state revenues by \$5 million for the 2007-09 biennium.

The committee learned the fiscal note for Senate Bill No. 2178 indicated a \$2 million increase in the counties' share and a \$2 million decrease in the state share of oil

and gas tax revenues. House Bill No. 1044 was anticipated to increase the counties' share and reduce the state share by \$5.9 million.

For the 2009-11 biennium, it is anticipated that provisions of these two bills will increase the counties share and reduce state revenues by \$22 million, \$12 million of which relates to provisions of Senate Bill No. 2178 and \$10 million relates to provisions of House Bill No. 1044.

The committee received information on the oil and gas tax agreement of the Three Affiliated Tribes - Mandan, Hidatsa, and Arikara Nation and the state. The committee learned the agreement was signed in June 2008 and established a uniform taxation system for oil and gas producers in the boundaries of the Fort Berthold Indian Reservation. The agreement is effective for production periods beginning July 1, 2008. The tax rate for production on trust land and nontrust land is 5 percent for gross production tax and 6.5 percent for oil extraction tax. The agreement provides that oil and gas tax revenue from production on trust land be allocated 50 percent to the tribe and 50 percent to the state and political subdivisions based on the statutory distribution formulas. Oil and gas tax revenue from production on nontrust lands will be allocated 20 percent to the tribe and 80 percent to the state for gross production taxes and 100 percent of oil extraction taxes to the state and political subdivisions based on statutory distribution formulas. The committee learned the agreement allows the tribe to impose one-time fees totaling \$100,000 relating to the siting of the well and use of the land.

The committee learned the new taxation structure applies to oil produced from previously drilled wells only during the term of the agreement; however, taxation of oil from any new wells drilled during the effective dates of the agreement apply for the life of the well under the terms of the agreement.

Property Tax Income Tax Credits

The committee received information on property tax income tax credits. The 2007 Legislative Assembly approved Senate Bill No. 2032 creating for the 2007 and 2008 tax years an income tax credit for property taxes paid by eligible individuals and corporations. The 2007 Legislative Assembly anticipated the income tax credits would reduce tax collections by \$112 million during the 2007-09 biennium--\$101 million relating to individual income tax and \$11 million relating to corporate income tax. The committee learned for the 2007 filing year through September 2008, residential and agriculture-related income tax credits totaling \$36.9 million were claimed by 149,057 taxpayers and \$3.6 million of commercial property tax income tax credits were claimed by 14,319 taxpayers. In total, \$40.4 million of income tax credits were claimed by 162,376 taxpayers. Of these, 6,053 taxpayers claimed the maximum credit allowed. Based on credits claimed to date, the Tax Department does not believe the total of \$112 million in credits originally anticipated to be claimed under the program for the biennium will be realized.

Status of Agency Expenditures

The committee received information on the status of state agencies' 2007-09 biennium budgets, federal funds and programmatic changes, agency compliance with legislative intent, extraordinary repairs funding and expenditures, and the status of one-time funding items. Agencies directly reporting to the committee regarding these items were the Information Technology Department, Tax Department, Department of Public Instruction, North Dakota University System, State Department of Health, Department of Human Services, Department of Corrections and Rehabilitation, Department of Commerce, State Historical Society, State Water Commission, and Department of Transportation. The committee learned that:

- The Department of Public Instruction anticipates a remaining balance of state aid formula per student payments funding of approximately \$730,000 for the 2007-09 biennium.
- Higher education institutions are experiencing budget shortfalls relating to the cost of utilities during the 2007-09 biennium.
- The University System anticipates \$1 million of the \$2.7 million appropriated from the permanent oil tax trust fund for the Northern Tier Network will not be needed during the 2007-09 biennium and plans to request authority to continue the appropriation for the 2009-11 biennium to pay for Northern Tier Network maintenance costs for the first year of the 2009-11 biennium.
- The State Department of Health anticipates spending \$1.4 million of the \$2 million from the general fund appropriated for the immunization program transition.
- The Department of Human Services increased the eligibility level for the children's health insurance program from 140 to 150 percent of poverty effective October 1, 2008.
- The State Water Commission anticipates spending a total of \$85 million on water projects for the 2007-09 biennium.
- The Department of Transportation received \$240 million of federal highway construction funds for the 2007 construction season, \$19 million more than the \$221 million anticipated.
- The Department of Transportation has experienced significant price increases in oil-based materials, steel, concrete, equipment, and other building materials.

