

Honolulu, Hawaii

March 5, 2010

RE: H.B. No. 2200  
H.D. 1

Honorable Calvin K.Y. Say  
Speaker, House of Representatives  
Twenty-Fifth State Legislature  
Regular Session of 2010  
State of Hawaii

Sir:

Your Committee on Finance, to which was referred H.B. No. 2200 entitled:

"A BILL FOR AN ACT RELATING TO THE STATE BUDGET,"

begs leave to report as follows:

#### **Introduction**

The 2009 Legislature was faced with an unprecedented budget challenge - a three-year shortfall of approximately \$2.1 billion. Although a balanced budget and financial plan were adopted by the Legislature by the end of the 2009 session, revenues continued to slide, and by January 2010 the State was faced with another daunting budget shortfall of approximately \$1.2 billion over a two-year period.

It appears that the budget submittal to the Legislature consists mostly of one-time, expeditious solutions including furloughs, layoffs, deferred payments, and delayed tax refunds. While these solutions are quick and easy to accomplish, the full effects of these actions are unknown and may have lasting effects on many. Only those solutions requiring controversial and difficult decisions remain. This budget is one piece of an integrated plan to address several key questions:



- How far can we cut government programs and services?
- What programs and services are we willing to live without?
- Are we willing to pay more for the programs and services we want?
- What do we want Hawai'i to look like when the recession ends?

A year ago, your Committee noted that:

*"The solution to our current problem must therefore be both systemic and sustainable. In short, this unprecedented challenge is an opportunity to re-evaluate the purposes and goals of certain functions of government so that fundamental change can occur to better meet the needs of our people. However, your Committee recognizes that discussions on making fundamental change will require more time . . ."*

It is questionable whether the Administration actually performed this evaluation. In adjusting the 2010 supplemental budget, your Committee recognizes that the solution to our problem must involve more than closing down state services on Fridays or cutting personnel.

#### **Approach**

The budget and financial plan submitted to the Legislature relied on:

- Taking personnel actions to furlough or lay off state employees;
- Increasing taxes and taking revenue from the counties;
- Delaying tax refunds to taxpayers; and
- Deferring the payment of certain obligations to future years.



A reduction-in-force (RIF) procedure was implemented and hundreds of state jobs were eliminated. Analysis by your Committee indicates that the RIF terminated nearly 1,000 employees, generating roughly \$43 million in general fund savings.

In contrast, the furloughs negotiated between the Governor and the various labor unions will result in a savings of approximately \$198 million for FY 2010-2011.

Unfortunately, great reliance was placed on one-time solutions to solve the State's deficit problem instead of focusing on core government functions and services. More disturbing, however, is the magnitude of the needs left unmet in the Administration's budget. In particular, unpaid Medicaid reimbursements for FY 2008-2009 and projected budget shortfalls in FY 2009-2010 and FY 2010-2011 have reached \$146.5 million.

This approach to the budget leaves a gap between revenues and expenditures, creating a structural deficit that will become more serious the longer difficult budget decisions are delayed.

In crafting this budget and financial plan, your Committee:

- Analyzed and cut expenditures in specific programs, rather than employing an "across the board" budget cutting approach;
- Evaluated program performance in order to determine where to cut expenditures as well as restore critical functions of government; and
- Raised revenue by repealing tax exemptions, transferring excess non-general funds to the general fund, and temporarily suspending and restructuring tax credits.

In its evaluation of the budget, your Committee discovered numerous consequences to both the RIF and furloughs -- consequences that may not fit with a vision of what Hawai'i can and should be. Although complete restoration is neither possible nor warranted, your Committee embarked on a deliberate process to balance the budget, mindful of that enormous responsibility.



### **Bond Rating Agencies**

Currently, Hawaii's G.O. bonds are ranked:

- 'Aa2' by Moody's Investors Service with a negative outlook;
- 'AA' by Fitch Ratings with a negative outlook; and
- 'AA' by Standard & Poor's with a stable outlook.

