STATE OF ARIZONA

Joint Legislative Budget Committee

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JOINT LEGISLATIVE BUDGET COMMITTEE
Thursday, October 18, 2007
9:30 a.m.
House Hearing Room 4

MEETING NOTICE

- Call to Order
- Approval of Minutes of September 20, 2007.
- DIRECTOR'S REPORT (if necessary).
- EXECUTIVE SESSION - Arizona Department of Administration - Risk Management Annual Report.

1. AHCCCS - Review of Proposed Acute Care and ALTCS Capitation Rate Changes.
2. DEPARTMENT OF ECONOMIC SECURITY - Review of Increase to Division of Developmental Disabilities' Therapy Rates.
3. DEPARTMENT OF PUBLIC SAFETY - Quarterly Review of the Arizona Public Safety Communications Advisory Commission.
4. ATTORNEY GENERAL - Review of Allocation of Settlement Monies.
5. ADMINISTRATIVE OFFICE OF THE COURTS - Review of Expenditures of Judicial Collection Enhancement Fund and Criminal Justice Enhancement Fund.
6. ARIZONA STATE UNIVERSITY - Review of Downtown Phoenix Campus Operational and Capital Plans.
7. ARIZONA DEPARTMENT OF REVENUE - Review of Business Reengineering/Integrated Tax System Contract Amendment.
8. ARIZONA COMMISSION ON THE ARTS - Review of the Arizona Arts Endowment Fund and Private Contributions.

9. ARIZONA DEPARTMENT OF ADMINISTRATION
   A. Review of Risk Management Deductible.
   B. Rule 14(3)(P) - Report on Loss Prevention Plans.

10. JLBC STAFF - Consider Approval of Index for School Facilities Board Construction Costs.

The Chairman reserves the right to set the order of the agenda.
10/11/07

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MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

September 20, 2007

The Chairman called the meeting to order at 9:40 a.m., Thursday, September 20, 2007, in House Hearing Room 4. The following were present:

Members:	Representative Pearce, Chairman	Senator Burns, Vice-Chairman
	Representative Biggs	Senator Aguirre
	Representative Boone	Senator Flake
	Representative Cajero Bedford	Senator Harper
	Representative Lopez	Senator Verschoor
	Representative Rios	Senator Waring
	Representative Yarbrough	
Absent:	Representative Adams	Senator Aboud
		Senator Garcia

APPROVAL OF MINUTES

Hearing no objections from the members of the Committee to the minutes of August 16, 2007, Chairman Pearce stated that the minutes would be adopted.

DIRECTORS REPORT

Mr. Richard Stavneak, Director of the Joint Legislative Budget Committee (JLBC), stated that at the August 16, 2007 meeting, the Committee gave a favorable review to 44 out of the 73 positions requested by the Department of Health Services (DHS) with a request that additional information be given by DHS on the remaining 29 requested positions. DHS has since stated that they will be hiring only the appropriated amount of 44 FTE Positions in FY 2008.

DEPARTMENT OF EDUCATION (ADE) - Review of Research Based Models of Structured English Immersion for English Language Learners.

Mr. Steve Schimpp, JLBC Staff, stated that the Review of Research Based Models of Structured Immersion for English Language Learners Task Force was on the agenda for the July 19, 2007 meeting.

Discussion ensued on this item.

Mr. Alan McGuire, ELL Task Force Chairman, responded to member questions.

Senator Burns moved that the Committee give a favorable review to the proposed Structure English Immersion models with 2 conditions:

1) *The review is limited to compliance with HB 2064 and does not extend to the issue of funding, which is an issue to be addressed by the full legislature.*
2) *The models will be implemented in a manner that is consistent with requirements of Proposition 203 from the November 2000 General Election.*

Senator Aguirre moved a substitute motion to not approve recommendation from the Committee. The substitute motion failed.

The original motion carried.

DEPARTMENT OF EDUCATION (ADE) - Review of Draft Request for Proposals for eLearning Pilot Program.

Mr. Steve Schimpp, JLBC Staff, stated that Laws 2006, Chapter 375 established a pilot program to provide mathematics instruction to pupils in Grades 6 through 9 through a digital curriculum. Pursuant to Laws 2007, Chapter 264 (Section 12), the Department of Education (ADE) and eLearning Task Force have submitted for "review and comment" the preliminary Request for Proposals (RFP).

Kathy Poplin, Chair of eLearning Task Force and Deputy Associate Superintendent for Educational Technology for ADE, responded to member questions.

Discussion ensued on this item.

Senator Burns moved that the Committee give a favorable review to the preliminary RFP for the eLearning pilot program. The draft RFP conforms with requirements stipulated in Laws 2006, Chapter 375. The motion carried.

ARIZONA BOARD OF REGENTS (ABOR) – Review of FY 2008 Tuition Revenues.

Ms. Amy Strauss, JLBC Staff, stated that the Arizona Board of Regents is requesting a favorable review from the Committee for their expenditure plan for tuition revenue amounts greater than the amounts appropriated by the Legislature and all locally retained tuition and fee revenue expenditures for the current fiscal year.

Discussion ensued on this item.

Ms. Christine Thompson, Assistant Executive Director for Governor Affairs, Arizona Board of Regents responded to member questions.

Ms. Lisa Price, Associate Vice President for Planning and Budget, Arizona State University, responded to member questions.

The Committee deferred the review to a future meeting. The Committee requested information on the following from the Arizona Board of Regents (ABOR):

1) Overview of need-based and merit-based financial aid system, including detail on the core components of the Free Application for Federal Student Aid (FAFSA).
2) The amount of tuition, books, living expenses that are defrayed by financial aid.
3) The rationale for setting tuition, specifically in light of increased tuition collections.
4) Retention rates for students receiving financial aid.
5) Amount and percentage of financial aid that is federal work study.

ARIZONA DEPARTMENT OF TRANSPORTATION – Review of Third Party Progress Report.

Mr. Bob Hull, JLBC Staff, stated that a General Appropriation Act footnote requires the Joint Legislative Budget Committee to review quarterly progress reports submitted by the Arizona Department of Transportation (ADOT) regarding their progress in increasing third party transactions, the status of third party quality assurance staffing, workload, backlog, the number of existing third parties, and the moratorium on accepting new third parties.

Senator Burns moved that the Committee give a favorable review of the Third Party Progress Report for ADOT. The motion carried.

DEPARTMENT OF ECONOMIC SECURITY

A. Review of Long Term Care Capitation Rate Changes.

Mr. Jay Chilton, JLBC Staff, stated that a footnote in the FY 2008 General Appropriation Act requires JLBC to review the expenditure plan for proposed capitation rate adjustments in the federal Title XIX Long Term Care (LTC) program. Capitation rates are a fixed amount paid for every person in the Developmentally Disabled Long Term Care Program. At the estimated caseload amount, the proposed capitation rate exceeds the budgeted amount by between $2.4 million and $4.4 million General Fund.

The Chairman requested a plan from the agency as to how it intends to rectify the overage.

Senator Burns moved that the Committee give a favorable review of DES' capitation rate changes with the provision that the favorable review does not constitute an endorsement of a supplemental request. The motion carried.

B. Review of Expenditure Plan for Adoption Services – Family Preservation Projects.

Mr. Jay Chilton, JLBC Staff, stated that a footnote in the FY 2008 General Appropriation Act requires the Joint Legislative Budget Committee to review an expenditure plan by the Department of Economic Security (DES) based on the recommendations of the Joint Legislative Committee on Adoption Promotion (JLCAP) for the $1,000,000 appropriation to the Adoption Subsidy – Family Preservation Projects line item.

A previously reviewed expenditure plan had exceeded the appropriated amount by about $800,000. As of the meeting, DES had not submitted a revised expenditure plan to the Committee.

Discussion ensued on this item.

Ms. Mary Gill, Deputy Director of DES, responded to member questions and agreed to give staff a revised expenditure plan.

Senator Burns moved that the Committee give a favorable review of the DES expenditure plan contingent upon submittal to JLBC Staff and provided it is within legislative intent. The motion carried.

Without objection, the meeting adjourned at 11:00 a.m.

Respectfully submitted:

_____
Sandy Schumacher, Secretary

_____
Richard Stavneak, Director

_____
Representative Russell Pearce, Chairman

NOTE: A full audio recording of this meeting is available at the JLBC Staff Office, 1716 W. Adams. A full video recording of this meeting is available at http://www.azleg.gov/jlbc/meeting.htm.

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DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Jenna Goad, Fiscal Analyst
Blake Riley, Staff Intern

SUBJECT: AHCCCS – Review of Proposed Acute Care and ALTCS Capitation Rate Changes

Request

Pursuant to a footnote in the General Appropriation Act, the Arizona Health Care Cost Containment System (AHCCCS) is required to report capitation and fee-for-service inflationary rate changes with a budgetary impact to the Committee for review prior to implementation.

Summary/Recommendation

The Committee has at least the following 2 options:

1. A favorable review of the proposed changes as the proposed rates are a combination of actuarial inflation adjustments and legislatively authorized policy changes.
2. An unfavorable review of the proposed changes as the proposed increases are higher than budgeted.

The proposed rates would cost $9 million more from the General Fund than budgeted in FY 2008, assuming budgeted caseload levels. The County requirement would be $(3.1) million less than budgeted due to lower-than-anticipated growth in the Arizona Long-Term Care System (ALTCS) capitation rates. The actual General Fund shortfall will also depend on enrollment growth. Current caseloads are above budgeted levels.

The $9 million unbudgeted cost represents a shortfall of $12.1 million in Acute Care and a $3.1 million surplus in the Long-Term Care program.

AHCCCS' actuaries use encounter data, financial information and projected enrollment to determine the actual cost of services and, thereby, recommend increases or decreases in capitation and Fee-For-Service (FFS) rates.

(Continued)

Analysis

Acute Care
This population represents members who participate in the Traditional Medicaid, Proposition 204, and KidsCare and KidsCare Parents programs.

In FY 2008, the approved Acute Care budget estimated capitation rate growth at 6.0%. AHCCCS states that the increase in the contract year ending (CYE) in 2008 will be higher at 6.9%. Based on enrollment projections used in developing the FY 2008 appropriation, this would cost $12.1 million more than budgeted from the General Fund ($31.1 million in Total Funds). *Table 1,* at the end of this memo, shows the proposed capitation rates for each patient group.