2009-11 BIENNIUM BUDGET INFORMATION Agency Budget Requests

The committee received information on the 2009-11 biennium state agency budget requests and information from OMB on the development of the 2009-11 biennium budget. Agencies directly reporting to the committee regarding their anticipated budget needs for the 2009-11 biennium were the Information Technology Department, Tax Department, Department of Public Instruction, North Dakota University System, State Department of Health, Department of Human Services, Department of

Corrections and Rehabilitation, Department of Commerce, State Historical Society, State Water Commission, and Department of Transportation.

The committee received information on the Governor's budget guidelines for the 2009-11 biennium. The committee learned the Governor directed agencies to develop a 100 percent, or hold-even budget, for the 2009-11 biennium. Major grant programs in the Department of Public Instruction are not subject to the 100 percent guideline, and for planning purposes, the University System is to submit a needs-based budget. The committee learned through October 20, 2008, 59 agencies had submitted their budget request. Eleven of the larger state agencies had been granted extensions by OMB; therefore, the committee was unable to review budget request data for these larger agencies since the budget requests had not yet been submitted. The committee reviewed information on total 2009-11 biennium budget requests of those agencies that had submitted their budgets and on major general fund increases being requested.

The committee received information from OMB on cost-to-continue items that may be included in the 2009-11 biennium budget. The committee learned it is difficult to determine a cost-to-continue percentage that would be applicable to all agencies since each agency is unique.

Preliminary Revenue Forecast

The committee received the preliminary 2009-11 biennium revenue forecast. The committee learned general fund ongoing revenues are anticipated to total \$2.735 billion for the 2009-11 biennium, an 8 percent increase, compared to the 2007-09 biennium revised revenue forecast adjusted for the 2007-09 biennium effect of the property tax income tax credit.

The committee learned the 2009-11 biennium forecast anticipates transfers of \$666 million to the permanent oil tax trust fund for the 2009-11 biennium, \$41 million or 6.6 percent more than the \$625 million anticipated to be transferred during the 2007-09 biennium.

Potential 2009-11 Biennium Transfers to the General Fund

The committee received information from the Bank of North Dakota, Mill and Elevator, Industrial Commission, and Land Department regarding potential amounts that may be available for transfer from the Bank of North Dakota, Mill and Elevator, student loan trust fund, and lands and minerals trust fund to the general fund during the 2009-11 biennium.

The committee learned continuing the \$60 million transfer of Bank of North Dakota profits to the general fund during the 2009-11 biennium will allow for capital growth of the Bank of North Dakota of an estimated \$50 million to provide the Bank nearly \$300 million in capital and a leverage ratio of nearly 8 percent by the end of the 2009-11 biennium.

The committee learned while the Mill and Elevator experienced a net loss of \$821,000 for fiscal year 2008, the mill is anticipating negative market conditions to

stabilize by the 2009-11 biennium, and if this occurs, the mill anticipates profits to return to a more normal level of approximately \$7.2 million per biennium which is the average of the last four bienniums.

The committee learned the student loan trust fund anticipates income of approximately \$2.4 million for the 2009-11 biennium, \$600,000 less than the \$3 million anticipated for the 2007-09 biennium.

The committee learned the Land Department is anticipating the lands and minerals trust fund will have a \$16.8 million June 30, 2009, balance and anticipated revenues of over \$24 million for the 2009-11 biennium. Based on these projections, an estimated \$39 million could be transferred to the general fund during the 2009-11 biennium resulting in a \$1 million ending balance for the fund on June 30, 2011.

State Debt

The committee received information on outstanding bond indebtedness and outstanding special assessment balances of state agencies on July 1, 2007, and July 1, 2009, and options available to prepay these bonds or special assessments during the 2009-11 biennium.

