

LEGISLATIVE AUDIT ADVISORY COUNCIL

Minutes of Meeting July 11, 2012

A meeting of the Legislative Audit Advisory Council (Council) was held on Wednesday, July 11, 2012, in House Committee Room 1 of the State Capitol.

CALL TO ORDER AND ROLL CALL

Representative Greene called the meeting to order at 10:10 a.m. A quorum was present with the following members in attendance:

Members Present

Senator Robert Adley
Senator Edwin R. Murray, Vice Chairman
Senator John R. Smith
Senator Mike Walsworth
Representative Hunter V. Greene, Chairman
Representative Dalton Honore', proxy for Representative Ledricka Thierry
Representative Girod Jackson III
Representative Anthony Ligi

Members Absent

Senator Ben W. Nevers
Representative Cameron Henry
Representative Ledricka Thierry

APPROVAL OF MINUTES

Senator Murray moved to approve the minutes for the December 15, 2011, meeting and with no objections, the motion was approved.

LEGISLATIVE AUDIT ADVISORY COUNCIL ORIENTATION

Daryl Purpera, Legislative Auditor, and Jenifer Schaye, General Counsel, presented an overview of the Legislative Audit Advisory Council's powers and authorities. Ms. Schaye reviewed the Louisiana Legislative Auditor's (LLA) responsibilities to provide audit of all fiscal records of the state and act as the fiscal advisor to the Louisiana Legislature. The law clearly outlines that the Council is to advise, aid and assist the Legislative Auditor in his role. Therefore the auditor will present audits to the Council members at their meetings, so they can review if the auditee has complied with the law with regard to reporting factually and correctly to this body and the public all the issues. The Council also has authority as all legislative committees do to subpoena witnesses and take up any issues that are peripheral to or that arise from the Legislative Auditor's reports, and to bring witnesses before the Council who can offer more information on a particular issue. Ms. Schaye said if the Council determines that an auditee is not performing in accordance with their public trust, the Council may bring the issues before the Joint Legislative Committee on the Budget, or various appropriation committees of the Senate & House to have further information from the auditees or stop funding if necessary.

Representative Ligi questioned the recent Department of Environmental Quality (DEQ) audit which contained a response of admittance of not complying thoroughly but pointed the finger at other agencies not having any protocol. Representative Ligi requested information on other agencies that are not complying with what they are supposed to be doing, and asked if Mr. Purpera could investigate this further. Mr. Purpera responded that Representative Ligi could certainly request further work in other areas, or the agency could be brought before the Council to answer questions. He said his office performs audits of all state agencies during the year at various levels of audit work, and offered to look further into other agencies to determine if this is a systemic problem or just within that one agency. Mr. Purpera mentioned that payroll and personnel services are a large part of the budget and has great risk, so his auditors do pay particular attention to that.

Representative Ligi read the response from Mr. Vince Sagnibene at DEQ that stated their HR officer confirmed that other state departments do not have an internal timeframe deadline for the certification of time and attendance records at all. He asked Mr. Purpera to follow up on that in whatever most efficient method he feels to approach it. Mr. Tom Cole, Director of Financial Audit Services, stated he was present at the exit conference where that comment was made by Mr. Sagnibene. Mr. Cole said he requested any information DEQ may have to support that statement, and his auditors would follow up on that in other audits because he takes that very seriously.

Senator Adley asked Ms. Schaye if the real power of the auditor lies in the ability to compel records and documents. Outside of that, once finding something wrong, the auditor does not have power beyond that because it appears to go elsewhere. Ms. Schaye responded that was correct because the auditor does not have enforcement authority by design from the 1973 Constitution. The auditor is to provide the factual basis for how people are dealing with the fiscal matters of the state. The auditor by statute is mandated to make the audits public via the LLA website, and if there are any law enforcement issues, it is sent to the Attorney General, the United States Attorney, and to District Attorneys throughout the state.

Senator Adley questioned the law regarding sending the audits to the appropriate committees in the Legislature, asking what power would they have. Ms. Schaye said it would be civil powers, for example the finding on Louisiana Department of Education, and the report is presented to the Committees on Education. Ms. Schaye said the auditor compels the production of factual information, so that various enforcement bodies, either regulatory or law enforcement, can deal with the findings.

Representative Honore asked if the reports are posted online prior to notification to the Attorney General or District Attorneys. Ms. Schaye explained that the law states once the auditor has determined that the report is finished it must be made public within three days. The real practice in the auditor's office is when the auditors see issues requiring law enforcement notification, it is discussed with them prior to the report being completed. Representative Honore wanted to be sure the law enforcement agencies were notified prior to public release. Ms. Schaye stated the Auditor has a good relationship with the Attorney General, the District Attorneys, and three U.S. Attorneys in the state.

Representative Greene asked for an overview of the progression of changes in the LLA regarding audits. Mr. Purpera detailed the creation and evolution of the Compliance Audit Services, and the objective is to be fact finders and perform a forensic audit. His office works closely with the local sheriffs and District Attorneys as the report is progressing. The entities are given the opportunity to respond to the findings in the audit prior to the public release.

Ms. Schaye pointed out R.S. 44:4.6, which states that the auditors' workpapers are not subject to public review. The auditors' workpapers are defined by the auditing standards as those papers the auditor relied on to make his opinion. She said various issues have arisen where these documents were requested, but cannot be given in a public records request, but rather to subpoenas from the District Attorney, and U.S. Attorney. Other issues arise when the auditor requests records from various state agencies, and they will not provide them because they believe the auditor is not entitled to receive them, or believes it will be put out publicly. Ms. Schaye said the auditor has had to deal with the issues in the courts.

Senator Murray pointed out how the auditor now goes out to the local governments, on the front end, to teach them. Mr. Purpera explained Advisory Services was created eight years ago to teach the local governments how to do things right. One method is by doing a Best Practice review with many local governments to help them understand the law, and ensure proper good controls are in place.

Representative Honore asked how a municipality can request a Best Practice review. Mr. Purpera said the local government can certainly request it, and his office also works with the CPA doing their audit. The local CPA audit contracts are approved by his office, thereby providing oversight and quality control in the audits. His staff works with the CPAs to make sure they are receiving the right information. Ms. Schaye stated that the LLA website is very helpful with Frequently Asked Questions, Best Practices, and many forums that are all kept updated, as well as the entities can call for more information.

Representative Hunter asked about the auditor's staff, and commended the office for having high quality employees. Mr. Purpera provided statistics on the percentage of CPAs, CFEs, etc., and stated that he strives to keep a professional staff with many certifications and degrees.

LOUISIANA DEPARTMENT OF ECONOMIC DEVELOPMENT (LED)- MOTION PICTURE TAX CREDITS

Kimberley Jones, Senior Auditor for Compliance Audit Services, provided a summary of the audit findings on the Louisiana Department of Economic Development. Specifically there was an allegation concerning a documentary production *Blaine Kern's Mardi Gras - Building of the Greatest Free Show on Earth*. Blain Kern Artists, Inc. (BKA), and the Louisiana Entertainment and Production, LLC (LEAP), executed a Letter of Intent to produce the documentary. In 2009, a total of \$935,114 in motion picture tax credits was issued by LED for expenditures made by LEAP and BKA from 2006-2009. The compliance audit indicated based on RS 47:6007 that 94.8% of the expenditures were not eligible production expenses. LED director Christopher Stelly questioned these expenditures that appeared to be for standard business operations, but the LEAP and BKA members eventually convinced him that the expenses submitted were not incurred during their standard business operations. The audit further revealed producer fees paid to LEAP were not substantiated by adequate documentation of services rendered, as well as tax credits issued for expenditures which did not actually occur. Therefore, members of LEAP or BKA may have violated state laws by misrepresenting the nature of these expenditures to LED and as a

result deprived the state of tax revenues totaling \$935,114. LEAP and BKA later sold the tax credits for \$821,343. Senator Adley asked how much of the expenses were actually eligible for tax credits. Ms. Jones said after subtracting what was considered to be ineligible, they found only \$172,000 to be eligible.