The proposed changes include adjustments for trends in service utilization and medical inflation. For CYE 2008, AHCCCS reports anticipated increases across all services categories with inpatient and outpatient hospital services, emergency room services, and pharmacy services seeing the largest increases.

Policy Changes
A.R.S. § 36-2901.06 limits capitation rate adjustments to utilization and inflation unless those changes are approved by the Legislature or are specifically required by federal law or court mandate. Three legislatively-approved Acute Care changes were incorporated into the capitation rates.

In addition to standard adjustments for utilization and medical inflation trends, the following 3 program changes authorized by the FY 2008 budget have been incorporated into the capitation rates:

- HPV Vaccine – Federal law requires that AHCCCS cover the cost of the human papillomavirus (HPV) vaccine for female AHCCCS members under age 21 who elect to receive the vaccine. The cost for providing the vaccine to AHCCCS members under age 19 is paid by the Department of Health Services. The budget assumed that the cost of providing the vaccine to those members age 19-21 would be covered by AHCCCS' base budget. The FY 2008 budget included $2,869,100 from the General Fund to provide the HPV vaccine to female AHCCCS members ages 21-26 who ask to be vaccinated.
- Hospice Services – The FY 2008 budget included a footnote allowing AHCCCS to cover hospice services for Acute Care members. No additional monies were added to the FY 2008 budget for this change. The cost of providing hospice services is $1,014,000 from the General Fund ($3,000,000 in Total Funds) on a full-year basis. At the time, it was anticipated that enrollment savings would generate funding for this option. Enrollment is now higher than projected and it is unlikely that caseload savings will be available for this cost.
- Outlier Methodology Revision – The FY 2008 budget directed AHCCCS to revise the methodology used to pay hospital claims with significantly high operating costs known as "outliers." These claims are paid by applying a cost-to-charge ratio (CCR) that is used to approximate the hospital's actual cost of providing the services. Prior to this year, these CCRs had not been updated since 1998, which has resulted in AHCCCS reimbursing hospitals at higher rates. This revision led to General Fund savings of $(6,929,000) ($20,500,000 Total Fund savings) on a full-year basis, or $(5.2) million in FY 2008. The FY 2008 budget assumed savings of $(5.5) million for this revision.

Long-Term Care (ALTCS)
ALTCS services are provided to the elderly and physically disabled in need of long-term care either in nursing care facilities or in home and community-based settings.

The approved FY 2008 budget provided for a 6.0% capitation rate increase; however, the proposed ALTCS monthly capitation rate (averaging approximately $3,207 for CYE 2008) represents an increase

(Continued)

of 3.6%. Based on enrollment projections used in developing the FY 2008 appropriation, the capitation rate change will result in state match savings of $(6.1) million ($20.1 million in Total Fund savings). Of the additional state match savings, approximately half would be realized by the state, and half by the counties, who also contribute to the program's funding.

The 2 main reasons for the lower-than-anticipated levels of spending include: (1) updated reinsurance projections and (2) a higher-than-anticipated utilization of home and community-based settings instead of nursing facilities.

Policy Changes
The primary policy change in ALTCS capitation rates results from providing preventive adult dental services. The FY 2008 budget allowed AHCCCS to provide preventive dental services of up to $1,000 annually to adult ALTCS members and appropriated $1 million from the General Fund ($5.3 million in Total Funds, including $0.8 million in county contributions) for this purpose. It is estimated that all adult ALTCS members will receive at least some level of preventive dental care. AHCCCS estimates that providing these services will cost $1,431,400 from the General Fund ($7,700,000 in Total Funds) on a full-year basis. The FY 2008 budget provided an additional $1 million from the General Fund for this purpose. The capitation rate change also includes small adjustments for the HPV vaccine and outlier methodology revision.

Unlike the Acute Care population, FY 2008 ALTCS enrollment has been below forecast. As a result, additional savings may be generated by lower-than-expected enrollment. These savings, however, are substantially less than the potential Acute Care shortfall.

Table 1

Monthly Regular Capitation Rates

Populations	Current CYE 07 Rate	Budgeted CYE 08 Rate	Proposed CYE 08 Rate	CYE 07-CYE 08 % Change
Traditional Medicaid/KidsCare				
Age<1	$ 503.88	$ 534.11	$ 525.88	4.4%
Age 1 – 13	105.80	112.15	109.66	3.6%
Age 14 - 44 (Female only)	191.92	203.44	218.18	13.7%
Age 14 - 44 (Male only)	135.88	144.04	144.89	6.6%
Age 45+	370.37	392.60	387.95	4.7%
SSI with Medicare	182.99	193.97	161.35	(11.8)%
SSI without Medicare	624.02	661.46	698.12	11.9%
Family Planning	17.34	18.38	18.38	6.0%
Deliveries	6,303.94	6,682.18	6,583.36	4.4%
Title XIX Waiver Group				
Prop 204 – Conversions	$ 461.78	$ 489.49	$ 503.67	9.1%
Prop 204 - Medically Eligible	1,110.91	1,177.57	1,194.14	7.5%
Prop 204 - Newly Eligible	459.26	486.82	499.69	8.8%
Hospital "Kick" Payment	10,491.29	11,120.77	10,858.49	3.5%
Weighted Average				6.9%
ALTCS				
Statewide Average Rate	$3,094.11	$3,279.76	$3,206.95	3.6%

RS/JG/BR:ym

Janet Napolitano, Governor
Anthony D. Rodgers, Director

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September 12, 2007

The Honorable Russell Pearce, Chairman
Joint Legislative Budget Committee
1700 West Washington
Phoenix, Arizona 85007

Dear Representative Pearce:

The Arizona Health Care Cost Containment System (AHCCCS) respectfully requests to be placed on the agenda of the next Joint Legislative Budget Committee (JLBC) meeting to review the following items.

- Long Term Care Capitation Rates for Contract Year Ending 2008
- Acute Care Capitation Rates for Contract Year Ending 2008

As required by the Federal Balanced Budget Act of 1997, Title XIX and Title XXI Managed Care Programs must have actuarially sound capitation rates. The following proposed rate adjustments are in the process of being reviewed by the Centers for Medicare and Medicaid Services (CMS) for an October 1, 2007 implementation.

Long Term Care Capitation Rates

For State Fiscal Year 2008 AHCCCS was appropriated an increase of 6.0% for ALTCS rates. In March 2007 AHCCCS estimated that the ALTCS increase would be in the range of 4.5-7.0%. The proposed rates for the new contract cycle came in below these estimates increasing at a rate of 3.6%.

There are two main factors that impacted the rates and resulted in an actual increase less than the estimate. Remarkably, the program continued to see a favorable mix change as a larger percentage of members moved into Home and Community Based Settings (HCBS). Since 1999 the ALTCS program has seen a shift from 43% of the population in HCBS to the projection for Contract Year Ending (CYE) 2008 of 64%. The second factor impacting the rate of increase was the updated reinsurance projections incorporated into the acute care component of the capitation rates.

The rates were also adjusted to reflect legislative budget changes including funding for a limited dental benefit and hospital inpatient outlier methodology modifications.

These rate adjustments reflect the Elderly and Physically Disabled population and do not include the Developmentally Disabled population, which is administered through the Arizona Department of Economic Security. The actuarial memo that has been submitted to CMS for approval has been attached for additional information.

Acute Care Capitation Rates

The State Fiscal Year 2008 budget assumed a 6.0% overall increase in Acute care capitation rates. On March 1, 2007 AHCCCS submitted an estimate that Acute care rates would increase 5-7% for the CYE 2008. The actual CYE 2008 capitation rate increase is 6.9%. The rates have been adjusted to include legislative budget changes for Hospice, Outlier, and the Human Papillomavirus Vaccine. The actuarial memo that has been submitted to CMS has also been attached for additional information.

Overall Fiscal Impact

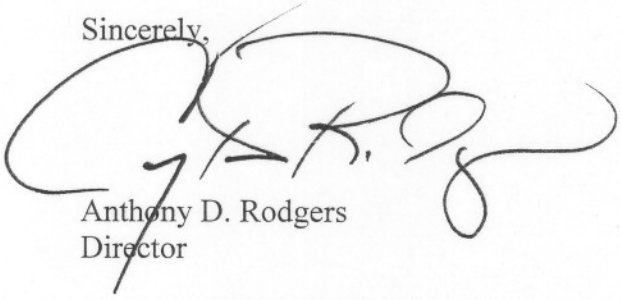
The combined weighted capitation rate average for the Acute care and the ALTCS program for CYE 2008 is 6.0%.

Policy Changes

Per the legislative mandate in ARS 36-2901.06 and 36-2941 AHCCCS has not included any changes beyond the limits that are now delineated in law.

Should you have any questions on any of these issues please feel free to contact Tom Betlach at (602) 417-4483.

Sincerely,



Anthony D. Rodgers
Director

c: Jim Apperson, OSPB
Richard Stavneak, JLBC

Arizona Long Term Care System (ALTCS) Actuarial Memorandum

I. Purpose:

The purpose of this actuarial memorandum is to demonstrate that the ALTCS capitation rates were developed in compliance with 42 CFR 438.6(c). It is not intended for any other purpose.

II. Overview of Rate Setting Methodology:

The contract year ending 2008 (CYE08) rates were developed as a rate update from the previously approved contract year ending 2007 (CYE07) capitation rates and represent the contract period October 1, 2007 through September 30, 2008, which is twelve months.

In updating the ALTCS rates, various sources of information were used including encounter data, audited and quarterly financial statements, fee for service rate increases, changes in placement in Home and Community Based Settings (HCBS), and actual cost and utilization experience reported by program contractors (PC). For the trends, a cap amount was set to limit the negative and positive trends to reasonable levels.

Historically Arizona Health Care Cost Containment System (AHCCCS) develops rates for each county and each PC. For CYE08, it is AHCCCS intent to consolidate to a geographic service area (GSA) for those GSAs where the county membership is too small to price appropriately. The ALTCS program has two rate cells: dual and non-dual. AHCCCS rates for the ALTCS population do not differ by gender and/or age.