The committee learned the North Dakota Building Authority had \$129.1 million in outstanding bonds on June 30, 2007, compared to \$107.8 million projected outstanding on June 30, 2009.

The committee learned that to prepay the \$107.8 million of outstanding bonds by July 2009 would cost \$114.6 million. Because of the additional cost to prepay the bonds at the present time based on current market conditions, representatives of the Industrial Commission recommend not prepaying the bonds at this time. The committee learned the Industrial Commission will continue to monitor market conditions and analyze the cost-benefit of prepaying outstanding bonds.

The committee learned, based on the preliminary 2009-11 biennium revenue forecast, the state will have available debt service of \$12.1 million in the 2011-13 biennium which would allow the 2009 Legislative Assembly to issue debt of between \$70 million and \$80 million and still remain within the statutory bond payment guideline.

The committee learned institutions of higher education and state agencies estimated outstanding special assessments balance on July 1, 2009, is \$2.1 million. The estimated future savings resulting from paying the outstanding special assessments balance is approximately \$800,000.

Committee Considerations

The committee reviewed preliminary estimates of ongoing general fund revenues and one-time funding available for the 2009-11 biennium and the effect of alternative general fund spending levels. The following charts summarize the information reviewed by the committee:

Preliminary Estimate of Ongoing Revenues and Potential Spending Levels - 2009-11 Biennium				
	Option A 8 percent ¹	Option B 10.8 percent ²	Option C 15.8 percent ³	Option D 21.6 percent ⁴
	(Amounts Shown in Millions)			
Estimated ongoing revenues	\$2,734.7	\$2,734.7	\$2,734.7	\$2,734.7
Estimated ongoing transfers	84.4	84.4	84.4	84.4
Estimated total available ongoing funds	\$2,819.1	\$2,819.1	\$2,819.1	\$2,819.1
Potential appropriations				
Base level - 2007-09 ongoing appropriations	(\$2,317.4)	(\$2,317.4)	(\$2,317.4)	(\$2,317.4)
Optional levels - Additional appropriations or revenue reductions	(185.4)	(250.3)	(366.2)	(501.7)
Total potential appropriations or revenue reductions	(\$2,502.8)	(\$2,567.7)	(\$2,683.6)	(\$2,819.1)
Potential ongoing funding balance (shortfall)	\$316.3	\$251.4	\$135.5	\$0.0
¹ Option A - Based on the same percentage increase (8 percent) that ongoing revenues are anticipated to increase during the 2009-11 biennium compared to 2007-09 biennium revised revenue estimates. ² Option B - Based on the same percentage increase (10.8 percent) that general fund appropriations have increased, on average, each biennium for the past 10 years. ³ Option C - Based on the same percentage increase (15.8 percent) that general fund ongoing appropriations increased for the 2007-09 biennium compared to the 2005-07 biennium. ⁴ Option D - Based on spending all the additional ongoing revenues available for the 2009-11 biennium which results in a 21.6 percent increase compared to 2007-09 biennium ongoing appropriations.				

Preliminary Estimate of One-Time Revenues - 2009-11 Biennium			
	General Fund	Permanent Oil Tax Trust Fund	Total
	(Amounts Shown in Millions)		
Estimated balance - July 1, 2009	\$388.6	\$632.2	\$1,020.8
Estimated revenues		666.0	666.0
Estimated total available	\$388.6	\$1,298.2	\$1,686.8

The committee considered, but did not recommend, establishing guidelines or targets for 2009-11 biennium spending levels. Committee discussion included:

- Because it is the Legislative Assembly's constitutional responsibility to set the state budget, it should not rely on the executive budget to establish revenue and spending parameters.
- It is important for the Legislative Assembly to clearly identify ongoing and one-time revenues and expenditures and to develop a method to monitor one-time expenditures.
- Concern that the preliminary revenue forecast for the 2009-11 biennium may be overstated due to recent reductions in oil and agriculture commodity prices.
- The state is currently experiencing similar economic conditions to those experienced by the state in 1981. In 1981 the Legislative Assembly was anticipating significant revenues from oil and, as a result, substantially increased spending levels. Because oil prices decreased substantially in the 1980s, state revenues and associated spending levels also were affected. The Legislative Assembly needs to consider the volatility of oil prices and related effect when establishing revenue and spending levels.