In its February 4, 2010, report, "Moody's Investors Service" noted that:

*"The negative outlook also reflects Hawaii's narrowed financial operations as underscored by significantly lower reserve levels and payment deferrals that indicate liquidity challenges; and out-year structural gaps due to one-time solutions already incorporated in the enacted budget and proposed for the recently identified budget shortfall."*

According to Moody's, maintenance of structural budget balance, rebuilding and maintenance of strong reserve levels, and annual funding of pension and other post-employment benefits annual required contributions are factors that may raise Hawaii's G.O. bond ratings.

Moody's also stated that increased use of non-recurring solutions to balance the budget and failure to adopt a plan to cover expenditures once federal stimulus moneys are no longer available may lower Hawaii's G.O. bond ratings.

Your Committee on Finance shares these concerns.

### **RIF Determination**

Your Committee agrees with the Administration that state government can be cut using layoffs as a tool. No organization the magnitude of state government can be perfectly efficient. However, efficiencies should drive layoffs, and not the other way around. An organization that is looking to downsize should assess its own strengths and weaknesses, eliminate redundancies and inefficiencies, and make needed adjustments. It appears that the Administration has not performed a programmatic analysis of its



own operations and has laid off workers without regard for the resulting impact on services or how layoffs might generate inefficiencies. Repeated questioning of various directors and agency heads could not uncover a single policy providing guidance for these layoffs. Equally troubling was the disclosure that individual termination decisions came from the Governor's office and her staff.

RIFs in the Department of Human Services (DHS), Department of Agriculture (DOA), and Department of Health (DOH) have the potential to irreparably harm Hawaii. Your Committee found it essential to find alternatives to these budget cuts, budget cuts which could:

- Keep children in dangerous, life threatening environments;
- Jeopardize the safety net for those who need it the most;
- Prevent the systematic inspection of airport and harbor facilities and allow invasive species to enter the islands; and
- Endanger the state's food supply.

With this in mind, your Committee restored critical programs decimated in the budget, and provided alternative adjustments. In making these difficult choices, your Committee not only sought input from department directors and managers of state programs, but also from those who implement these programs and are intimately involved in their success or failure. Front counter personnel, intake workers, and line agents provided guidance and advice on budget cuts and service impacts. Finally, your Committee took into careful consideration the effect of these programs on the lives of those who depend on them.

### **Contract Reductions**

To generate additional savings, your Committee on Finance also looked at cutting contract costs. This was a difficult task as the various agencies were, in many areas, either unwilling or unable to provide requested information on a timely basis.

Your Committee was especially mindful of the expenditures of the Office of School Facilities and Support Services of the Department of Education (DOE), which houses the bus



transportation, food service and repair and maintenance of school facilities. Two Auditor's Reports released in February 2009 (*Procurement Audit of the Department of Education: Part 1 and Part 2*, Report Nos. 09-03 and 09-04) focused on these areas.

Furthermore, your Committee has learned of a DHS purchase of service (POS) contract with the individual who is now leading the department's reorganization known as the Eligibility Processing Operations Division (EPOD) re-organization. When delving into this individual's past, your Committee is puzzled by DHS's decision to hire this individual. This individual left the position of Director of Adult and Family Services in Oregon apparently to pursue private consulting. A December 15, 2009, article in the *Willamette Week Online* reported that this individual was:

*"frequently and vociferously criticized by advocates for the poor for making it harder than necessary to get food stamps and cash assistance."*

In light of this example, your Committee finds that DHS has used questionable judgment in awarding POS contracts.

Your Committee was also informed by DHS of several agencies that double charged the department. In response, your Committee has eliminated those contracts. As a result of contract savings, your Committee was able to restore personnel lost due to vacancies or layoffs in the most needed areas.