Senator Murray asked how many productions has the Legislative Auditor reviewed. Mr. Allen Brown, Assistant Legislative Auditor for Local Audit Services stated this is the only production reviewed by the LLA specifically because the District Attorney in New Orleans asked for it to be investigated. Senator Murray asked if there is an internal function in LED to confirm accurate before allowing tax credits issued. Mr. Brown stated Mr. Stelly was asking the right questions, but the answers from LEAP told him it was not normal operating expenses. Ms. Jones said the tax credits are audited by a CPA firm not approved by the LLA. Mr. Brown said it is a private entity hiring a private CPA to do their audits. Mr. Purpera added that his performance audit section has to do three projects within LED annually, and will expand the work into other productions.

Stephen Moret, Secretary of Louisiana Economic Development, stated his office has zero tolerance for anyone who would attempt to misuse the Motion Picture Tax Credit Program in Louisiana, or any other tax credit program that his office administers. His office is in the process of seeking recovery of the wrongfully issued tax credits in this particular case. Mr. Moret said the project was initially certified under the prior administration in 2006. The staff and Chris Stelly repeatedly questioned the applicant and required written statements to verify that the expenditures submitted were eligible film production costs, rather than standard business operations costs. Despite the clear directive, based on the Legislative Auditor's report, it appeared that material misrepresentations may have been made by the applicant. Therefore his office is investigating this very seriously. Over the last ten years, since the creation of the film production tax credit program, this industry has experienced unprecedented growth. Louisiana is now the third largest state in the country for film production, largely due to this tax credit program. But shortly after Mr. Moret took office in January 2008, he did his own internal performance audit of LED. The unprecedented growth of the production program had put a tremendous strain on his staff, who was hundreds of millions of dollars of expenditures to work through to determine the appropriate amount of tax credits to be issued. Over the last 4 ½ years, his office has made improvements which dramatically improved the administrative oversight and function of the program, including adding additional staff and attorney focused on the film production activity. They shifted their focus on advertising to more administration, including financial and audit backgrounds to ensure the staff is capable to handle the program. He issued rules and audit guidelines with extensive input from the Louisiana Society of CPAs, because neither existed when the program started. Mr. Moret stated they engaged a forensic auditor over the last couple of years to support case by case audits as directed by the office. Finally, they enhanced their online and offline educational programs to improve understanding of the program and what are appropriate expenses. Mr. Moret generally agreed with the recommendations of the auditor on this report, and most of the recommendations have been implemented over the last couple of years.

Senator Adley asked Mr. Stelly why he approved the tax credits in spite of his questions. Mr. Moret stated that he does not have the legal authority to compel production of documents prior to filing suit in this particular case, and wanted to build the strongest evidentiary basis before doing that. Therefore, he is looking forward to the outcome of the New Orleans District Attorney before proceeding with the suit. Because of the potential of a suit, they must be careful what is shared in a public forum. Chris Stelly, Executive Director of the Office of Entertainment Industry Development, said at the time reviewing the expenditures in question, they had the support from an independent CPA validating these expenditures, as well as three statements from the principals involved in the production attesting that these were non business related expenditures, so they felt at that time that the expenses could be approved. Mr. Stelly said the final approval of the expenditures were in 2009.

Mr. Moret explained the initial certification that the project would be eligible for tax credits was in 2006, and the final certification was in 2009. Senator Adley asked what his office is doing to correct the mistakenly given tax credits which have also been sold as per the auditor. Mr. Moret explained this is the first case to recover previously issued credits, and because there is so much film production activity supported by the transfer of tax credits, they want to be careful to not impact innocent third parties who have purchased tax credits not knowing any issue. He said they will be collecting more in the form of damages against the individuals who misrepresented facts to the state and not the purchaser of the credits themselves. Senator Adley said he and his wife purchase tax credits, and would like to know the attitude of the office in regard to the purchaser. Mr. Moret said the innocent third party who purchased the tax credits should not be affected by the mistake.

Ms. Leu Anne Greco, Executive Counsel, stated the party responsible for misrepresentation has perpetrated fraud. Due to the New Orleans investigation by the District Attorney which is gathering evidence, the LED does not want to discuss the evaluation of strategy or the merits of their claim and how it may be fraud, but the focus will be on the responsible parties.

Senator Adley asked if the District Attorney was not involved, what steps could LED take to recover funds. Ms. Greco said they would have to evaluate the merits of the claim and take into consideration the cost of the lawsuit. Senator Adley asked if only civil action could be taken. Ms. Greco responded as an administrative agency, it could only take civil action because it has no criminal authority.

Representative Honore asked how many tax credits were issued under this administration. Mr. Moret said there were no tax credits issued for this particular production under the previous administration. He explained the application process and determination of eligible expenses for tax credits. All tax credits were issued after the audited expenditure reports are submitted to LED and the Office of Entertainment Industry Development and when LED has satisfied any concerns or questions about the submissions. Mr. Moret said he would have to get back on the total amount of tax credits issued during this administration, but in the range of \$100-200 million per year for the last three or four years.

Representative Honore asked if this is the first production company to have problems. Mr. Moret stated it is very common that in the process of his office reviewing the audited expenditure reports, that there are questioned items and issues. Mr. Stelly briefly explained their review process and when they find expenditures not in accordance with state law, it will be rejected from the final credit certification letter. When not comfortable with the presented audit report, he uses a forensic auditor to do additional examination of expenditures. Representative Honore asked for LED's process when the tax credit has been given, and then they find out there are errors. Mr. Moret said the misperceptions of the tax credit program is that credits are given based on what they promise to do, and then having to collect if not delivered. However, nearly all the companies receive tax credits after they have produced a result. When the film is completed and submitted audited expenditures, LED evaluates and ensures all is consistent with the law. Mr. Moret stated that Louisiana was the first state in the USA to have a substantial program of this type, which put Louisiana in the position to develop a film industry much faster than any other state that did not already have one, but it also put the state in the position of being a pioneer in that industry. He added professional staff to focus purely on supporting these entertainment industry programs to ensure properly handled. Equally important was finalizing rules for the programs and explicit audit guidelines developed in conjunction with Louisiana Society of CPAs to make very clear what is appropriate for use of tax credits.

Senator Murray asked Mr. Stelly if the written statements were in a form of affidavits. Mr. Stelly replied it was signed letters submitted. They continued to discuss the legal benefit of requiring affidavits. Ms. Greco pointed out a criminal provision in the law that any submission to a governmental agency for the purpose of receiving funds that is fraudulent is a felony offense, regardless of notarizing. Senator Murray asked why not request an affidavit, requiring them to go before a lawyer or notary. Ms. Greco replied that she does not believe a notarial signature would have enhanced the protection of the state.