The committee requested the Legislative Council staff to prepare a summary preliminary budget report for the 2009-11 biennium identifying preliminary ongoing and one-time revenue and alternative spending levels and major special funds anticipated to be available for the 2009-11 biennium. The report entitled *Budget and*

Finance Committee Preliminary State Budget Outlook - 2009-11 Biennium is provided at the end of this report.

FORMAT OF APPROPRIATION BILLS

The committee reviewed information on the possibility of identifying the number of authorized full-time equivalent (FTE) positions in appropriation bills and the possibility of changing the appropriation bill format to identify base level funding, adjustments or enhancements, and the appropriation for an agency within one section of the bill using a three-column format rather than the current format utilizing three sections of the bill.

The committee reviewed the current process of authorizing the number of FTE positions for each agency as follows:

1. The number of authorized FTE positions for each agency is included in supporting documentation submitted to the Legislative Assembly as part of the executive budget recommendation.
2. The number of authorized FTE positions recommended in the executive budget and any legislative changes to the number of FTE positions are identified in the statements of purpose of amendment to appropriation bills and included in postsession Legislative Council reports.
3. New FTE positions are at times identified in other appropriation bills affecting a state agency or in fiscal notes to bills affecting an agency's budget.

4. The Emergency Commission may authorize additional FTE positions for agencies during the interim for the remainder of the current biennium based on agency requests.

If the number of authorized FTE positions for each agency is identified in appropriation bills, the committee anticipates:

1. The agency's primary appropriation bill will include only those FTE positions associated with the funding in that bill. Additional FTE positions for the agency may be authorized in other appropriation bills.
2. The Legislative Assembly will specifically take action amending the appropriation bill to change the number of FTE positions similar to the action taken to change funding levels of an agency.
3. Full-time equivalent positions identified in fiscal notes would not be authorized unless also specifically identified in an appropriation bill.

Regarding the Emergency Commission's role, the committee learned based on agency requests, the Emergency Commission may authorize additional FTE positions during the interim, generally as part of the approval of additional appropriation authority for the agency under NDCC Chapter 54-16. These positions are authorized only for the current biennium and, if the agency wishes to continue the position, the position must be requested by the agency as a new FTE position from the next Legislative Assembly. If the Legislative Assembly includes the number of authorized FTE positions for an agency in the appropriation bill, to continue the current Emergency Commission process, the Emergency Commission would need specific authority to approve additional FTE positions for state agencies.

The committee received testimony from OMB supporting the three-column format for providing agency appropriations within one section of the appropriation bill and identifying the total number of FTE positions for an agency in the appropriation bill.

Committee Recommendations

The committee recommended that pursuant to NDCC Section 54-44.1-07 relating to the form of the budget data, the Budget Section request OMB to prepare the appropriation bills for the 2009 Legislative Assembly in a format that provides:

- Base level funding, adjustments or enhancements, and the appropriation for each agency in a single section using a three-column format.
- The number of FTE positions in total for each agency shown for the base level, adjustments or enhancements, and the authorized (appropriation) level.

The committee recommends House Bill No. 1027 to allow the Budget Section, based on a recommendation of the Emergency Commission, to authorize state agencies to hire FTE positions in addition to those authorized by the Legislative Assembly. The authority provided is effective only for the biennium during which the authority is granted.

DEFERRED MAINTENANCE/ EXTRAORDINARY REPAIRS

The committee reviewed funding and requests for extraordinary repairs and deferred maintenance. The committee learned OMB's definition of a **capital project** is one that involves significant funding amounts. A significant funding amount is defined as more than 2 percent of the agency's total building value, more than \$500,000, or more than 50 percent of the agency's capital assets line item requested.

The Office of Management and Budget defines an **extraordinary repair** as relatively large expenditures that benefit more than one operating cycle or period. Extraordinary repairs include all repairs to buildings and infrastructure involving dollar amounts in excess of \$5,000 that are nonrecurring in nature and increase the value or service life of the asset.