Additionally, your Committee restored position counts abolished by the Administration when it cut vacant or filled positions. Restoring these position counts will maintain cost savings from RIFs, while enabling these positions to be filled immediately, should the current or future Administration find funding for these positions.

#### Department of Human Services

During an economic downturn, individuals depend even more on the social safety net than in times of economic prosperity. The loss of these services, however slight, will put additional strain on vulnerable populations that are already under a great deal of pressure simply to make ends meet. While the State needs to cut expenditures to close a significant budget gap, reducing DHS funds and personnel who provide protection to our vulnerable populations will only exacerbate an already critical situation. Your



Committee is concerned with the direction current management is leading DHS.

Your Committee is perplexed that DHS reduced a total of 21 percent of its positions, including vacancies, during the RIF process in the fall of 2009. A RIF of this size will have a severe and enduring impact on quality service delivery. While the Director and the Department's division heads consistently insist that their proposed reductions will result in no change in service delivery to the public, line staff has reported a workload increase of up to 400 percent.

Child Welfare Services (CWS) lost 24 percent of their positions in the recent RIF, most of which involve direct contact with children. The loss of personnel has increased the size of geographic service regions, putting additional strain on line workers in conjunction with the increased workload.

DHS's own policies and procedures require a CWS investigator to attempt to make contact with a client within 48 hours of an initial report. Currently, some investigators have reported cases where initial contact was not able to be made for weeks because of staff shortages. While your Committee is troubled by DHS's lack of adherence to its own established policies, your Committee is very concerned about the safety and well-being of Hawaii's children, and feels that this division requires immediate attention before another preventable child fatality occurs. Consequently, your Committee has restored the CWS positions cut by the RIF, and has also funded position vacancies.

Furthermore, your Committee is troubled by the recent news of the planned department re-organization known as EPOD. This re-organization will eliminate 31 eligibility offices and 230 eligibility workers, leaving only one office on Oahu and one on the Island of Hawaii. Your Committee notes that federal rules require face-to-face interviews. These interviews are critical to assist in prosecuting welfare fraud. Your Committee is concerned that the proposed EPOD will not sufficiently address this federal requirement. The conversion of traditional eligibility determination procedures to an electronic format will make the State welfare system more susceptible to abuse with the concomitant negative fiscal impact.

Finally, your Committee is puzzled that DHS was not able to produce a Temporary Assistance to Needy Families (TANF) financial plan prior to the start of the 2010 legislative session as



required by Section 156 of Act 162, SLH 2009. Your Committee notes that the TANF financial plan, once delivered, did not account for TANF additions that were included in the budget, and relies upon American Recovery and Reinvestment Act and Deficit Reduction Act extensions through 2014. In other words, the DHS TANF financial plan relies on congressional action that has not occurred. Also of concern is the proposal to change the method of funding for two-parent families from general funds to TANF funds. This change will impose a work participation rate of 90 percent, in line with TANF requirements, on enrollees, which is unrealistic given current job market conditions. As a result, your Committee has denied all additions to TANF spending.

#### Department of Health

Your Committee commends DOH for its continued hard work in carrying out a wide array of increasingly difficult tasks while faced with a shrinking pool of resources.

However, the critical role DOH holds in keeping Hawaii's people healthy and vibrant demands this department maintain an adequate level of staffing. Therefore, your Committee has restored position counts to levels similar to those set prior to the RIF taken in the fall of 2009, so that DOH will have the ability to hire staff necessary to carry out its duties.

Your Committee finds that the restoration of DOH position counts is essential in light of your Committee's decision to cut funding for POS contracts. After careful examination of DOH's large number of POS contracts, your Committee believes that a consolidation of contracts to increase efficiency will bring about cost-savings for DOH. Renegotiation with service providers may also be necessary to find an equitable and uniform cost-per-client price for each service provided. However, until DOH can standardize costs for these contracts, your Committee believes it is more cost-effective for DOH to provide these services with its own staff.