Senator Murray inquired about the recovery efforts for the state money. Mr. Moret referred to Ms. Greco so as to not comment on anything that would affect their litigation. Ms. Greco complimented the auditor's staff in supplementing their records, and they are waiting for the outcome of the Orleans District Attorney's investigation. Ms. Greco said they are gathering all the evidence possible to make their case. Senator Murray asked if LED had written a letter requesting the money back. Ms. Greco replied that they have not, and only assembling evidentiary basis to file suit. Mr. Moret stated that the Orleans DA is in a better position to get documents, and was clear in the response to the LLA's report that the applicant will not return any money.

Senator Murray asked if LED has asked the auditor's office to get the records needed. Ms. Greco said the auditor has been helpful to allow them to review records, but LED needs to develop an independent source to obtain those for use in court because they cannot rely on the workpapers of the auditors because of confidentiality. Senator Murray asked her why she has not asked the auditor to request more records from Blaine Kern Artists. Mr. Moret stated he is not sure if the auditor can request more documents since the audit is complete. Representative Greene asked if there is a prescriptive period for filing the lawsuit. Ms. Greco said they are taking all the timing into the theories and strategies of the lawsuit.

Senator Smith questioned the expenses not eligible for tax credits, and how much the state has lost by this tax credit. Mr. Moret said that Blaine Kern would not qualify for any tax credits. He said LED does not have a process for taking action after the credits have been issued, because of the many protection efforts before the issuance of the tax credits. Senator Smith said then there may be many ineligible tax credits out there. Mr. Moret explained that this program did not have approved rules by LED and the state legislature until 2010, and the actions taken by his office in the last 4 ½ years have put them in the position to avoid this situation in the future. He mentioned some refinement to the statute to state more explicitly, and anticipates making recommendations in the upcoming session. Mr. Moret said they are starting to see things that happen after the tax credits are issued. Because the law allows for transfer of tax credits, there has been some activity which is not regulated by the state between third parties that has involved some fraudulent activity. There may be a more formalized mechanism for tracking after the fact to make easier for the tax credit buyers to ascertain the legitimacy of the tax credits. Senator Smith complimented Mr. Moret on his progress and stated that the program is a good thing for Louisiana.

Representative Greene said lawsuit is the next step based on the evidence, but would like to learn from this and decide how to change legislation. He questioned if the auditor's office should become more involved in these tax credit programs since it involves a lot of money. Mr. Moret explained how they

determine the typical producer fees, and asked Mr. Stelly to explain the audit guidelines including special events.

Senator Walsworth stated his concern that this is only one audit reviewed and with a lack of written rules until 2010, wonders how many more instances could have occurred. He said other committees will be reviewing all tax credits. Senator Walsworth asked if the legislative auditor could audit some more recent productions to give more confidence in the program. Mr. Moret said the law allows them to select their own independent auditor, but since 2010, LED has had the ability to select a second audit in his direction if any concerns. Mr. Moret replied he welcomes that review and suggested it would make the most sense to evaluate current programs. Representative Greene said the legislative auditor is looking at three productions as a follow up.

Senator Adley asked if they approached the Inspector General to investigate. Ms. Greco said she has asked them to look into several issues, and they are aware of the New Orleans investigation, but has not answered on this one. Senator Adley asked Mr. Stelly if anyone in state government has asked him to change your position or support these credits after your objections, or if the decision was his own. Mr. Stelly stated he reviewed the documentation with general counsel and the independent auditor, and made the decision based on their qualifying according to law. Senator Adley supports the tax credits to help the state, but it must be transparent so rules and accuracy are crucial.

Representative Greene commented that a fourteen member commission will be reviewing all the tax credits and rebates, and questioned if an emergency rule may be needed. He mentioned changing the legislation to make it not a CPA firm hired by the entity, but chosen from an approved list by the LLA. He pointed out the cost of verifying that the submitted expenses are accurate, and if they get enough benefit for the expenses.

EXTENSION REQUESTS

Ms. Joy Irwin, Director for Advisory Services, reviewed the audit law as related to extensions and the Council's extension request policy. The noncompliance list was created to provide a list of entities who have not submitted their audit reports in the time allotted. Ms. Irwin explained the distinction between extension requests that are 90 days or less, and extension requests that are greater than 90 days past the statutory due date of the report. The Council reviewed the emergency extension requests which include the reason for the agencies' requests, which must be a gubernatorially declared emergency to qualify for this extension. Ms. Irwin stated that all three agencies on the emergency extension request list have turned in their reports. Representative Greene made the motion to approve the extension requests, and with no objections, the motion passed to approve the extensions for Lafourche Parish Fire Protection District No. 3, Town of Vidalia, and the Village of Sicily Island.

Ms. Irwin presented the nonemergency extension request greater than 90 days list which only had DeSoto Parish Police Jury. She said there is an administrative approval under the rules, which was given by Senator Murray, and still requires confirmation by the Council in an open meeting. She recommended approval since their report was received. Representative Greene asked if the Police Jury had any problems since they had not submitted reports timely in the last five years. Ms. Irwin said her staff is monitoring this police jury and had sent advisors to give them advice and assistance. They have chosen a new auditor and already sent in their next audit. Representative Greene made a motion to approve the extension to DeSoto Parish Police Jury, and with no objections, the motion passed.

Ms. Irwin said extensions for governments are not a good thing, because information should be readily available and when past six months her staff works diligently with those entities. The next list presented was less than 90 day extensions, and as per the policy, Mr. Purpera has the ability to grant these extensions, but then confirmation by the Council at the next meeting is required. She pointed out that many reports have fortunately been turned in, including the City of Springfield that morning, but the list was lengthy because the Council had not met in many months.

Ms. Irwin explained the policy allows for a second extension request, but are not presenting any to the Council because Mr. Purpera would have to recommend those. By talking to the various parties, he did not feel that he should recommend a second extension for these entities. Ms. Irwin said she must determine whether these are legitimate extension requests, and the delay on reports causes stale data to be provided.

Mr. Purpera stated after disasters there is a need to allow additional time to provide audits, but he is no longer granting extensions so readily past the statutorily provided six months. He notified the CPAs and local governments that they will no longer receive an automatic extension. The ramification of that is the treasurer cannot cut a check to the entity if they are on the noncompliance list. The audited data is valuable when current for them to make decisions.

Representative Greene asked if the entities that have received the 90 day extension are receiving funds during that time. Ms. Irwin replied that those entities are not entered on the noncompliance list during that period; however, shortly after the 90 days are past if the audit is not received they are placed

on the noncompliance list. Mr. Purpera said the transferring agencies must look at the list periodically to know who is on the list.

Senator Adley asked if Red River Film Society had any film credits and if they were given an extension. Ms. Irwin said she would find out about film credits, and the extension was granted, but they turned in their report already. The council members discussed various agencies on the list, and Ms. Irwin provided information on the Town of Richwood and the Louisiana Leadership Institute.

Representative Ligi asked what is happening with the Housing Authority (HA) of Kenner. Ms. Irwin stated that the HA has not provided records to the auditor Paul Andoh with Bruno and Tervalon, CPA audit firm as of June 28, 2012. When the auditee is not providing cooperation with the auditor, her staff sends a records letter to the District Attorney (DA) notifying them that the auditee is not compliant with the audit law. Since that was so close to the meeting today, the records letter was sent to the auditee and copied to the DA on June 15, 2012. Representative Ligi asked what enforcement can be done by the DA. Ms. Irwin referred the question to the General Counsel, but understands there are penalties in the audit law for noncompliance.