The encounter and audited financial experience only includes ALTCS Medicaid eligible expenses for ALTCS Medicaid eligible individuals. Non-covered services have been removed from the data. In addition, the experience includes reinsurance amounts and share of cost (SOC). Additional payments are given for HIV/AIDS members.

The general process for the prospective rate calculation involves trending the CYE07 capitation rates to the midpoint of the effective period, which is April 1, 2008, and applying the mix percentage (see Section V). The next step involves adjustments for share of cost offsets and, if applicable, any program changes. In the final step, the projected administrative expenses, risk/contingency margin and premium tax are added to the projected claim PMPMs to obtain the capitation rates. Each step is described in the sections below. There are also separate sections describing the PPC population, the Acute Care Only population and the HIV/AIDS supplemental payment. Due to experience emerging differently than expected for the new rate cells (i.e. dual and non-dual, implemented CYE07), AHCCCS performed a recalibration of the two rate cells using CYE06 encounter data and CYE07 year-to-date (YTD) financial information, trended forward.

III. Projected Trend Rates

The trend analysis includes both the financial data experience and the encounter data experience from the quarter beginning October 2003 through the quarter ending September 2006. The claim PMPMs were computed on a yearly basis and a trend factor was calculated. These encounter and financial trend factors were compared with trend rates from sources such as the changes to the State's fee-for-service (FFS) schedules and PCs' subcontracted rates. The trend rates developed were used to bring the base encounter data to the effective midpoint of the contract year.

The final trends for the Nursing Facility (NF) component were selected from changes to the State's FFS schedule effective October 1, 2007, as well as changes to the FFS schedules over the past few years that are not reflected in the encounter data. The final trend rates for Home and Community Based (HCBS) services include the changes to the State's upcoming FFS schedule and past increases not reflected in the encounter data, as well as trend information from the PC audited financial statements and encounters. For the Acute Care component, the trends were developed using both the encounters and financial information, and the rates were adjusted downward primarily due to the reinsurance offset. The Case Management trends were developed using the AHCCCS Case Management model as well as looking at financial data. The trend rates used in projecting the claim costs are identified in Table I.

Table I: Average Annual Trend Rate before Mix and SOC

Service Category	Combine (Dual and Non-Dual)
Nursing Facility	9.0%
Home	23.2%
Community	-8.0%
Acute	-25.5%
Case Management	5.4%

IV. Projected Gross Claim PMPM

The CYE07 rates reflect the 12-month period of October 1, 2006, through September 30, 2007, therefore, the midpoint of the CYE07 rate period is April 1, 2007. The contract period for CYE08 rates is October 1, 2007 through September 30, 2008, so the midpoint is April 1, 2008. The claims' PMPMs were trended from the midpoint of the CYE07 rate period to the midpoint of the CYE08 rate period.

V. Mix Percentage

The CYE08 combined mix percentages are set using a combination of current placement percentages, program growth/saturation and the number of ALTCS members. These sources were reviewed by contractor and by county, over an 18-month period. A separate mix percentage for individuals in the home and individuals in alternative community settings was developed.

It appears that CYE08 will follow the same trend as that in CYE07, which showed certain counties hitting their saturation point with the number of members that are placed in HCBS settings. This results in small changes in the HCBS placement percentages. The HCBS and NF placement percentages can be found in Table II.

Table II: Combined Mix Percentages Weighted by Projected Member Months from CYE08

GSA	CYE07		CYE08		Difference
	NF Mix	HCBS Mix	NF Mix	HCBS Mix	HCBS Mix
GSA 40 (Pinal, Gila)	34.3%	65.7%	32.6%	67.4%	1.7%
GSA 42 (LaPaz, Yuma)	46.3%	53.7%	45.5%	54.5%	0.8%
GSA 44 (Apache, Coconino, Mohave, Navajo)	37.5%	62.5%	37.1%	62.9%	0.4%
GSA 46 (Cochise, Graham, Greenlee)	40.8%	59.2%	40.0%	60.0%	0.8%
GSA 48 (Yavapai)	42.8%	57.2%	44.8%	55.2%	-2.0%
GSA 50 (Pima, Santa Cruz)	39.6%	60.4%	37.7%	62.3%	1.9%
GSA 52 (Maricopa)	35.2%	64.8%	34.3%	65.7%	0.9%
Statewide	36.9%	63.1%	36.0%	64.0%	0.9%

VI. Program Changes

Impacts of several program changes were incorporated in the CYE08 capitation rates due to State and Federal mandates described below.

Adult Dental

State legislation, signed into law in 2007, requires AHCCCS to provide non-emergency (basic and preventive) dental services for ALTCS adults up to a limit of $1,000 annually per elderly and physically disabled (EPD) member starting October 1, 2007. The statewide impact to the ALTCS EPD program is an increase of approximately $7.7 million or $26.31 PMPM.

Outlier Hospital Reimbursement Rates

This amendment of State law, also passed in the 2007 legislative session, changes the methodology for the payment of claims with extraordinary operating costs per day. It stipulates that AHCCCS shall phase in the use of the most recent statewide urban and rural average Medicare or Medicare approved cost-to-charge ratios to qualify and pay extraordinary operating costs starting October 1, 2007. Once fully-phased in, those cost-to-charge ratios will be updated annually. In addition, routine maternity charges will be excluded from outlier consideration. The statewide impact to the ALTCS EPD program is a savings of approximately $330,000 or $1.14 PMPM.

Human Papillomavirus (HPV)

Federal law requires that AHCCCS cover the human papillomavirus (HPV) vaccine, as part of the EPSDT benefit package, for all females age 20 and under. In addition, State legislation during the 2007 legislative session added funds for the coverage of

women up to age 26. The cost to AHCCCS to provide this service is estimated to be approximately $34,000 or $0.12 PMPM.

Institution for Mental Disease (IMD) Waiver and In-Lieu of Services
With the phasing out of IMD services for members aged 21-64, it is expected that most of these services previously provided at an IMD facility will now need to be provided at inpatient non-specialty hospitals. However, services provided in non-specialty inpatient hospitals are approximately 101.5% more expensive than those provided by alternative inpatient settings. Thus these rates assume that the PCs will utilize "in-lieu of" services in alternative inpatient settings that are licensed by the Arizona Department of Health Services/Assurance and Licensure Services/Office of Behavioral Health Licensure, and therefore no increase will need to be made in the rates.

VII. Projected Net Claim PMPM

The Nursing Facility and Home and Community Based Services projected gross claim PMPMs were adjusted for the mix percentages. The projected gross claims PMPMs were discounted for the recipients' Share Of Cost (SOC). The SOC component is fully reconciled with each PC. The reinsurance offset is already included in the acute care component of the rates for the elderly and physically disabled (EPD) population.

VIII. Administrative Expenses and Risk Contingency

The administrative expenses range from 5% to 8% of medical expenses plus case management. The risk contingency is 2% of the total capitation rate, excluding SOC.

IX. Proposed Capitation Rates and Their Impacts

The proposed capitation rates for the EPD population equal the sum of the projected net claim PMPM (in Section VII) and the projected administrative expenses and risk contingency PMPM (in section VIII) divided by one minus the two percent premium tax. Table III shows the proposed capitation rates for the EPD population statewide, combining dual and non-dual risk groups. Table IV shows the proposed capitation rates for the EPD population statewide for the dual and non-dual risk groups.

Table III: Statewide Projected Net Capitation PMPM EPD Combined

Service Category	Gross CYE07 Rate	Mix	Net CYE07 Rate	% Gross Change	% Net Change	Gross CYE08 Rate	Mix	Net CYE08 Rate
Nursing Facility	$ 4,410.44	36.9%	$ 1,628.84	9.2%	6.4%	$ 4,815.69	36.0%	$ 1,732.63
Share of Cost			$ (263.74)		-3.2%			$ (255.26)
Net Nursing Facility			$ 1,365.10		8.2%			$ 1,477.37
HCBS - Home	$ 1,322.32	45.1%	$ 596.14	23.1%	20.2%	$ 1,628.25	44.0%	$ 716.53
HCBS - Community	$ 1,449.35	18.0%	$ 260.67	-8.2%	2.2%	$ 1,330.88	20.0%	$ 266.38
Case Management			$ 104.93		5.4%			$ 110.59
Acute Care			$ 545.71		-25.5%			$ 406.79
Administration			$ 201.09		5.4%			$ 212.03
Risk Contingency			$ 61.47		3.8%			$ 63.79
Premium Tax			$ 63.98		3.8%			$ 66.40
Net Capitation PMPM			$ 3,199.10		3.8%			$ 3,319.88

Table IV: Statewide Projected Net Capitation PMPM Dual and Non-Dual EPD Rates

Service Category	Gross CYE08 EPD Dual Rate	Mix	NET CYE08 EPD Dual Rate	Gross CYE08 EPD NonDual Rate	Mix	NET CYE08 EPD NonDual Rate
Nursing Facility	$ 4,781.69	38.1%	$ 1,821.26	$ 5,104.47	24.5%	$ 1,249.01
Share of Cost			$ (294.20)			$ (42.76)
Net Nursing Facility			$ 1,527.06			$ 1,206.25
HCBS - Home	$ 1,528.17	40.6%	$ 620.50	$ 1,982.64	62.6%	$ 1,240.54
HCBS - Community	$ 1,361.51	21.3%	$ 290.11	$ 1,056.07	13.0%	$ 136.88
Case Management			$ 110.62			$ 110.41
Acute Care			$ 235.24			$ 1,342.93
Administration			$ 194.81			$ 306.04
Risk Contingency			$ 59.57			$ 86.86
Premium Tax			$ 62.00			$ 90.41
Net Capitation PMPM			$ 3,099.90			$ 4,520.32

X. Acute Care Only Members

As in prior years, members who are only eligible for the acute care services in the ALTCS program will be paid the acute care component plus the case management and administrative components. Since the reinsurance policy is the same for these members as for the other ALTCS members, the same reinsurance offset is appropriate.

XI. Prior Period Coverage (PPC) Rates

PPC rates cover the period of time from the effective date of eligibility to the day a member is enrolled with the Contractor. PPC rates are reconciled to a ten percent profit/loss corridor.