#### Department of Education

Unlike other state departments, with the exception of the University of Hawaii (UH), the Department of Education (DOE) did not impose staff reductions or vacancy reductions, and instituted minimal operating cost reductions in FY 2009-2010. Rather, the Board of Education (BOE) relied on furloughs to address the necessary departmental budget reductions.





Furlough Fridays have affected all public school students. To help address this unfortunate situation for the next school year, your Committee has appropriated \$50,000,000 in general funds to the Department of Education, Public Libraries, Charter Schools, and the department of Budget and Finance. While recognizing that this amount is less than half of what may be needed to fully restore all instructional days, your Committee feels this encourages all parties to come to the negotiating table to find a solution.

Your Committee has found that while student enrollment in the public schools steadily declined from 1999-2009, falling approximately four percent, total funding for DOE -- considering all funding sources -- nearly tripled during that same period, increasing from approximately \$987,000,000 to \$2,800,000,000. Your Committee notes that federal regulations regarding special education and those contained in the No Child Left Behind Act (NCLB) were instituted during that time, and now comprise \$402,000,000 of the current \$1,700,000,000 budget proposal.

While BOE has approved of the proposed budget cuts in overall dollars, it has not approved any breakout of funding cuts within the department. Although DOE's suggestions for the distribution of these cuts include reductions in federal funds to carry out NCLB requirements, your Committee restored these funds both to ensure compliance with federal mandates, and because these are federal funds not tied to any general fund expenditures. In addition, in light of the nation's current fiscal environment, your Committee anticipates a modification in those federal mandates, as each state struggles to maintain the funding needed to fulfill them.

To avoid increasing the number of furlough days to address the budget crisis, your Committee identified areas in which efficiency could be improved. Your Committee has crafted a budget that would involve reductions in POS contracts to spread the burden of general fund shortfalls among those who have been benefiting from private contracts with DOE but have not experienced cuts in funding for those contracts. Also, based on feedback received from teachers indicating that instructional support seminars and classes are too often unproductive and wasteful of teacher time, your Committee has reduced funding for these programs.



### *Libraries*

Your Committee finds that while library usage soars during economic downturns, Hawaii's library system has been struggling to maintain services to the public during this time of heavy budget cuts. Any further cuts would force the closure of branches in rural areas. Closure of facilities that serve as community centers as well as lending libraries at a time when use of the library system has increased would be detrimental to the public. Given the importance of the services provided by public libraries, your Committee has funded an increase in their hours of operation.

### *Charter Schools*

Your Committee has struggled this session to obtain necessary information on the sources and uses of all funding for charter schools, as they continue to operate without full participation in the budget process. The Charter School Administrative Office (CSAO) was unable to provide documents required for the budget briefing in January. In addition, instead of reflecting the proposed reduction in their budget submittal for FY 2010-2011, the charter schools submitted a budget that included an additional \$22,424,611 - a 43 percent increase in general funds over the budget proposal.

Your Committee is concerned with the inability of CSAO to provide information in an accurate and comprehensive fashion. For example, Act 162, SLH 2009, required charter schools to submit, prior to the convening of the 2010 legislative session, a report detailing all means of financing for the current and next fiscal year and actual expenditures for the last completed fiscal year for each charter school, together with a report of all other funds expended on behalf of each school. Unfortunately, three charter schools did not comply, rendering the report incomplete. It is also notable that the charter schools did not comply with the requirement in Act 162, SLH 2009, that they submit a report for each charter school on the internal policies and procedures for procurement.

Your Committee has worked diligently to encourage the charter schools to be transparent and accountable for the State funding they receive, but has found it necessary to go directly to the individual charter schools for funding information. The insistence by charter schools that they should not be held accountable in the same manner as other State entities is troubling, as they willingly partake of State funds. In light of



the ongoing lack of transparency and accountability for funding between the charter schools, the CSAO and your Committee, this Committee's concerns are reflected in the bill through a proviso which requires each charter school to utilize a portion of their funding to conduct an independent annual financial audit that will be submitted to the legislature prior to each regular session

In light of the claim by the charter schools that their budget reduction has left many schools struggling to survive, your Committee finds the existence of two advocacy entities -- CSAO and the Hawaii Charter School Network -- both funded either in part or in full by the charter schools, may be excessive to meet the needs of approximately 8,500 charter school students.