Mr. Purpera explained that housing authorities receive their funds directly from the federal government, so their funding is not withheld, so there is no real consequence to the HA when on the noncompliance list. His office has been in communication with the organizations that oversee the housing authorities, which also has problems disciplining them because they provide a needed service. Representative Ligi said that is his concern because there are people relying on the HA who are not doing what expected.

Ms. Irwin said the records letter was also copied to the Office of the Inspector General with the Federal Housing of Urban Development (HUD). She said they are in constant contact with HUD and the DA in the region, as well as putting them on the noncompliance list not because of any state money going to the HA, but if the City of Kenner (Kenner) was dispersing any funds to the HA through any state appropriations, they could stop those moneys from going to the HA.

Representative Ligi asked if Kenner would be notified of any noncompliance at this point. Ms. Irwin stated that she has not notified Kenner of the noncompliance here. Normally the city has very little oversight over those housing authorities other than to provide the board members and they would report to the city. But there is not really oversight by the city necessarily. She mentioned the experience with Slidell Housing Authority, where she contacted the City of Slidell in that case, and there was some movement to replace some of the board members by the new mayor of Slidell.

Representative Ligi asked if he misunderstood her that money may flow through Kenner. Ms. Irwin said in an abundance of caution, if that were to happen, she would want to make sure to notify anyone that might be disbursing funds to an agency on the noncompliance list. She was not certain if Kenner is providing funds or not, but they would have access to the noncompliant list. Mr. Purpera stated that Representative Ligi had an excellent suggestion, and would contact the City of Kenner.

Representative Honore' noted that the majority of the reasons given were change in personnel and illness, which might be true. He asked for the agencies' parishes to be included on the list. Ms. Irwin said that she would add the parish information, and pointed out that the parish is shown on the noncompliance list on the LLA website.

Senator Murray explained that Sojourner Truth Academy was a charter school in New Orleans and has had many problems. He pointed out that almost all charter schools have had difficulty turning in their audits on time. Senator Murray asked if the schools that receive vouchers as per the new law will have to do audits. Ms. Irwin said in the audit law there is a specific exemption for parochial and private schools from having to submit audits to the LLA. If the voucher or public money extends to a parochial or private school, they will be exempt from the audit law.

Senator Murray asked if for the past four years the nonpublic schools in New Orleans have not been required to submit an audit. He said the law needs to be changed and to include the Arch Diocese. Ms. Schaye said either the law would have to be changed or the Board of Elementary and Secondary Education (BESE) could create some rules to require the schools to provide an audit. She stated that BESE has included that requirement in some contracts for charter schools. Ms. Irwin said it will not fall under the audit law, so the LLA would not have the same oversight as public schools. She suggested that BESE could put in their rules subject to audit by the LLA under R.S. 24:513. Senator Murray asked Ms. Schaye to prepare the language for BESE to put in their contracts.

Representative Greene asked how state funds can be audited that are given to a private school. Ms. Schaye replied it depends on how BESE puts it in their rules and the language in the contract. In the audit law, it states that if private money is mixed with public money, all can be audited. She believes that BESE can make any rules they want, and can state that if a school receives state funds through the voucher scholarship program, the school must be audited for all finances at that school.

Representative Greene asked what is the result if the council does not approve the 90 days or less extensions. Mr. Purpera said the policy approved by the council five years ago gave him the authority to grant a 90 day extension, which he did so. It also requires that he informs the council of those extensions, and the council typically confirms it. Senator Walsworth made a motion to ratify or approve the non-emergency extension requests less than 90 days, and with no objections, the motion was adopted.

EXECUTIVE DEPARTMENT

Tom Cole, Director of Financial Audit Services, provided a brief summary of the LLA Management Letter findings on the Executive Department, State of Louisiana, issued May 23, 2012. The findings included: (1) Inadequate grant recovery of Homeowners Assistance Program (HAP) awards by the Office of Community Development (OCD); (2) Inadequate recovery of Small Rental Property Program (SRPP) loans; (3) Inadequate monitoring of credit cards issued to employees within the Statewide Travel Card program; (4) Noncompliance with procurement and suspension and debarment requirements at the Office of Coastal Protection and Restoration (OCPR); (5) Inaccurate annual financial report submitted by the Office of Facility Planning and Control (OFPC).

Senator Murray questioned the percentage for the entire HAP. Mr. Purpera explained that only a sampling was used in the audit, but if compared to the entire program, the potential problem would be \$3 billion. It was not reported in that way because of his meeting with OCD, the Executive Department and HUD, in which HUD explained they saw the problem and working towards making corrections. Mr. Purpera said if they follow the strict guidelines of the program, HUD would have to ask for the money back, which would be very significant amount of money. Senator Murray queried if the funds would come from the state's general fund, or future payments to the state by HUD would be held back. Mr. Cole said many homeowners may be in compliance, but simply have not supplied OCD with evidence of compliance showing occupancy or insurance on the home. Mr. Cole stated as of June 30, 2011, there were approximately 21,000 SRPP loans in effect, with total value of \$165 million, and the same issue of state responsibility applies to this program.

Representative Greene questioned the credit card expenses by state employees, who receive reimbursement for travel expenses from the state accounting office, but did not pay their credit card bills to the credit provider which affects the individual's credit. Mr. Cole explained the rebate to the state was calculated by a formula, but by September 30, 2011, the credit card company wrote off over \$385,000 in unpaid balances, which reduced the rebate to the state. Mr. Cole stated as of January 2012, the Statewide Travel Card program had been terminated and the department was seeking restitution for the unpaid balances.

Senator Walsworth questioned the delinquent balances written off by card issuer in the report, and if any further probing would be done. Mr. Cole replied the credit card statements would be needed to determine how much of the balances were business or personal expenses, and more investigation could be done. Representative Greene questioned how much was credited by the card issuer. Mr. Cole said rather than the card issuer collecting from the state employee for the bad debt, the amount of the bad debt was deducted from the rebate amount due to the state.

Representative Honore' asked if the employees were charged with abuse of the state issued credit cards. Mr. Cole replied the Division of Administration (DOA) will ensure that the old balance has been paid in full before issuing a new credit card to the employee. Representative Honore' asked if anyone explained to the employees they could be terminated if they wasted state money. Mr. Cole said that should have been included in the administration of the credit cards.

Mr. Cole reported that the findings regarding the OCPR has been resolved, and his staff is working with the appropriate person at OFPC to ensure those errors do not occur this year.

Mr. Pat Forbes, Executive Director of OCD, explained that nonresponsive does not necessarily mean noncompliance in regard to the HAP. Mr. Forbes pointed out in the report that HUD is not likely to request repayment of funds from the state, but continually working on reaching the program objectives of putting families in the homes. The process will become more aggressive with deadlines set for homeowners to demonstrate compliance through documentation and implementation of programs to provide additional assistance from HUD to become compliant. In the end they will recover funds, and have already done so from many Road Home applicants.

Representative Ligi asked if extensions are granted for Road Home covenants. Mr. Forbes said not as a general rule, but extensions can be granted if the homeowner was in HMGP program to elevate, and demonstrated reasons and requested an extension, then it can be allowed. Representative Ligi asked how many people have been granted an extension. Mr. Forbes replied he can find that number for him. Representative Ligi asked if extensions were considered in the audit report. Mr. Cole replied that those extensions were taken into account in the sample population.