The committee learned the term **deferred maintenance** is not defined in OMB's budget request guidelines; however, is considered maintenance and repairs that have been deferred or postponed, typically due to budget constraints. Deferred maintenance items are included as part of extraordinary repairs.

The committee learned OMB does not generally monitor extraordinary repair project expenditures of agencies in detail. Although extraordinary repair requests are listed by project for each agency, OMB considers the appropriations for extraordinary repairs a pool to be managed by each agency to address both planned and emergency repairs as they arise. Because extraordinary repair project priorities of agencies change during the biennium based on needs, actual projects completed during a biennium will vary from projects identified in agency budget requests. Because of this, OMB does not compare actual expenditures for specific extraordinary repair projects to budgeted amounts.

The committee received information on the extraordinary repairs funding formula used by OMB. The committee learned the formula is based on 2 percent of the building replacement value for buildings at least five years old. The committee learned the infrastructure formula takes under consideration various components of the infrastructure to identify the appropriate amount of funding that should be provided each biennium.

For the 2007-09 biennium, state agencies and higher education institutions identified a total of \$178.7 million of deferred maintenance. The extraordinary repairs funding formula generated the need for \$109.5 million for a total of \$288.2 million to address all deferred maintenance and extraordinary repair needs during the 2007-09 biennium.

The 2007 Legislative Assembly appropriated \$40.4 million, of which \$28.8 million is from the general fund for extraordinary repair projects for the 2007-09 biennium.

The committee received information from the University System regarding extraordinary repairs. The University System believes the extraordinary repairs funding formula used by OMB is appropriate but is concerned that the formula has not been fully funded. The University System presented the following schedule

showing the higher education funding that has been provided as a percentage of the formula for recent bienniums:

- 2003-05 biennium - 16.6 percent.
- 2005-07 biennium - 15.1 percent.
- 2007-09 biennium - 30.8 percent.

The committee reviewed options for legislative monitoring of state agency extraordinary repair expenditures. The committee learned the current process for providing funding begins with state agencies requesting funding for extraordinary repairs as part of the state agency budget request process. Agencies identify and prioritize each extraordinary repair project for which funding is being requested. The Office of Management and Budget considers the agency extraordinary repairs request as it develops the executive budget recommendation for each agency. Any change to the extraordinary repairs included as part of the agency's base budget request and any approved extraordinary repairs optional adjustment requests are documented and explained as part of the executive budget recommendation. The executive budget summary report includes a schedule identifying the extraordinary repairs funding approved for each agency in the executive budget recommendation. The executive budget summary report includes a schedule identifying the extraordinary repairs funding approved for each agency in the executive budget recommendation. The funding recommended as part of the executive budget for extraordinary repairs for each agency is included in the capital assets line item of the appropriation bill for the agency along with funding being recommended for capital projects, other capital payments, information technology equipment over \$5,000, and other equipment over \$5,000. Any legislative changes to extraordinary repairs funding are explained in the statement of purpose of amendment to the appropriation bill and included in the Legislative Council's *Analysis of Legislative Changes to the Executive Budget* report at the end of the legislative session. The report also includes a schedule of legislatively approved funding for extraordinary repairs by project for each agency.

As agencies spend funds from the capital assets line item for extraordinary repair projects, the agency charges the costs to an extraordinary repairs account code under the capital assets line item. Although agencies may internally monitor actual expenditures to budgeted amounts for specific extraordinary repair projects, there is no statewide report generated comparing actual expenditures to budgeted amounts for extraordinary repair projects. The committee considered the following options to provide more information on actual expenditures compared to the legislatively approved amounts for extraordinary repair projects:

1. An interim legislative committee or the Appropriations Committees during a legislative session may request selected agencies to report on the status of these expenditures periodically.
2. An interim legislative committee or the Appropriations Committees during a legislative session may request the Legislative Council staff

to prepare a report on the status of these expenditures for all agencies.