AHCCCS used the actual PPC cost and PPC enrollment data for CYE04, CYE05 and 9 months of CYE06. This data was utilized as the base in the development of the CYE08 PPC rates. Historical trends were developed and reviewed for appropriateness. Due to the relatively short PPC time period, AHCCCS actuaries analyzed the data by combining rate cohorts or geographic regions to enhance statistical credibility when needed.

XII. HIV/AIDS Supplemental Payment

AHCCCS reimburses its contractors with a separate HIV/AIDS Supplemental Payment (HASP) for enrollees that have contracted the HIV/AIDS virus. This supplemental payment was developed to cover the costs of HIV/AIDS medications and lab testing.

AHCCCS used actual cost, utilization, and enrollment data for the CYE05 and CYE06 time periods. This data was utilized as the base in the development of the CYE08 HASP. There is no proposed rate increase for CYE08.

XIII. Proposed Capitation Rates and Budget Impact

Table V includes the net capitation rates on a statewide basis for all rate cells as well as the estimated budget impact based off of CYE08 projected member months. Appendix I shows dual and non-dual EPD rates by county and program contractor.

Table V: Proposed Capitation Rates and Budget Impact

Rate Cell	CYE08 Projected MMs	CYE07 Rate	CYE08 Rate	Based on CYE08 Annualized Projected Member Months		Percentage Impact on CYE 07 estimated capitation
				Estimated CYE07 Capitation	Estimated CYE08 Capitation	
EPD	272,480	$ 3,199.10	$ 3,319.88	$ 871,689,406	$ 904,600,507	3.8%
PPC	8,522	$ 942.36	$ 928.98	$ 8,030,969	$ 7,916,909	-1.4%
Acute Only	3,943	$ 688.39	$ 536.41	$ 2,714,280	$ 2,115,033	-22.1%
HIV/AIDs	384	$ 1,051.86	$1,051.86	$ 403,914	$ 403,914	0.0%
Total				$ 882,838,569	$ 915,036,362	3.6%

XIV. CMS Rate Setting Checklist

1. Overview of rate setting methodology

A.A.1.0: Overview of rate setting methodology

AHCCCS is performing a rate update from the previously approved contract year ending 2007 (CYE07) under 42 CFR 438.6(c). Please refer to Section II.

AA.1.1: Actuarial certification

Please refer to Section XVI.

AA.1.2: Projection of expenditure

Please refer to Section XIV.

AA.1.3: Procurement, prior approval and rate setting

AHCCCS is operating under the Sole Source contracting method.

AA.1.5: Risk contract

The contract is an at risk contract, however there are some provisions for reconciliations on specific service components and for specific contractors for CYE08.

AA.1.6: Limit on payment to other providers

AHCCCS makes no additional payment to the providers, except for Disproportionate Share Hospital (DSH), Graduate Medical Education (GME) and Critical Access Hospitals. GME is paid in accordance with state plan. DSH and Critical Access Hospital payments are paid in accordance with Waiver Special Terms and Conditions. None of the additional payments to the providers were included in the capitation calculation.

AA.1.7: Rate modification

Please refer to Sections III, V, VI, VII, X, XI, XII and XIII.

XV. Actuarial Certification of the Capitation Rates:

I, Windy J. Marks, am an employee of Arizona Health Care Cost Containment System (AHCCCS). I am a Member of the American Academy of Actuaries and a Fellow of the Society of Actuaries. I meet the qualification standards established by the American Academy of Actuaries and have followed the practice standards established from time-to-time by the Actuarial Standards Board.

The rates were developed using generally accepted actuarial principles and practices and are considered to be actuarially sound. The rates were developed to demonstrate compliance with the CMS requirements under 42 CFR 438.6(c) and are in accordance with applicable laws and regulations. The rates are appropriate for the Medicaid populations covered and Medicaid services to be furnished under the contract. The rates may not be appropriate for any other purpose. The documentation has been included with this certification. The actuarially sound capitation rates that are associated with this certification are effective for the twelve-month period beginning October 1, 2007.

The actuarially sound capitation rates are a projection of future events. It may be expected that actual experience will vary from the values in the rates. The rates are actuarially sound in aggregate by GSA. It is not possible to certify that every cell is actuarially sound since some rate cells are too volatile, although AHCCCS strives to make each rate cell actuarially sound at the time the rates are set.

In developing the actuarially sound capitation rates, I have relied upon data and information provided by the Program Contractors and the AHCCCS internal databases. I have accepted the data without audit and have relied upon the Program Contractors auditors and other AHCCCS employees for the accuracy of the data.

This actuarial certification has been based on the actuarial methods, considerations, and analyses promulgated from time to time through the Actuarial Standards of Practice by the Actuarial Standards Board.

Windy J. Marks — 08/14/07

Windy J. Marks — Date

Fellow of the Society of Actuaries
Member, American Academy of Actuaries

Acute Care Actuarial Memorandum

I. Purpose:

The purpose of this actuarial memorandum is to demonstrate that the Acute Care capitation rates were developed in compliance with 42 CFR 438.6(c). It is not intended for any other purpose.

II. Overview of Rate Setting Methodology:

The contract year ending 2008 (CYE08) rates were developed as a rate update from the previously approved contract year ending 2007 (CYE07) capitation rates. The CYE08 rates cover the twelve month contract period of October 1, 2007 through September 30, 2008.

The Acute Care rates were developed from historical Acute Care data including Arizona Medicaid managed care encounter data (via an extract that provides utilization and cost data, referred to as the "databook"), as well as health plan financial statements. Other data sources include programmatic changes, Center for Medicare and Medicaid Services (CMS) National Health Expenditure (NHE) Report estimates and Global Insight Prospective Hospital Market Basket Inflation Index (GI) information.

The contract between the Arizona Health Care Cost Containment System (AHCCCS) and the Health Plans (HPs) specifies that the HPs may cover additional services. Non-covered services were removed from the databook and not included in the rates.

Trend rates were calculated from the databook and other sources on a unit cost and/or utilization basis by category of service (COS) and a cap was applied to limit the negative and positive trends to a reasonable level. Experience adjustments were calculated using profit/loss information from the health plan financial statements as well as the encounters per member per month (PMPM) compared to the capitation rate. The encounter data used for the experience adjustments pulled in more recent experience and completion factors were applied to this data. These adjustments also include state mandates, court ordered programs and other program changes, if necessary. For more information on trends and experience adjustments see the Trend and Experience sections.

The Acute Care program has a large membership base, which allows for the experience data to be analyzed by the different rate cells, which are comprised of members with similar risk characteristics. The rate cells were analyzed by major categories of aid (COA), i.e. risk groups, and COS. In addition, AHCCCS develops rates by Geographic Service Area (GSA).

The experience data includes only Acute Care Medicaid eligible expenses for Acute Care Medicaid eligible individuals, as well as reinsurance amounts. The Prior Period Coverage (PPC) rates are reconciled to a maximum 2% profit or loss. Additional payments are made for HIV/AIDS members receiving certain drugs, for Medical Expense Deduction members via a Hospital Supplemental payment, and for members giving birth via a Maternity Delivery Payment.

The general process in developing the prospective rates involves trending (with experience adjustments) the CYE07 capitation rates to the midpoint of the effective period, which is April 1, 2008. The next step involves the deduction of the reinsurance offsets. Following this calculation, the projected administrative expenses, risk/contingency margin and premium tax are added to the projected claim PMPMs to obtain the capitation rates. In the final step, an eligibility choice adjustment is applied creating budget neutral results. Each step is described in the sections below. In addition there are sections dedicated to the development of other rates including, but not limited to, the Maternity Delivery Payment, Hospital Supplemental Payment, PPC rates and HIV/AIDS rates.

III. Projected Trend Adjustments

The trend analysis includes both the financial data experience and the encounter data experience. Financial data experience is from the contract year ending September 2004 through March 2007. Encounter data experience is from the contract year ending September 2004 through June 2006. Due to recent trend changes, AHCCCS also used encounter data from July 2006 through December 2006 and applied completion factors in order to complete the data. Encounter data was used from those plans that provided reasonably complete and accurate encounter submissions for the trend analysis and the experience adjustment. The resulting data provides an actuarially sound data set for which to trend the CYE07 rates forward. In addition to using encounter and financial data, AHCCCS used information from CMS NHE Report estimates, GI information, and changes in AHCCCS' Professional and Outpatient Fee Schedules, Dental Fee Schedule, Transportation Schedule and other sources. AHCCCS developed utilization and unit cost trend estimates using the encounter data. These trends were developed by major COA and COS, with a cap on the percentage increase and decrease to smooth out exceptional trends. Once these trends were developed they were analyzed by comparing the results to reports and studies (for example the CMS NHE report). The utilization and unit cost trend rates used in projecting the claim costs are summarized in the Appendix in Table A1. The prospective PMPM trends are shown below in Table I.

Table I: Prospective Average Annual PMPM Trends

PMPM Trends					
Categories of Service	TANF & KidsCare Combined	SSI With Medicare	SSI without Medicare	HIFA	TWG
Hospital Inpatient	10.4%	13.6%	7.2%	9.8%	13.3%
Outpatient Facility	9.8%	7.0%	6.4%	13.5%	7.4%
Emergency Room	10.4%	6.9%	4.8%	9.6%	8.2%
Primary Care	6.1%	10.1%	3.6%	5.0%	3.8%
Referral Physician	6.0%	10.1%	3.6%	4.6%	3.8%
Other Professional	2.7%	-0.1%	1.2%	6.9%	0.9%
Pharmacy	9.5%	9.2%	10.9%	14.2%	9.2%
Other	7.0%	4.4%	0.5%	3.2%	4.6%

Hospital Inpatient Trends
Using the data sources mentioned in Section II and emphasizing the AHCCCS encounter data, the inpatient utilization varied from 0.5 to 10.1 percent annually, depending upon risk group. For CYE08 AHCCCS used the encounter data to develop the inpatient unit costs which varied from 3.2 to 9.3 percent annually. On a combined basis, the per member per month (PMPM) trends for inpatient hospital have been trended at 7.2 to 13.6 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

Hospital Outpatient and Emergency Room Trends
Per the AHCCCS Rule for the Outpatient Fee Schedule (OPFS), on an annual basis the rates are to be adjusted by multiplying the rates effective during the prior year by the GI or by adjusting rates at varying levels with the total dollar impact equal to that of the GI inflationary increase. Based on this requirement, unit costs for hospital outpatient have been trended at four percent annually. The utilization trends were developed using the data sources mentioned in Section II with emphasis on the AHCCCS encounter data. On a combined basis, the PMPM costs for hospital outpatient and emergency room have been trended at 4.8 to 13.5 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

Physician and Other Services Trends
Using the data sources mentioned in Section II and emphasizing the AHCCCS encounter data, the assumed utilization for physicians and other professionals ranged from -4.6 to 15.3 percent annually, depending upon rating group and category of service. Based on a review of the same sources, unit costs have been trended at -5.4 to 5.7 percent annually. On a combined basis, the PMPM costs for physicians and other professionals have been trended at -0.1 to 10.1 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

Pharmacy Trends
Using the data sources mentioned in Section II and emphasizing the AHCCCS encounter data, the assumed pharmacy utilization increased by 3.0 to 10.1 percent, depending upon rating group. Based on a review of the same sources, unit costs have been trended at 0.4 to 7.1 percent. On a combined basis, the PMPM costs for pharmacy have been trended at 9.2 to 14.2 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

Other Services Trends
Using the data sources mentioned in Section II and emphasizing the AHCCCS encounter data and changes in transportation and dental fee schedules, the assumed PMPM costs for other services have been trended at 0.5 to 7.0 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

IV. Projected Experience Adjustments

The projected experience adjustments are calculated by GSA and COA using the health plan financial statements, AHCCCS encounter data and medical capitation rates.