Mr. Forbes stated the SRPP acknowledged the need for the recapture program and they did not have a process in place. The SRPP loan carries a mortgage with it, and foreclosure is the last resort which

is used as a tool if needed. Their goal is to fill the homes with low to moderate income renters. The SRPP developed the policies and procedures by April 30, and approved by OCD by the end of May and in the process of implementation. They recognize the necessity of recovery of funds from those people who refuse to be in compliance with the program. If landlords refuse to meet the covenants, then foreclosure is the last resort.

Denise Lea, Director of the Office of State Purchasing & Travel Guidelines with DOA, said the travel card is an employee liability card which is part of the State Procurement card. The two cards together have generated over \$4.1 million to the state. Basically, the program was modeled on Best Practices and is being used by other states and by private industry. The travel card which is the individual employee liability card attempted to restrict employees to use the account for business reasons. Unfortunately, some employee's disregarded this restriction. The program has been discontinued and a new program has taken its place which is supported by the state. The employees sign an agreement and must go through training and understand they can be terminated if they use the card for any other purchase than allowed. The employees who misused the previous cards are prohibited from use of the new cards. Ms. Lea explained the banks offered incentives if the program achieves an overall value of the cards. At the end of the year, the charge offs were reduced from the incentives, so no cost to the state and only the bank would take a loss if the charge offs exceeded the incentives. Ms. Lea said the program had no cost and the state could receive additional funds depending on the volume. She explained the employees were paid only one time for expenses by the state, and was a tool to help employees who did not have the credit or income to receive a personal card, and help them pay for their travel expenses. Unfortunately, there are employees who do not pay their bills.

Representative Greene asked if payroll garnishments were an option. Ms. Lea explained in the new program it will be a liability of the state, so they will be able to garnish the employees if make any unapproved purchases. Mr. Cole stated that reimbursing an employee for an expense which they did not really incur was a violation of Article 7 Section 14.

Senator Murray questioned the process of recouping the money from employees. Ms. Lea said she is working with the Bank of America on the legal issues, and some agencies have been successful in recouping the money. So far \$10,000 of the \$385,000 has been recouped.

SELECT LOUISIANA RETIREMENT SYSTEMS - INVESTMENT PROCESSES

Mr. Purpera explained that the chairmen of the House and Senate Retirement Committees asked his office to research the investment processes and practices. Nicole Edmonson, Director of Performance Audit Services, stated the request for this audit was based on media attention for three of the Louisiana retirement systems which invested with the Fletcher Asset Management, Inc. (Fletcher) through the investment consulting firm, CSG Holdings. This resulted in a performance audit of the Firefighters' Retirement System (FRS), Municipal Employees' Retirement Systems (MERS), Firefighters' Pension and Relief Fund of the City of New Orleans (NOFPRF). These three systems invested independently of each other a total of \$100 million with Fletcher Asset Management. Also included in the audit was the Registrars of Voters Employees' Retirement Systems (ROVERS), who did not invest in Fletcher, but does use CSG Holdings.

Ms. Edmonson stated the audit only covers from March 2008 - April 2012, but the provided newspaper article from the Wall Street Journal dated July 5, 2012, provided more recent events. She gave a brief review of the audit highlights and findings and the responses from the retirement systems.

Senator Smith asked if this investment into Fletcher factors into the unfunded accrued liability (UAL). Mr. Purpera said these four systems are not included in the \$18 million UAL, but when reviewing the individual financial statements of each system, if their assets lessen their liabilities is negative, then it is an unfunded liability. Mr. Purpera said it was \$100 million invested in a risky investment company.

Ms. Edmonson reviewed the chronology of the retirement boards as provided in the LLA report. On April 18, 2012, the Grand Court of the Cayman Islands ruled in favor of FRS, MERS, and NOFPRF's petition, granting all relief that had been requested. However, as per a Wall Street Journal article, Fletcher filed bankruptcy the previous week.

Senator Adley questioned the required percentage of return to be sound, and commented that the management is responsible for making the investment decisions. Ms. Edmonson replied they did not reach their actuarial assumption through the Fletcher investment. She pointed out the statutory investment process and education criteria, and the issues presented for the four retirement systems in the audit.

Steven Stockstill, Executive Director for FRS, responded to Senator Adley's question regarding achieving their actuarial assumption, but wanted to emphasis it was an average, and for more year than not, they did meet their average. Their board includes the chief investment officer for the state, and a chairman of the House and of the Senate, and a representative from the Commissioner of Administration's office, as well as two Mayors. The FRS board is well represented by state and local government - not loose cannons making decisions, losing money every year. They make well thought out decisions and

FRS' experts reported that in 2008-2009 everyone lost money because the worldwide banking system was about to crumble. If remove those two crisis years from the average, they did fine.

Bob Rust, Executive Director for MERS, felt the Legislative Auditor's staff was very professional, but for some areas had no initial experience. Investment returns must be viewed by what was possible in the marketplace, and over the 20 year period MERS' fund did 7.7% - 3/10 of 1% below expectations. The S&P during the same time only did 7.6%, and the internal stock market only achieved 3.9%, and the bond market only did 7.1%, and the high yield bond market (junk bonds) made 8.9%, and hedge funds did 7.7%, and real estate did 10%. Mr. Rust said it must put in context of what was possible during that period.

Richard Hampton, Executive Director for NOFPRF, said prior to 2008 all the systems made their actuarial bogey, and only the financial meltdown caused lower returns and was unfortunately included in the average.

Senator Adley commented that he makes his money in investments and in the years described, his hurdle rate is 8.5% and exceeded it each year. It is not difficult, even in this market to make 7.5%. He said he appreciates their situation, but the legislative body meets every year and fights the battle over the UAL, and they act like 1/10 of a point is meaningless when we have to find ways to get several hundred million dollars to deal with the problem. He asked what strategic changes were recommended or did they make any when they hit those times or did they leave the portfolio the same. Mr. Stockstill replied that their investment advisor was present to answer those questions. Senator Adley said he made some changes when his financial advisor gave him advice when those difficult times were coming, and would like to know what their financial advisor suggested to them. Mr. Stockstill stated during that 20 year period they did make their hurdle most of those years. Senator Adley pointed out with the dollar amount managed by the retirement systems they should have more leverage in the investing. Senator Adley wanted to confirm the representatives for the investment systems were not benefiting personally by using the investment advisor. Mr. Rust said absolutely not.

Mr. Rust explained MERS does not take state dollars, and is a completely voluntary system - the only one in the state that is 100% voluntary. Mr. Rust explained they have two funds, one integrated with social security which is 95% funded, and one that is not integrated with social security is 90% funded. Senator Adley asked how much more money is needed to be 100% funded. Mr. Rust said approximately \$27-30 million, which is called the UAL. He explained that their funds are frozen and amortized like a mortgage payment, so it only increases by the interest that is paid on. Senator Adley asked if everyone retired today would it be a problem. Mr. Rust replied that he would have to ask his actuaries, but does not believe it would be a problem because the money is paid out over a long period of time. The MERS board felt it necessary to reduce the cost to the employers which are the municipalities, so in the last session legislation was passed to bring down the cost. He commented that their board acts responsibly to steward the assets.

Senator Adley questioned why they are unable to reach the 7.5% because others are doing it. Mr. Stockstill said they made changes during the difficult time to move out of the equity class and move into other classes that would be less volatile. Mr. Rust explained that when he reviewed national surveys of what public pension plans have done, not many have made that rate of return. When comparing MERS investment results it was notably better than others because the board reduced the risk profile.