#### Department of Agriculture

The budget proposal reduces DOA's general funds by 44 percent, the largest reduction in general funds of any executive department. When put into perspective, the change to DOA will be profound and will have a severe impact on Hawaii's agricultural resources and environment.

Therefore, your Committee restored 59 positions, with the majority in the Plant, Pest, & Disease Control Division. Restoration of these positions will help DOA address the issue of invasive species.

#### Department of Public Safety

Your Committee recognizes the importance of maintaining public safety while providing adequate health care to Hawaii inmates, who are currently housed at in-state and out-of-state facilities, and also recognizes the difficulties the current fiscal crisis has placed on the Department of Public Safety (DPS). On March 14, 2007, the United States Department of Justice (DOJ) issued a Findings Letter that concluded that certain conditions at the Oahu Community Correctional Center (OCCC) violated the constitutional rights of detainees of OCCC. Based on that Findings Letter, the State and DOJ entered into a settlement agreement in which the State agreed to provide adequate mental health care to detainees at OCCC.

As a result of the settlement agreement, the 2008 Legislature authorized 28 positions to bring the State into compliance with the DOJ settlement agreement and to address mental health care and other health care issues at OCCC, Halawa Correctional Facility,



and the Women's Community Correctional Center. To date, only six positions have been filled, although the State must come into substantial compliance with the DOJ settlement agreement by June 2011.

In addition, while DPS must be commended for its attempt to prioritize its core functions by requesting the abolishment of all of its security officer positions, your Committee finds that this will adversely affect DOH's budget because a majority of these security officers are assigned to the Hawaii State Hospital and the Waimano Hospital and Training School. Abolishing these positions may provide some savings for DPS but does not provide any savings to the general fund as the DOH will need to find, and fund, its own security.

#### Department of Labor and Industrial Relations

Your Committee has concerns about operational and fiscal management of Hawaii Occupational Safety and Health Division (HIOSH), which is currently under an audit investigation regarding these issues. Your Committee has learned that without proper fiscal and operational management, the State may have to reimburse the Federal Occupational Safety and Health Administration for inappropriate spending by DLIR. To help address these concerns, your Committee restored all positions of HIOSH that were eliminated.

#### **Capital Improvement Projects Program**

Consistent with ongoing efforts to prepare a fiscally responsible budget that will also stimulate our economy, your Committee has restructured the State's capital improvement projects (CIP) program to maximize the use of all available resources.

Earlier, the Administration submitted an austere budget request for \$879,907,000 for G.O. bond-funded projects. This represented a reduction of \$75,248,000 or 12.7 percent less than what the Administration had submitted prior to the Regular session of 2009.

Using the Administration's request as a starting point, your Committee examined all existing G.O. and G.O. reimbursable bond funded projects that the Administration has not acted upon and re-



appropriated these resources toward construction-ready projects, wherever possible.

In total, your Committee recommends the appropriation of \$990,305,000 in G.O. and G.O. reimbursable bond funds, and a grand total of \$3,894,638,000 for all means of financing. In making this recommendation, your Committee is confident that our limited resources will be used in a manner that best spurs construction and economic revitalization within our State.

Education, especially lower education, continues to be a key component in the supplemental CIP budget. Accordingly, the supplemental budget includes an additional \$30,000,000 for the repair and maintenance of our schools beyond what was requested by the Administration. In addition, because most of our schools are aging, your Committee has provided an additional \$30,000,000 specifically to upgrade electrical systems in school facilities statewide.