The projected experience adjustments are a function of two components: a financial component and an encounter component. The financial component is based on the health plans' reported profit/loss (1st half of CYE07). The encounter component is based on the encounter data from July 1, 2006 through December 31, 2006 with completion factors trended forward to the midpoint of CYE07. The result is compared to the CYE07 medical capitation rate. Next, AHCCCS combines the financial and encounter percentage components to come up with a weighted average percentage, using 25% weight on the financial component and 75% on the encounter component. This weighted component is capped with a ceiling and floor to exclude exceptional percentages. This experience adjustment is applied to the final medical rate, before reinsurance, admin, risk contingency and premium tax.

The prospective PMPM experience adjustments are shown below in Table II.

Table II: Prospective Average Annual PMPM Experience Adjustments

	TANF & KidsCare Combined	SSI With Medicare	SSI without Medicare	HIFA	TWG
Experience Adjustment	0.8%	-21.8%	10.6%	-0.3%	3.8%

V. State Mandates, Court Ordered Programs, Program Changes and Other Changes

Human Papillomavirus (HPV)

Federal law requires that AHCCCS cover the human papillomavirus (HPV) vaccine as part of the EPSDT benefit package for all females age 20 and under. In addition, the recently enacted budget provided funding to cover women up to age 26. The cost to AHCCCS to provide this service is estimated to be approximately $11.5 million for CYE08. The statewide impact is a 0.37% increase.

Outlier Hospital Reimbursement Rates

Laws 2007, Chapter 263, changes the methodology for the payment of claims with extraordinary operating costs per day. It stipulates that AHCCCS shall phase in the use of the most recent statewide urban and rural average Medicare or CMS approved cost-to-charge ratios to qualify and pay extraordinary operating costs starting October 1, 2007. Once fully-phased in, those cost-to-charge ratios will be updated annually. In addition, routine maternity charges will be excluded from outlier consideration. The statewide impact to the AHCCCS Acute program, net of reinsurance, is a savings of approximately $20.5 million for CYE08. The statewide impact, net of reinsurance, is a 0.67% decrease.

Hospice

Legislation passed by the 2007 State Legislature allows the AHCCCS Acute program to cover Hospice services for adults. The cost to AHCCCS to provide this service is estimated to be approximately $3 million for CYE08. The statewide impact is a 0.10% increase.

Institution for Mental Disease (IMD) Waiver and In-Lieu of Services
With the phasing out of IMD services for members aged 21-64, it is expected that most of these services previously provided at an IMD facility will now need to be provided at inpatient non-specialty hospitals. However, services provided in non-specialty inpatient hospitals are approximately 101.5% more expensive than those provided by alternative inpatient settings. Thus these rates assume that Contractors will utilize "in-lieu of" services in alternative inpatient settings that are licensed by the Arizona Department of Health Services/Assurance and Licensure Services/Office of Behavioral Health Licensure, and therefore no increase will need to be made in the rates.

VI. Prospective Projected Net Claim PMPM

The CYE07 utilization, unit costs and net claims PMPMs are trended forward and adjusted for experience trends, state mandates, court ordered programs and program changes to come up with the CYE08 utilization, unit costs and net claims PMPMs for each COS and COA.

VII. Prospective Reinsurance Offsets

The CYE07 reinsurance offsets were reviewed by AHCCCS for appropriateness and reasonableness using reinsurance encounter and payment information. As a result of this review AHCCCS recalibrated the reinsurance offsets using CYE06 data for the base period. Completion factors were added to the base period and these results were trended forward. The statewide prospective impact is -2.81%. In addition, one contractor switched from the $50,000 deductible level to the $20,000 deductible level, as permitted by contract, which has a statewide prospective impact of -0.47%.

VIII. Prospective Administrative Expenses and Risk Contingency

The administrative expense is 9% for general administration, which was determined to be appropriate to cover the contractors' average expenses. The risk contingency load remained at 2.5% for the rate cohorts without a risk corridor and 2.0% for the PPC rate cohorts as they include a 2.0% risk arrangement.

IX. Prospective Proposed Capitation Rates and Their Impacts

The proposed capitation rates equal the sum of the projected net claim PMPM (in Section VI) less the reinsurance offsets (in section VII) and the projected administrative expenses and risk contingency PMPM (in section VIII), divided by one minus the two percent premium tax. The final adjustment, which is a budget neutral adjustment, is the eligibility choice adjustment (in Section X). Appendix II contains the proposed capitation rates and the budget impact for all capitation rates using projected contract year ending 2008 member months and actual health plan reinsurance deductible levels.

X. Eligibility Choice Adjustment

AHCCCS evaluated eligibility choice data to determine if a selection bias by higher acuity individuals existed between the contractors. After considering the population

size of rate cells within all geographic regions on an individual health plan basis, only Maricopa County contained enough data to credibly evaluate. Also, for CYE08, AHCCCS excluded the SSI with Medicare risk group as past experience and enrollment choice patterns could differ from current patterns due to the implementation of Medicare Part D on January 1, 2006, and the resulting Medicare Advantage Prescription Drug Special Needs Plans.

After completion of the analysis, AHCCCS concluded that an adjustment was necessary to five of the six contractors to compensate for selection bias. The budget neutral adjustment had an overall average impact, depending on the contractor, ranging from a 2.7% decrease to a 2% increase on a PMPM basis.

XI. Maternity Delivery Payment

The methodology followed in developing the Maternity Delivery Payment was similar to the methodology used in the development of the prospective capitation rates. This methodology involves updating CYE07 rates with utilization and inflationary trends and program changes. The impact is a 4.3% increase per delivery to the overall global maternity payment rate over the CYE07 rate.

XII. Extended Family Planning Services (FPS)

Financial analyses indicated that an adjustment to the FPS rates was necessary for CYE08. After reviewing the audited CYE06 financials, and six months of unaudited CYE07 financials, the FPS capitation rates for all AHCCCS contractors were trended forward at 6.0%.

XIII. HIV/AIDS Supplemental Payment

The current HIV/AIDS supplemental payment cost and encounter data was reviewed and it was determined that an increase was not needed. AHCCCS used actual cost, utilization, and enrollment data for the CYE05 and CYE06 time periods. This data was utilized as the base in the development of the CYE08 HIV/AIDS supplemental payment. There will be no increase for this rate for CYE08.

XIV. Hospital Supplemental Payment

The methodology followed in developing the Hospital Supplemental Payment was similar to the methodology used in the development of the prospective capitation rates. This methodology involves updating CYE07 rates with utilization and inflationary trends and, if applicable, any program changes. The impact is a 3.5% increase over the CYE07 rate.

XV. KidsCare and HIFA Rates

Continuing with the methodology of previous years, AHCCCS contractors will be paid one blended capitation rate that includes experience from both the traditional TANF Medicaid population and the Title XXI SCHIP population. The rate cohorts whose experience is blended together are detailed as follows:

- TANF < 1 and KidsCare < 1;
- TANF 1– 13 M&F and KidsCare 1 – 13 M&F;
- TANF 14 – 44 F and KidsCare 14 – 18 F; and
- TANF 14 – 44 M and KidsCare 14 – 18 M.

Recent cost and encounter data indicated that no adjustment specific only to one or the other of the COAs is necessary for CYE08.

Effective January 1, 2003, AHCCCS implemented a new HIFA II Waiver population. This population is eligible for Title XXI funding and the total membership is subject to an enrollment cap.

Since AHCCCS now has reasonable encounter data and financial information on this risk group, AHCCCS used the same methodology that was used on all other prospective rate cells. The statewide impact across all HIFA cells is a 7.3% increase over CYE07 HIFA rates. For HIFA trends see Section III and Appendix I.

XVI. Prior Period Coverage Rates (PPC)

PPC rates cover the period of time from the first day of retroactive eligibility to the date of eligibility determination. An analysis of AHCCCS contractor financial data, encounter data and recent reconciliations indicates a large increase is necessary for this population. The statewide impact is 23.1%. The PPC rates are reconciled to a maximum 2.0% profit or loss in CYE08.

XVII. Final Capitation Rates and Their Impact

Table IV below summarizes the adjustments made to the CYE07 rates.

Table IV: Adjustments to CYE07 Rates

AHCCCS Medicaid Managed Care Summary			
Adjustments to CY07 Rates	Prospective	PPC	Weighted Average
Trend:			
1. Utilization	4.23%	7.48%	4.41%
2. Inflation	2.59%	3.25%	2.62%
Experience Adjustments			
1. Total	1.89%	11.14%	2.41%
Program Changes			
1. HPV	0.40%	n/a	0.37%
2. Outlier	-0.71%	n/a	-0.67%
3. Hospice	0.11%	n/a	0.10%
Total Percentage Change	5.84%	23.09%	6.94%

XVIII. CMS Rate Setting Checklist

1. Overview of rate setting methodology

A.A.1.0: Overview of rate setting methodology

AHCCCS is performing a rate update from the previously approved contract year ending 2007 (CYE07) under 42 CFR 438.6(c). Please refer to Section II.