Mr. Stockstill stated that FRS exceeded their hurdle more years than not. In 2008 he surveyed all 13 of the statewide retirement systems, and all were below zero for that year. Representative Greene asked if he looks two years out from now, and average the past five years, would they expect their average to exceed their actuarial assumption. Mr. Stockstill explained they smooth over a five year period, and the year prior to 2008 was their highest return at 17.8%, and the most recent year return was only 1.1%. Mr. Stockstill forewarned the legislators that for FRS the employer contribution rates will spike up again in 2013, and all the constituents will be asking why. Representative Greene said in the bigger picture, the actuarial assumptions are not being returned over the life of the investment. Representative Greene commented he knows the board has to be educated and hire the right professionals, and try to make the right decisions, but must secure the money is available for the retirees. Mr. Stockstill commented that an independent report by Fitch Rating Commission states that if a pension fund is 70% funded it is considered adequate funding.

Senator Murray asked about the findings regarding lack of documentation. Mr. Stockstill said the Legislative Auditor report conceded that FRS had been documenting 4 of the 6, and the law requiring the documentation did not exist until 2010 Regular Session. Mr. Stockstill said the board embraced the recommendations to document the other two to be in compliance with the law. He said the past few years have been a tightening of the belt regarding expenses, and only has six people on staff, so doing their best. Mr. Stockstill swore in every last trustee in the past 10 years, and confirms they have the educational requirements prior to swearing in, so they can vote immediately. He never required a written confirmation that they have viewed their training DVDs because he had no reason to believe they lied.

Mr. Rust commented that the auditors suggested they document things differently than they currently do, and MERS has embraced their recommendations and have begun to do it better. He said they do an asset allocation study monthly with the board, and have training on investments for the board members. Mr. Hampton said they were in compliance with everything, but accept the recommendations and begun to document as per the given guidelines. It does put a stress level on the office staff, but important to have documentation in place.

Representative Honore' asked if there is a minimum education requirement to be a board member. Mr. Rust replied there is an education requirement before they can vote as a trustee, so provided prior to swearing in, as well as minimum requirement for every year.

Senator Adley asked which recommendations did MERS refused to adopt. Mr. Rust said they refused none, but did request more clarification and an example, and will adopt all their recommendations. Senator Adley said the auditors are here for a reason, and the council's job is to defend them, and he believes the auditors are operating in our best interest. Mr. Rust said the information asked for was available, but just included more documentation as recommended by the auditors. Mr. Stockstill said his board accepted all the recommendations, even if do not agree with all.

Mr. Joe Meals, Investment Consultant to the four retirement systems, and principal in the Consulting Services Group, has been in this business since 1978. Representative Greene asked why ROVERS did not invest in Fletcher. Mr. Meals replied that the Fletcher Fund was only capable of accepting \$100 million for their strategy to work as presented, because it needed a second set of investors who agreed to be subordinate in their investment to the investment they had here. In fact, what was required under the strategy was someone had to be willing to invest \$.50 in the same fund for every \$1.00 that these systems invested in, and that their \$.50 had to be completely at risk to performing the performance returns for the investments the system did. In looking at what was being done, you had \$.50 worth of collateral basically set up to ensure the performance of this fund, and that \$.50 had to be entirely lost before the systems would be at risk to having any loss of not only of their principle, but any loss of the return on that principle, the 12% that was being prepared. So the fact that they only had \$50 million of capital raised in that class limited how much could be done in this.

Representative Greene asked if Fletcher raised the \$50 million. Mr. Meals said yes, it was in place before the \$100 million was put in place. Representative Greene asked him if he was the only investment advisor for these retirement systems. Mr. Meals said yes, the only investment advisor they have, but they have accountants and actuaries as well as legal representatives that advise them. Plus their staff has investment experience in varying degrees and then the trustees on the committees have varying degrees of investment expertise as well. Mr. Stockstill said Mr. Meals is the only investment consultant that the systems have, but FRS has 40 different investment managers that work for the system.

Mr. Meals corrected one statement made by the auditors, because they did not have access to the information. Mr. Meals stated the NOFPRF had been investing with Fletcher since 2003, so their investment had preceded this audit. NOFPRF initially invested with Fletcher to provide a portable alpha source of income in a particular strategy because we were looking for an enhancement to their fixed income program because believed they could get better returns from their fixed income by using this. Over the course of time, it was determined that market related performance, which is referred to as beta is in the fixed income area was not producing the kind of base return that we wanted to add the alpha on to. So they cancelled the contract and cancelled the strategy there, and that was the first time that Fletcher came back to NOFPRF because we basically submitted the redemption notice then, and they came back and said you have been a client for several years, and wanted to keep their client. Mr. Meals said Fletcher asked what could they do, and he told them that the return potential was not adequate to support staying as a manager in the portfolio because there are better return opportunities in other investments. That led to Fletcher saying their return potential was going to get better, so Mr. Meals told them to put their money where their mouth was, so to speak. That was when the structure where they had people willing to put money up to be subordinate to the retirement systems because they believe it would produce returns in excess of what we are saying we will pay you.

Representative Greene asked if Fletcher said rather than return their money give them a better deal. Mr. Meals said they did receive money back, and from 2003 - 2008, there was at least three different occasions, but not sure if more, where NOFPRF submitted a redemption and was paid on time with no issues and no indication of there being any concern. Mr. Meals said concern was when the reporting from Fletcher started coming late, from 30 to 45 days. He said Fletcher explained the problem of being late on reports by blaming their change to new auditors and also changed fund administrators, who are the ones that prepare the monthly reports, to both reputable independent firms that had good credentials for what they were doing. These changes were supposed to improve their performance, and this is what led to the suggestion to pull some money out as the account had grown. It initially had a two year lock up associated with money, but after that they could withdraw monthly so had monthly liquidity after the two year program.

Senator Adley asked Mr. Meals what his recommendations are now to the retirement systems to get them above the 7.5% that they require. Mr. Meals said they look at the return potential in the market

place every month when he meets with them. At this particular moment, Mr. Meals suggested that they lower their allocation to international equities in favor of U.S. equities, and recommend they pull some money from their emerging market debt allocation and look into the U.S. high yield market because the yield potential in that particular asset class over treasuries. Mr. Meal said if investing in investment grade fixed income today, which is sort of stable, the expected return is 3% or less, and so not a very attractive return potential.

Senator Adley asked the highest fixed rates of return that he has found. Mr. Meals said when looking at total return, you get a significant component of that from the income or the coupon that is paid on the bond, and then you can have capital gain or loss depending on the direction of the interest rates. We do not believe that interest rates have much lower to go, so that says that most of your return will have to come from the coupon or yield side. In the treasury market right now your yields for five year securities and under are less than 1% - very low. Even 10 year bonds are yielding less than 3%, so have to go very far out on the yield curve, and even then will not get more than 3-4%. In the high yield space still able to get yields in the 7-8% range, and in fact the high yield manager that is in the MERS portfolio is 11%. Senator Adley asked why not allocate more to them to ensure 7.5%. Mr. Meals said they believe the best way to manage the risk associated with the portfolio is through diversification. That is a pretty standard acknowledged process for risk management in the industry. Mr. Meals said the allocation in the portfolio to the investment grade fixed income market, like the treasury market yielding 2-3%, it has been pulled down to about 5% allocation in favor of some of these other types of investments to ensure a better probability of achieving that 7.5% return. We keep some in those investments for liquidity purposes.