3. A statutory change to NDCC Section 54-44.1-06 could be made to require a report on the status of these expenditures for all agencies be included as part of the budget data prepared as part of the executive budget.
4. The Office of Management and Budget could implement a policy that agencies account for these budgeted amounts and expenditures using project reporting or separate account codes for each project within PeopleSoft. The Office of Management and Budget could generate a periodic report comparing budgeted to actual expenditures by project for all agencies that may be provided to interim legislative committees or the Appropriations Committees upon request.
5. The Legislative Assembly could choose to appropriate extraordinary repairs funding in a separate line item. The Office of Management and Budget could implement a policy that agencies account for these budgeted amounts and expenditures using project reporting or separate account codes for each project within PeopleSoft. The Office of Management and Budget could generate a periodic report comparing budgeted to actual expenditures by project for all agencies that may be provided to interim legislative committees or the Appropriations Committees upon request.

OTHER INFORMATION

The committee received other information, including information on previous studies relating to the budgeting process, information on various tax revenue sources and major expenditure items, and state revenue and expenditure levels during the last 10 years.

The committee reviewed information on the common schools trust fund and learned the balance in the common schools trust fund, excluding land and mineral values, on July 1, 2007, totaled \$884.7 million. It is anticipated that \$76.2 million will be distributed from the tuition trust fund for state aid to schools during the 2007-09 biennium. Of that amount, \$66.8 million is from transfers from the common schools trust fund and \$9.4 million from fines for violation of state laws.

The committee received information on projected prison inmate population and appropriation trends through 2017. The committee learned that based on historic inmate trends, in the year 2017 North Dakota can anticipate 2,051 inmates compared to 1,439 in November 2007. Regarding general fund appropriation projections based on historic appropriation trends, the committee learned the Department of Corrections and Rehabilitation's general fund budget could total \$188 million in the 2015-17 biennium compared to the current general fund appropriation in the 2007-09 biennium of \$130.6 million, excluding the \$41 million of one-time funding provided for future correctional facility needs during the 2007-09 biennium.

The committee received information on the consumer price index. The committee learned that while the

consumer price index is a measure of the average change over time and prices paid by consumers for goods and services in 87 urban areas in the United States, it does not include the spending of persons living in rural nonmetropolitan areas or farm families and none of the data used to calculate the consumer price index is collected from North Dakota.

The committee received information on state assistance to political subdivisions and revenue sources of schools, cities, counties, and other political subdivisions. The committee learned the average number of mills levied in 2005 for property taxes payable in 2006 was 401.66. Each mill generates approximately \$1.7 million statewide. State assistance to political subdivisions for the 2005-07 biennium totaled \$1.1 billion or \$550 million per year. In terms of mills, this assistance was equivalent to levying 323.5 mills statewide in 2006.

The committee received information on the North Dakota Lottery, lottery proceeds used for compulsive gambling treatment services, casino and tribal contributions for compulsive gambling treatment services, and the history of lottery revenue transferred to the general fund. The committee learned the lottery is anticipated to meet its general fund revenue projection for the 2007-09 biennium of \$11,155,000. The committee learned the tribal casinos provide Lutheran Social Services \$90,000 per biennium for compulsive gambling treatment and that the North Dakota Indian

Gaming Association and Lutheran Social Services are proposing a North Dakota compulsive gambling treatment initiative of \$1.2 million for the 2009-11 biennium.

The committee reviewed information relating to the federal REAL ID Act. The committee learned the goal of the REAL ID Act is to enhance the security, integrity, and protection of licensing and identification systems in the United States. Compliance with REAL ID standards is voluntary; however, if a state does not comply it would be required to print "not REAL ID compliant" on all cards issued. The Department of Transportation requested and was granted an extension for REAL ID Act compliance through December 2009. The extension allows North Dakota citizens to continue to use current driver's licenses to board planes and enter federal facilities. North Dakota will need an additional extension to allow the North Dakota driver's license to continue to be used for these purposes until May 2011. The department has attempted to keep all options available and will be seeking direction from the 2009 Legislative Assembly relating to compliance with the REAL ID Act.

The committee received information on the Northern Tier Network, including information on a proposal by the University System to allow expansion of the use of the network and concerns expressed by representatives of private telecommunications companies regarding expansion of the network.