AA.1.1: Actuarial certification

Please refer to Section XX.

AA.1.2: Projection of expenditure

Please refer to Appendix II.

AA.1.3: Procurement, prior approval and rate setting

AHCCCS is operating under the Sole Source contracting method.

AA.1.5: Risk contract

AHCCCS limits risk for the Prior Period Coverage (PPC) time period to 2% profit or loss.

AA.1.6: Limit on payment to other providers

AHCCCS makes no additional payment to providers, except for Disproportionate Share Hospital (DSH), Graduate Medical Education (GME) and Critical Access Hospitals. GME is paid in accordance with state plan. DSH and Critical Access Hospital payments are paid in accordance with the Waiver Special Terms and Conditions. None of the additional payments to providers were included in the capitation calculation.

AA.1.7: Rate modification

Please refer to Sections III, IV, V, VII, VIII and X through XVI.

XIX. Actuarial Certification of the Capitation Rates:

I, Windy J. Marks, am an employee of Arizona Health Care Cost Containment System (AHCCCS). I am a Member of the American Academy of Actuaries and a Fellow of the Society of Actuaries. I meet the qualification standards established by the American Academy of Actuaries and have followed the practice standards established from time-to-time by the Actuarial Standards Board.

The rates were developed using generally accepted actuarial principles and practices and are considered to be actuarially sound. The rates were developed to demonstrate compliance with the CMS requirements under 42 CFR 438.6(c) and are in accordance with applicable laws and regulations. The rates are appropriate for the Medicaid populations covered and Medicaid services to be furnished under the contract. The rates may not be appropriate for any other purpose. The documentation has been included with this certification. The actuarially sound capitation rates that are associated with this certification are effective for the twelve-month period beginning October 1, 2007.

The actuarially sound capitation rates are a projection of future events. It may be expected that actual experience will vary from the values in the rates. The rates are actuarially sound in aggregate by GSA. Given the distribution of the AHCCCS population, it is not possible to certify that every cell is actuarially sound. Some rate cells do not contain a large enough base of data from which to derive actuarially sound trends.

In developing the actuarially sound capitation rates, I have relied upon data and information provided by the health plans and the AHCCCS internal databases. I have accepted the data without audit and have relied upon the health plan auditors and other AHCCCS employees for the accuracy of the data.

This actuarial certification has been based on the actuarial methods, considerations, and analyses promulgated from time to time through the Actuarial Standards of Practice by the Actuarial Standards Board.

Windy J. Marks — 09/12/07

Windy J. Marks — Date

Fellow of the Society of Actuaries
Member, American Academy of Actuaries

Appendix

Table A1: Prospective Trends

Utilization per 1,000 trends					
Categories of Service	TANF & KidsCare Combined	SSI With Medicare	SSI without Medicare	HIFA	TWG
Hospital Inpatient	6.3%	10.1%	2.4%	0.5%	5.7%
Outpatient Facility	5.6%	2.8%	2.3%	9.2%	3.3%
Emergency Room	0.6%	1.7%	-2.8%	2.3%	1.0%
Primary Care	2.3%	15.3%	7.9%	3.2%	9.7%
Referral Physician	2.2%	15.3%	7.9%	3.7%	9.7%
Other Professional	-0.9%	-4.6%	-4.2%	4.2%	-0.4%
Pharmacy	4.8%	3.0%	3.6%	10.1%	8.8%
Other	n/a	n/a	n/a	n/a	n/a

Unit Cost Trends					
Categories of Service	TANF & KidsCare Combined	SSI With Medicare	SSI without Medicare	HIFA	TWG
Hospital Inpatient	3.8%	3.2%	4.7%	9.3%	7.2%
Outpatient Facility	4.0%	4.0%	4.0%	4.0%	4.0%
Emergency Room	9.7%	5.1%	7.8%	7.2%	7.2%
Primary Care	3.7%	-4.4%	-4.0%	1.8%	-5.4%
Referral Physician	3.7%	-4.4%	-4.0%	0.9%	-5.4%
Other Professional	3.7%	4.7%	5.7%	2.6%	1.2%
Pharmacy	4.6%	6.0%	7.1%	3.7%	0.4%
Other	n/a	n/a	n/a	n/a	n/a

PMPM Trends					
Categories of Service	TANF & KidsCare Combined	SSI With Medicare	SSI without Medicare	HIFA	TWG
Hospital Inpatient	10.4%	13.6%	7.2%	9.8%	13.3%
Outpatient Facility	9.8%	7.0%	6.4%	13.5%	7.4%
Emergency Room	10.4%	6.9%	4.8%	9.6%	8.2%
Primary Care	6.1%	10.1%	3.6%	5.0%	3.8%
Referral Physician	6.0%	10.1%	3.6%	4.6%	3.8%
Other Professional	2.7%	-0.1%	1.2%	6.9%	0.9%
Pharmacy	9.5%	9.2%	10.9%	14.2%	9.2%
Other	7.0%	4.4%	0.5%	3.2%	4.6%

Acute Capitation Rate Analysis (Renewal Rates--pending approval)
Point in Time Comparison--no member growth factor
CYE '08

Actual RI levels (ie HC and PHP at 50K all others at 20K)

Title XIX Waiver Group		CYE08 Projected Member Months	Cap Rate-'07 based on CYE08 Projected Member Months	Total Annual Dollars CYE '07 based on CYE08 Projected MMs	Cap Rate-'08 based on CYE08 Projected Member Months	Total Annual Dollars CYE '08 based on CYE08 Projected MMs	Difference	% Increase
	[1] Prospective-MED	54,997	$ 976.55	$ 53,706,908	$ 959.99	$ 52,796,164	$ (910,743)	-1.7%
	[1] PPC-MED	13,072	$ 1,709.61	$ 22,348,817	$ 2,237.49	$ 29,249,510	$ 6,900,693	30.9%
	[1] Hospitalized Supp-MED	5,298	$ 10,491.29	$ 55,582,854	$ 10,858.49	$ 57,528,280	$ 1,945,426	3.5%
	Total MED			$ 131,638,579		$ 139,573,955	$ 7,935,375	6.0%
	[1] Prospective-non-MED	1,218,382	$ 437.07	$ 532,518,369	$ 464.59	$ 566,048,251	$ 33,529,882	6.3%
	[1] PPC -non-MED	129,492	$ 703.02	$ 91,035,679	$ 885.19	$ 114,625,291	$ 23,589,613	25.9%
	Total non-MED			$ 623,554,048		$ 680,673,542	$ 57,119,495	9.2%
	Total TWG			$ 755,192,627		$ 820,247,497	$ 65,054,870	8.6%
TXIX								
	[1] <1	666,958	$ 483.07	$ 322,187,203	$ 508.41	$ 339,087,908	$ 16,900,705	5.2%
	[1] 1-13	4,338,615	$ 108.53	$ 470,869,926	$ 112.03	$ 486,055,080	$ 15,185,154	3.2%
	[1] 14-44F	1,868,318	$ 192.03	$ 358,773,056	$ 217.09	$ 405,593,099	$ 46,820,043	13.1%
	[1] 14-44M	806,462	$ 134.80	$ 108,711,135	$ 142.14	$ 114,630,570	$ 5,919,434	5.4%
	[1] 45+	245,849	$ 368.00	$ 90,472,349	$ 384.35	$ 94,491,976	$ 4,019,627	4.4%
	[1] SSI w/Med	736,318	$ 184.63	$ 135,946,354	$ 161.73	$ 119,084,677	$ (16,861,677)	-12.4%
	[1] SSI w/o Med	635,326	$ 637.76	$ 405,185,548	$ 708.50	$ 450,128,513	$ 44,942,965	11.1%
	[1] SFP	76,638	$ 17.34	$ 1,328,911	$ 18.38	$ 1,408,614	$ 79,704	6.0%
	[1] Delivery Supplemental Payment	34,725	$ 6,303.94	$ 218,901,228	$ 6,583.36	$ 228,603,950	$ 9,702,723	4.4%
	Total Prospective-non-TWG			$ 2,112,375,709		$ 2,239,084,387	$ 126,708,678	6.0%
	[1] PPC'<1	21,942	$ 1,249.76	$ 27,422,434	$ 1,152.23	$ 25,282,415	$ (2,140,019)	-7.8%
	[1] PPC'1-13	223,125	$ 47.94	$ 10,696,607	$ 59.30	$ 13,231,306	$ 2,534,699	23.7%
	[1] PPC '14-44F	137,000	$ 177.30	$ 24,290,030	$ 225.67	$ 30,916,700	$ 6,626,671	27.3%
	[1] PPC '14-44M	49,952	$ 154.93	$ 7,739,024	$ 196.61	$ 9,821,013	$ 2,081,989	26.9%
	[1] PPC '45+	12,924	$ 343.14	$ 4,434,655	$ 381.24	$ 4,927,050	$ 492,395	11.1%
	[1] PPC 'SSI w/Med	10,509	$ 61.72	$ 648,634	$ 133.54	$ 1,403,411	$ 754,777	116.4%
	[1] PPC 'SSI w/o Med	17,466	$ 149.90	$ 2,618,181	$ 339.89	$ 5,936,580	$ 3,318,400	126.7%
	PPC All non-TWG rate codes	472,918		$ 77,849,564		$ 91,518,476	$ 13,668,912	17.6%
	Total Title XIX-non-TWG			$ 2,190,225,273		$ 2,330,602,862	$ 140,377,590	6.4%
Other								
	[1] HIFA Parents 14-44F -TXXI	79,888	$ 210.19	$ 16,791,562	$ 230.13	$ 18,384,520	$ 1,592,958	9.5%
	[1] HIFA Parents 14-44M -TXXI	54,033	$ 135.49	$ 7,320,892	$ 141.24	$ 7,631,580	$ 310,688	4.2%
	[1] HIFA Parents 45+ -TXXI	37,382	$ 392.55	$ 14,674,361	$ 411.40	$ 15,379,015	$ 704,653	4.8%
	[1] HIV/AIDS Supp	10,872	$ 1,051.86	$ 11,435,822	$ 1,051.86	$ 11,435,822	$ -	0.0%
Grand Total Capitation				**$ 2,995,640,537**		**$ 3,203,681,295**	**$ 208,040,759**	6.9%

[1] Population estimates for CYE 2008 are taken from DBF projections.