Senator Adley asked if he knows why he keeps asking 7.5%. Mr. Meals said yes, he knows the goal, and they focus more on trying to achieve with these plans to meet that return more so than relative performance. He does not know of very many public funds, endowment plans, foundations, whomever that can tout the track record that Senator Adley has been able to accomplish with his portfolio. Senator Adley asked why is that. Mr. Meals said the marketplace has just not provided that opportunity - the statistics that Mr. Rust mentioned earlier are more what is available to most markets and the most that investors can achieve, even though there are exceptions. Senator Adley said he clearly disagrees with him, and asked if because this is municipal public dollars that there are restrictions written to prohibit better returns. Mr. Meals answered no, these systems are primarily governed by the prudent man rule - the main restriction that is in law associated with them is that no more than 65% of their portfolio can be in equity securities. None of these systems are even approaching 65% because of the move to diversification.

Senator Adley asked how his firm is compensated for their services. Mr. Meals said they are paid a fixed management fee by the systems for what they do. Mr. Meals said with two of the systems there is a potential incentive program that if hit certain targets, like if the portfolio achieves better than the 7.5% return, there is a fixed dollar amount that can be earned, about 1/3 of the standard contract. Also if this is the best performing public fund in Louisiana, there can be a small additional amount paid to CGS. But his firm is not paid based on the investments they make. Senator Adley asked for the terms of his contract. Mr. Meals said with each of the systems they operate off a 30 day cancellation policy. They can terminate their relationship at will, with or without cause, with a 30 day notice. Senator Adley asked when the last time an request for proposal (RFP) had been done for consultants. Mr. Meals stated he has been the consultant for NOFPRF for over 10 years, and for MERS and FRS for about seven years, but was not aware of either systems having done an RFP during his tenure. He hopes that is a reflection of their satisfaction with the service given, because they have the ability to cancel any time with 30 days' notice.

Senator Adley said every year it is a battle over the UAL because not getting the 7.5% yield, and asked if the systems will get 7.5% yield this year. Mr. Meals said for year ending June 2012, not a chance, but for year 2013 he believes the portfolio is positioned in a way that it has a reasonable chance to do that.

Representative Greene asked when the last time Mr. Meals signed a contract with the systems. Mr. Meals replied initially the contracts had a three year renewal, but because of the 30 day out clause, the systems basically just let it go on a month to month basis. He was not sure exactly when he last signed a contract, but the rate remains the same and would require an amendment to the contract to change the rate. Mr. Meals said the first year he took a discounted fee, but because he delivered the services satisfactorily, he received the full fee the following years.

Senator Smith asked if there is an industry wide, accepted UAL balance or percentage, and complimented the systems he represents because well-funded. Mr. Meals replied he did not know of any universally accepted numbers, but his understanding is for most publicly defined benefit systems to evaluate the UAL to look at what period of time like a mortgage can be amortized over 20-30 years, that is generally deemed to be financially sound.

Gregory Curran, Actuary for ROVERS, MERS and FRS, said there is not an industry standard percentage because as actuaries they are tasked with making sure that their long term assumptions are to produce either on average a gain or a loss that would offset over time. Obviously, since 2008 that has not happened. Their boards have been reviewing investment assumptions for the plans and recommended

changes to a number of our systems and continue to do that to review the investment assumptions. Actuaries review for a much longer period of time than an investment consultant. These are big ships and do not want to move quickly in response to good or bad news. In the late 90's, policy makers wanted actuaries to increase the assumed rate of return because average rates of return exceeding 8% almost universally. Actuaries resisted doing that because of our long term perspective and belief that over time better to be conservative. In 2008, it certainly was a game changer for many of the plans who suffered 25-30% investment losses. The results of those returns will be felt for many years based on their techniques on purpose because we would not want the employers to pay employer contribution rates based on what happened in 2008 immediately. Also 2009 was a positive year and somewhat offset the losses. Mr. Curran said what the Legislature hears from the state and teachers' systems, which have a different mechanism for UAL than the systems here today, so hard to compare the two. But the methodology chosen by the systems and legislature and actuaries in the time when these systems became actuarially funded was to have a frozen unfunded liability that only looked back pre-1989. It was set to pay back unfunded liability by 2029, and everything else that happens in these plans are paid by employers through the normal cost, which means that we are stretching out the payment for any good or any bad investment news, etc. Therefore this is a mortgage like unfunded liability that will be paid off on a schedule and all good and bad experience will be paid off based on the demographics of the plan. A younger plan with high turnover is going to have less impact to the bottom line when bad news occurs. Older plans with larger retired populations will have a harder hit to the bottom line when bad years. The demographics affect the systems greatly, such as the high turnover in the sheriff's retirement system helps to make it less reactive to losses.

Mr. Meals said he is aware of the issues this state faces regarding UAL, and saw statistics recently that almost 90% of the defined contribution plans in the United States are in an underfunded position now. It is the result of weak market performance and would share the chart if he finds it.

Senator Smith asked if unable to compare UAL overall between various systems because of demographics, is there an unacceptable rate. Mr. Curran replied the boards have discussed the level of risk to the employers and the employer rate in their plans. His advice as an actuary is to set assumptions reasonably, and to not change quickly every time something good or bad happens because may cause loss of what trying to achieve with actuaries' methods. He admitted trying to give the systems an employer contribution rate as level as possible, but difficult with the volatility of the market. Without the smoothing actuarial techniques, it would be even worse.

Senator Smith commented it would be impossible to have 100% funded retirement system. Mr. Curran compared the social security system to the actuarially funded retirement system, as well as older and newer systems' issues. Mr. Curran said he believes Louisiana is doing the best of any state, and that Louisiana's laws and constitution are imperfect in their attempt to fund benefits, but Louisiana is doing more than any other state to try to fund and prepare to pay benefits.

Senator Smith asked for the financial definition of the court ruling that Fletcher is insolvent based on cash flow. Mr. Meals replied he is not an attorney, but insolvency means the inability to immediately meet its financial obligations, and thus liabilities exceed assets. Senator Smith commented there are two parties vying for control of the assets to disperse them. Mr. Meals said he understands Fletcher was trying to control the liquidation of the assets, and the liquidators wanted to get it under an independent parties' control. Mr. Stockstill asked Senator Smith to redirect any questions from their investment consultant who has had zero involvement in the litigation to himself. Senator Smith asked for the percentage of each of the systems' assets invested in the Fletcher Fund. Mr. Stockstill said \$45 million out of \$1.1 billion, and hoping to get all the money back. Mr. Meals pointed out it was under 5%. Mr. Stockstill said this amount will register, but not be a huge actuarial disaster.

RECOVERY SCHOOL DISTRICT - LDOE - CAPITOL CONSTRUCTION PROGRAM

Mr. Purpera stated that during the 2011 Session, in the Senate Governmental Affairs Committee, a discussion of the Recovery School District (RSD) construction efforts led to his office being asked to perform a continuous audit of the construction activities.

John Morehead, Director of the Recovery Assistance Services, presented the compliance audit report on the Recovery School District - Capitol Construction Program issued June 13, 2012. Mr. Morehead discussed all the findings and recommendations listed in the audit, pointing out that change orders has been RSD's main problem area. He commended the RSD staff on their assistance during the audit process.