Higher education remains a priority in this supplemental budget. Therefore, your Committee has added \$31,000,000 for a new building for the Hawaiian language program at UH-Hilo. The sum of \$24,000,000 has also been earmarked for the construction of the UH West Oahu campus.

Lastly, the 2009 Legislature appropriated \$30,000,000 in FY 2009-2010 for the Rental Housing Trust Fund (RHTF) in the Hawaii Housing Finance and Development Corporation (HHFDC) to provide additional affordable rental housing. However, the Administration proposed to lapse the entire amount, despite HHFDC's objections that such action would effectively preclude it from carrying out its primary functions. Accordingly, your Committee has re-appropriated \$10,000,000 into the RHTF.



### National Outlook

In December, 2009, fiscal committee chairs from approximately 30 states met in San Diego prior to the National Conference of State Legislatures (NCSL) Fall Forum. A November, 2009, budget survey of the 50 states that was released at the conference revealed that:

- "State lawmakers closed a cumulative budget gap of \$145.9 billion in their FY 2010 budgets. ... midway through FY 2010 for most states, new gaps have opened";
- "To date, states have reported a total estimated budget gap of \$428.5 billion (FY 2008 through FY 2012)";
- "Ironically, a contributing factor to future state budget gaps is the end of federal stimulus funds provided by the ARRA"; and
- "Despite a growing consensus that the national recession - the principal cause of state fiscal problems - has ended, state finances will not recover in the near term. **History shows that state budgets continue to struggle long after a recession ends.** [emphasis added]"

The NCSL report noted that:

*"The state revenue nightmare continues. Officials were hopeful that fiscal year (FY) 2009 would mark the bottom of the revenue plunge, but their hopes have been shattered. Not only have revenues continued to fall below expectations, they are projected to be anemic for years to come. This means another round of budget gaps, certainly in FY 2010, but even beyond in many states."*

The fiscal challenges facing Hawaii are similar to what, according to this information, many states are currently facing.



### Conclusion

As the current economic situation runs its course, your Committee asks this question: What do we want Hawaii to look like when the recession is over?

Your Committee crafted a budget that recognizes the need to reduce expenditures while being responsive to the most essential services that state government provides -- caring for those least able to care for themselves, protecting our natural resources, and cultivating an environment where our children thrive.

Budget cuts are necessary, but they should be thoughtful and responsive, rather than haphazard. Additionally, public input as to the impact of budget reductions should happen before they occur, not after.

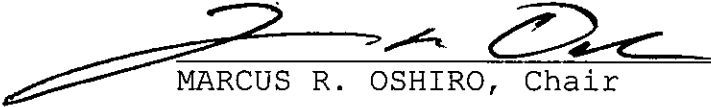
Your Committee notes that the general fund budget has been reduced significantly in recent years. Act 158, Session Laws of Hawaii (SLH) 2008, the supplemental budget for fiscal year (FY) 2008-2009, appropriated \$5,318,212,647 in general funds for FY 2008-2009. In contrast, this draft of the supplemental budget appropriates \$4,858,822,596, an 8.6 percent decrease, for FY 2010-2011.

For the operating budget, this draft appropriates \$4,858,822,596 in general funds and \$10,050,017,231 in all means of financing for FY 2010-2011. In contrast, the original proposal by the Administration appropriated \$4,919,353,775 in general funds and \$10,089,112,150 in all means of financing. This is a reduction of \$60,531,179 in general funds and \$39,094,919 in all means of financing from the Administration's proposal.

As affirmed by the record of votes of the members of your Committee on Finance that is attached to this report, your Committee is in accord with the intent and purpose of H.B. No. 2200, as amended herein, and recommends that it pass Second Reading in the form attached hereto as H.B. No. 2200, H.D. 1, and be placed on the calendar for Third Reading.



Respectfully submitted on  
behalf of the members of the  
Committee on Finance,

  
MARCUS R. OSHIRO, Chair