[2] APIPA switched from a 50,000 reinsurance deductible level to a 20,000 deductible level for CYE08. Thus CYE07 numbers are at the 50,000 reinsurance deductible level and at a 20,000 deductible level for C\

STATE OF ARIZONA

Joint Legislative Budget Committee

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STEVE YARBROUGH

DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Jay Chilton, Fiscal Analyst

SUBJECT: Department of Economic Security – Review of Increase to Division of Developmental Disabilities' Therapy Rates

Request

Pursuant to a footnote in the FY 2008 General Appropriation Act (Laws 2007, Chapter 255), the Department of Economic Security (DES) requests that the Committee review an increase to the Division of Developmental Disabilities' (DDD) therapy rates.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review as DES has said that it has sufficient funds in its current year budget to fund this increase.
2. An unfavorable review of the request as implementation of the higher rates precludes the use of these funds as an option to reduce the state's budget shortfall.

DES estimates that the increase will have an estimated General Fund impact of $1.1 million in FY 2008. The estimated annualized cost of the increased rates is $1.6 million from the General Fund.

Analysis

In a September 2005 performance audit, the Office of the Auditor General reported that therapy services are the greatest unmet service need of individuals with developmental disabilities. This includes occupation, physical, and speech therapy. The report noted that one of the reasons for the lack of therapy service availability is that reimbursement rates are not adequate. In an effort to address this issue, DES contracted with an independent consultant to evaluate the rates paid to occupational, physical, and speech therapists. The proposed new rates will be effective beginning November 1, 2007.

(Continued)

Reimbursement will vary according to a client's location. Previously, rates paid for services provided in natural settings (such as in the client's home) varied according to the distance traveled by the therapist. Under the new rate structure, the state is divided into 4 reimbursement tiers, with rates increasing as client density decreases. DES expects that the new reimbursement rates will encourage more providers to participate and will increase the availability of service, thus increasing the total number of clients served. DES estimates that in FY 2008 it would otherwise provide 326,000 units of therapy service. DES believes that the adjusted therapy rates will enable an additional 14,000 units of service, for an FY 2008 total of 340,000. A unit of service is 1 therapy or evaluation session. DES does not track the number of individual clients receiving therapy services.

Concerns regarding the new rates have been raised by some providers, as the rates may impact the ability of providers to provide services to clients in rural areas. In-home services rates vary depending on the distance that the provider travels while the new rates will provide a fixed rate depending on the tier in which the client lives. This may reduce the total reimbursement for therapists traveling from the urban areas of Phoenix and Tucson to outlying urban fringe and rural areas, where there may be no local providers. The reduced reimbursement may discourage therapists from being willing to provide services in such areas. The higher rates in rural areas may encourage therapists in those areas, however, to provide services if they have not previously.

DES acknowledges that therapists who drive significant distances to provide services will see decreases in rates, but states that the new methodology is designed to increase the capacity to provide therapy services locally in the more rural areas of the state. Therapists who provide services in natural environments near their homes or offices in rural areas will see the greatest increase in their rates.

The department estimates that the rate increase will have a $1.6 million General Fund ($2.7 million Total Funds) annual impact, which reflects both the increased rates as well as the anticipated increase in the number of clients served. The new rates will be effective beginning November 1, 2007, resulting in an 8-month FY 2008 cost of approximately $1.1 million from the General Fund. The FY 2008 General Fund cost to the state-only program will be about $700,000 and the General Fund cost to the Arizona Long-Term Care System (ALTCS) will be about $371,000. The state-only portion will be funded from a surplus within the existing General Fund appropriation for the state-only Home and Community Based Services Special Line Item. The department anticipates that the increase to the ALTCS program will be covered by the FY 2008 capitation rate.

RS/JC:ym

ARIZONA DEPARTMENT OF ECONOMIC SECURITY
1717 W. Jefferson - P.O. Box 6123 - Phoenix, AZ 85005

Janet Napolitano
Governor

Tracy L. Wareing
Director

SEP 14 2007

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SEP 17 2007
JOINT BUDGET COMMITTEE

Mr. Richard Stavneak
Director, Joint Legislative Budget Committee
1716 West Adams
Phoenix, Arizona 85007

Dear Mr. Stavneak:

Pursuant to a footnote in Laws 2007, Chapter 255, Section 28, the Department of Economic Security requests review of an increase to the Division of Developmental Disabilities' therapy rates.

> Prior to the implementation of any developmentally disabled or long term care statewide provider rate increases not already specifically authorized by the legislature, court mandates or changes to federal law, the department shall submit a report for review by the joint legislative budget committee. The report shall include, at a minimum, the estimated cost of the provider rate increase and the ongoing source of funding for the increase.

In a September 2005 performance audit (Report No. 05-07), the Auditor General noted that therapy services are the greatest unmet need of individuals with developmental disabilities. The audit also noted that reimbursement rates are one of the primary issues causing the lack of service availability. Partly to address this finding, the Department contracted with an independent consultant to evaluate the rates paid to occupational, physical, and speech therapists. These rates were then released for public comment. Many of the comments were incorporated in the revised rates. The table below illustrates the resulting rates, which will be effective beginning November 1, 2007.

	Clinical Setting		Natural Setting	
	Therapy	Evaluation	Therapy	Evaluation
Base	$62.80	$172.56	$77.94	$192.98
Tier 1	$63.27	$172.56	$85.73	$192.98
Tier 2	$71.90	$172.56	$97.43	$192.98
Tier 3	$86.28	$172.56	$116.91	$192.98

Reimbursement will vary according to the client's geographic location. To incentivize the provision of services to clients in more rural areas, the state has been divided into four reimbursement tiers. Rates increase as client density decreases. Previously, rates paid for services provided in natural settings varied according to the distance traveled by the therapist. As a result, the new and old rates are not directly comparable. The $57.52 benchmark rate for clinic-based services in the 'base' areas is less than the current adopted rates for these services. As displayed in the preceding table, the Department will hold these providers harmless and continue paying $62.80 per hour until the benchmark exceeds this amount. Since the clinic-based rate is currently the same regardless of the location in the state, clinic-based providers in each of the three tiers will experience rate increases.

Overall, the Department estimates that this rate increase will have a $2.7 million annual impact, including the projected increase in the number of units of services delivered as more therapists become available to provide services to individuals currently on a waiting list. The new rates will not become effective until November 1, 2007; therefore, the nine-month cost in fiscal year 2008 will be $1.8 million. The cost to the state-only program will be approximately $700,000 and the cost to the Arizona Long Term Care System (ALTCS) will be about $1.1 million. The increases will be funded from the existing appropriations made for home and community-based services (HCBS). In fiscal year 2007, the state-only HCBS appropriation had a General Fund surplus that was transferred to resolve a shortfall in the ALTCS program resulting from an under-funding of the capitation rate. These funds will be adequate to support the cost of this rate increase to the state-only program. The fiscal year 2008 capitation rate for the ALTCS program should be adequate to fund the cost of the increase to that program.

Please contact Stephen Pawlowski, Financial Services Administrator, at (602) 542-3786 if you have any questions.

Sincerely,

Tracy L. Wareing
Director

cc: Members of the Joint Legislative Budget Committee
James Apperson, Director, Governor's Office of Strategic Planning and Budgeting

STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Kimberly Cordes-Sween, Senior Fiscal Analyst

SUBJECT: Department of Public Safety – Quarterly Review of the Arizona Public Safety Communication Advisory Commission

Request

Pursuant to A.R.S. § 41-1830.42C, the Department of Public Safety (DPS) has submitted for review its FY 2007 fourth quarter expenditures and progress for the statewide interoperability design project.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the request. Fourth quarter expenditures totaled $524,100. For the entire fiscal year, DPS expended $1.3 million of $4.3 million in FY 2007 funding. Activities in the fourth quarter addressed projects identified in the Public Safety Communication Advisory Commission (PSCC) timeline relating to both the "short-term" and "long-term" interoperable solutions.

The PSCC plans to have the short-term solution fully deployed by August 2009. In the last quarter, the Commission also adopted its technical standards for the long-term solution.

Analysis

Background
The Arizona PSCC was established to develop a statewide standard-based interoperability system that allows public safety personnel from one agency to communicate, via mobile radio, with personnel from other agencies. An interoperable system enhances the ability of various public safety agencies to coordinate their actions in the event of a large-scale emergency as well as daily emergencies. Construction costs of a statewide interoperability communication system have been estimated to be as high as $300 million. The PSCC timeline (*see Attachment A*) targets the establishment of a financing and development plan for the system by July 2008.

(Continued)

Activities

PSCC progress in the fourth quarter regarding the timeline and the "short-term" interoperable solution included increasing the number of Arizona Interagency Radio System (AIRS) user agencies to 90. This short-term solution, while allowing interagency communication, is limited to a single talk group, which is described as a conversation between users in a geographical area. The PSCC describes this functionality as "basic interoperability" for first responders. The full deployment of AIRS, which includes the installation of equipment at over 40 sites, is expected by July 2009 (Milestone 9).

The long-term solution differs from the short-term solution in that it will allow an unlimited number of talk groups, creating a more robust interoperability solution open to more simultaneous users than AIRS. With respect to the "long-term" interoperable solution, the Commission formally adopted the technical standards for the statewide interoperable solution and is exploring technology that would allow users on different communications systems to "seamlessly" communicate. This technology will be a major element in the long-term solution for PSCC. In addition, DPS personnel have met with counterparts from Sonora, Mexico to discuss a proposal for cross-border communications, as part of a larger ongoing effort between the 2 federal governments (Milestone 10).

The PSCC is working on a demonstration project, which will be based on the technical standards adopted by the PSCC in April 2007. The demonstration project will show the improved day-to-day interoperability between multiple jurisdictions using a shared radio. PSCC hopes to have the demonstration project in place for the 2008 Super Bowl. To advance the demonstration project, PSCC is considering using Inter-governmental Agreements (IGAs) to pass monies through to Phoenix and Yuma, since those locales will be purchasing project equipment (Milestone 6).