Senator Murray asked if the New Orleans Inspector General was also working on the audit of the RSD construction efforts. Mr. Purpera replied that after a meeting with John White, then Superintendent of RSD, and with Mr. Quatreveaux, New Orleans Inspector General (NOIG), they lined up what items would be covered by the LLA and by the NOIG.

Senator Murray questioned a change order that occurred prior to the contract signed. Kelly Russell, LLA Construction Manager, replied he was not aware of that issue, but the normal procedure is to

have all permits and contracts signed before putting out for bid. He said if some design change occurs after the bids are requested, it immediately becomes a change order without further bidding and up to the contractor on what price they pay. Then the project manager, architect and the owner have to decide if the pricing is reasonable, and usually they are at a disadvantage to the contractor.

Senator Murray asked about the additional labor costs on change orders and the industry index that determines if the costs are reasonable. Mr. Russell explained labor burden which is generally the costs paid by the employer on behalf of the employees which include the social security and unemployment taxes. The state contract from Facility Planning & Control (FP&C) that RSD uses has a very narrow definition of what labor burden is - only four things. However, in the construction industry, they add many other costs - extra types of liability insurance, car insurance, etc., and it is not uncommon to find labor burdens of 40-50%. If follow the strict labor burden from FP&C it will vary from 10-30%, and 30% is for the most dangerous positions. As shown in Table 5 of the report, the labor burden charged to RSD exceeded the normal range. The contract states that prior to submission of a change order, the contractor is to submit what his labor burden is by trade. RSD did receive labor burden for the whole company which included various trades, so it is impossible to calculate how much they were being overcharged because not known which trade worked on the particular task. Mr. Russell said his recommendation to RSD was to change their contracts to require labor burden by trade.

Senator Murray asked if a project manager is supposed to oversee this issue. Mr. Russell said the architect is supposed be the first person to review a change order, and give a professional opinion regarding the quantity of work which produces a certain number of hours and also review the rates for the work as well. Then the project manager is supposed to be the second check on the change order and determine what is reasonable. The owner will then review and also have their consultants review it, and then all three would sign off on the change orders. Senator Murray asked if during the LLA's review they saw this procedure was followed. Mr. Russell confirmed there was a lot of communication on several change orders when the architect would tell the contractor that charges were not reasonable, and happens regularly on construction jobs. Mr. Russell said they did find some instances where change orders were overlooked and unreasonable prices were charged, which were pointed out to RSD. He showed in the report the comparison to R.S. Means pricing, which is considered a respected published pricing. He found in his research two change orders for the exact same work, but one change order approved was 247% more than the other.

Representative Jackson asked if they ever recommended design build as a practice which would cut out a lot of change orders. Mr. Morehead replied he has not made that recommendation, which is a management decision on how they choose to build, and there may be impediments to that method given the relationship that RSD has to maintain with Orleans Parish School Board (OPSB). It is not just rebuilding RSD schools but Orleans Parish Schools and OPSB is a part of that. The same project manager oversees both sides of that. Representative Jackson said based on the overcharges on the change orders, a lot could have been eliminated through design build.

Lona Edwards Hankins, Director of Capital Improvements for RSD, said she concurred with most findings except the testing because it has to do with the procurement process and how far in advance must plan things. The challenges include that BESE meets every two months to review contracts, and the contractor contacts the vendor that tests concrete aggregate and is responsible for the cost. If it rains or there is a delay and he does not call or notify RSD appropriately, RSD still has to pay for the testing firm to go to the site for a cancellation fee. So it is a coordination issue that she is trying to avoid the overage of costs by doing it the other way.

Senator Murray commented change orders have been the main issue, because the change of scope has even happened, and asked how RSD can get a better handle on the change orders. Ms. Hankins replied that the change order rate is 2% across their open contract portfolio of about \$350 million. There are some specific challenges, and they have worked with Jacob CSR to implement consistent change order review process across their portfolio, so they would not have inconsistent performance between one project versus another. Ms. Hankins said that Jacobs has also brought on an estimator who will validate their estimates across the portfolio so they could see the cost for the same scope of work across the board to avoid the overage of costs. Senator Murray asked if it should have been done from the beginning. Ms. Hankins replied probably so and explained the program was ramped up quickly in 2008 and it has been a continuous improvement process. Senator Murray asked about a DBE program set up with RSD construction. Ms. Hankins said for contracts going forward it is in effect, and for the Carver School it will be the first contract with that language in it.

Senator Adley asked Beth Scioneaux, Department of Education Undersecretary, if she heard the conversation earlier in the meeting about the auditor not being involved unless included by BESE's rules in the audit of the scholarship dollars going to public schools. Senator Adley gave Ms. Scioneaux a copy of the letter addressed to Ms. Dastugue and Mr. White requesting that rules be adopted for the scholarship program that would ensure the Legislative Auditor would have access to all the records just as he has with anyone else. Senator Adley requested that Ms. Scioneaux ensure that Mr. White received a copy of the letter. He asked if she knew whether the Department of Education did not want the LLA to audit, or just assumed that BESE would take care of it.

Ms. Scioneaux stated there is a statute which already requires an audit as originally implemented and as Act 2 stands now, there is a requirement for a limited scope audit with regards to payments. That has been carried out in the past with the previous scholarship program, and in the participation rules it does state that the audits will continue and any noncompliance with this existing audit, the schools would be subject to discipline. Senator Adley asked if because of that limited audit that the LLA is not allowed to audit the charter schools in New Orleans. Ms. Scioneaux said she would have to get him that information. Senator Adley asked her to let Mr. White know the letter outlined his concern, and would appreciate a call from Mr. White because hoping to keep transparency in this process.

Mr. Purpera said he does agree with Ms. Scioneaux that there is an audit responsibility in the education law, but it does not give him the authority to follow those scholarship dollars, and it is a fairly limited scope audit. Senator Adley asked if Mr. Purpera is allowed to follow MFP dollars. Mr. Purpera answered he can if those dollars go to a public school system. Senator Adley said by law, charter schools are defined as public, but they are not a system. Mr. Purpera said the charter schools must have their annual audits approved by his office, and submitted to his office, and if an allegation of fraud, he can look at those dollars. Senator Adley stated that BESE needs to make that same authority for the LLA regarding the scholarship dollars.

Senator Murray asked if all the schools in New Orleans receiving scholarships submit audits to the Department of Education (DOE). Ms. Scioneaux said for the least expensive route, DOE actually used some of its money to get one audit firm approved by the LLA to audit all the schools in regard to their payments, and whether the submitted information substantiated the payments they were receiving based on the students attending those schools. Senator Murray asked if the audit was basically matching the number of students to the amount given to the schools, but not auditing how those dollars were spent. Ms. Scioneaux said that was correct, because the law states the schools can only be paid for the students that are attending. Senator Murray asked why DOE did not think that an audit of how that money was spent by the schools was important. Ms. Scioneaux replied that they are following the law.

OTHER BUSINESS

Mr. Purpera complimented his performance audit staff for receiving the Excellence in Accountability Award by the National State Auditors Association.

Mr. Purpera informed the council that the following Monday would be a court hearing regarding the appointing of a fiscal administrator over the Town of Jonesboro as deemed necessary by the Fiscal Review Committee.

ADJOURNMENT

Senator Murray made the motion to adjourn, and with no objections, Representative Greene adjourned the meeting at 3:20 p.m.

APPROVED BY:



REPRESENTATIVE HUNTER GREENE
CHAIRMAN



DARYL G. PURPERA
SECRETARY

09/26/12
DATE