In July 2007, the U.S. Departments of Commerce and Homeland Security announced that Arizona will be eligible to receive $17.7 million in grant awards for statewide interoperable communications systems, which will be received through the Public Safety Interoperable Communications Program. The proceeds from a commercial radio spectrum sale, $968 million, were divided among the 50 states, 5 U.S. territories and possessions, and the District of Columbia. The awards were determined based on a risk assessment formula, with 5% being made available at the end of September and the remaining 95% available in March 2008 based on a completed statewide interoperability plan.

Sixty-three interoperable project requests, totaling $19.5 million, have been reviewed by the Arizona Department of Homeland Security; however, no decisions have been made on which projects will be funded. The Statewide Interoperability Executive Committee (SIEC) submitted a completed draft plan in September 2007 and intends to submit the final plan for use of this funding by December 2007.

The PSCC expects to use this funding for completion of the AIRS network and upgrading the DPS microwave system. The microwave system is the backbone of the DPS statewide radio system and is divided into 3 segments, also called loops. The total cost of the microwave system upgrade project is currently estimated at $46.4 million. The Legislature has approved funding for the South Loop in the amount of $2.5 million each year from FY 2007 through FY 2009. The amount is a combination of General Fund, Game and Fish Fund, and State Highway Fund dollars. It was also expected that $1.6 million of Homeland Security money would be distributed for this project in each year over the same span. At the July 2007 JLBC Meeting, the Arizona Department of Homeland Security (AZDOHS) indicated that they intend to follow legislative intent to fund the entire $4.8 million for the microwave

(Continued)

project, despite not having funded the original FY 2007 microwave project request (Milestone 4 and 13).

Expenditures

Laws 2004, Chapter 275 included a non-lapsing appropriation of $3 million to DPS in FY 2005 for design costs of a statewide radio interoperability communication system. At the beginning of FY 2007, $2,987,200 was remaining from that non-lapsing appropriation. In addition, the Legislature appropriated $1,335,000 to DPS in FY 2007 from the General Fund for PSCC. Therefore, there was a total of $4,322,200 in monies available for expenditure in FY 2007.

In the fourth quarter, the PSCC expended roughly $417,600 for costs associated with 6 filled FTE Positions, federal engineering costs, and capital and non-capital equipment. Total fourth quarter expenditures also included $106,600 from the PSCC's non-lapsing funds paid to the consulting firm contracted to create the conceptual design of the "long-term" solution. Total expenditures for the quarter were $524,100, leaving $3,016,600 to be carried forward in FY 2008.

Table 1 indicates FY 2007 monies available for expenditure and expenditures for all quarters in FY 2007.

Table 1

PSCC Appropriation & Expenditures

	FY 2007 Funding Available	1st Quarter Expenditures	2nd Quarter Expenditures	3rd Quarter Expenditures	4th Quarter Expenditures	Total FY 2007 Expenditures
Personal Services	$737,300	$118,100	$79,600	$95,800	$149,600	$443,100
Employee Related Expenditures	230,100	20,100	13,900	18,800	17,800	70,600
Professional & Outside Services	2,987,200 1/	65,700 2/	195,000 2/	125,100 2/	313,400 2/	699,200 2/
Travel - In State	41,400	400	400	200	700	1,700
Travel - Out of State	26,600	2,500	--	1,200	900	4,600
Other Operating Expenditures	299,600	47,100	9,400	6,200	8,500	71,200
Equipment	--	--	--	--	33,200	33,200
Total Operating Expenditures	**$4,322,200**	**$253,900**	**$298,300**	**$247,300**	**$524,100**	**$1,323,600**

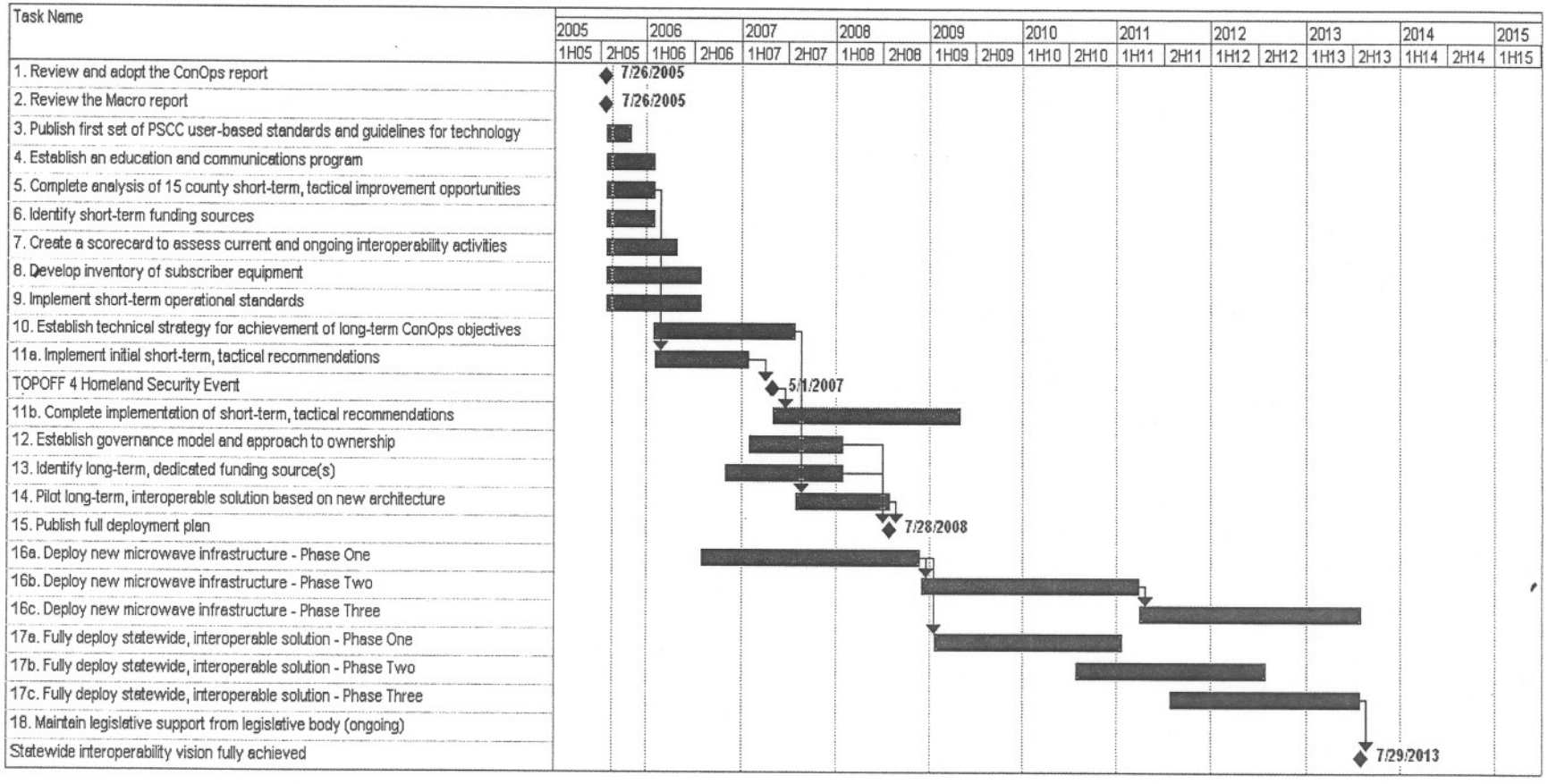
1/ The amount remaining from the Laws 2004, Chapter 275 non-lapsing appropriation of $3 million is included in the Professional & Outside Services line.

2/ Expenditures in Professional & Outside Services for all quarters are from the $3 million in non-lapsing monies, with the exception of $206,800 in the 4th Quarter, which was due to indirect costs transfers for services provided by AZ DPS and federal engineering costs.

RS/KCS:ss
Attachment

The following project plan conveys the major components of the short- and long-term strategies for achieving statewide interoperability in the State of Arizona. Through execution of this plan, the State can address the critical communications issues facing public safety and realize the vision for radio interoperability shared by the PSCC and the State of Arizona.

Figure 2. Arizona Statewide Interoperability Project Plan



Attachment 1

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ARIZONA DEPARTMENT OF PUBLIC SAFETY

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SEP 17 2007
JOINT BUDGET COMMITTEE

September 14, 007

Representative Russell Pearce, Chairman
Joint Legislative Budget Committee
1716 West Adams
Phoenix, AZ 85007

Dear Representative Pearce:

Attached is the FY 2007 fourth quarter report for the Arizona Public Safety Communications Commission (PSCC). Included is the narrative of our activities and progress relative to milestones identified in our Concept of Operations document for the reporting period of April 1, 2007 through June 30, 2007.

If we can answer any questions or assist you or your staff in any manner, please contact Mr. Curt B. Knight, Executive Director, PSCC at (602) 271-7400.

Sincerely,

for J. A. Felix DEPUTY

Roger Vanderpool
Director

rl

Attachments

PUBLIC SAFETY COMMUNICATIONS COMMISSION
FY 2007 Fourth Quarter Report

MILESTONE 4 – EDUCATION AND COMMUNICATION PROGRAM

The Public Safety Communications Commission made contact with the police and fire chiefs of the Cities of Phoenix and Mesa as well as with the Yuma Regional Communications System and Pima County, with the proposed plans of the upcoming demonstration of improved day-to-day interoperability between local, county, state, tribal and federal public safety responders.

Mr. Knight presented a PowerPoint illustrating both design approaches – a separate state system versus the expansion of a regional systems approach to the Executive Steering Committee members for Super Bowl planning and the public safety officials at the City of Mesa

Mr. Knight attended meetings with the North, South, Central, West and East Regional Advisory Councils (RACs) the first part of the quarter. Topics have focused on the May 2007 review of grant requests by an ad hoc group of subject matter experts from state and local government who assisted AZ Department of Homeland Security (AZ DHS) in reviewing interoperability projects. Sixty-three (63) projects totaling a requested amount of $19.5 million were reviewed during an all-day session. Recommendations from that review were made to Director Leesa Morrison's office. Discussion at these meetings have also centered around the technical standards adopted at the April 24 PSCC meeting dictating the statewide solution for Arizona to be a single-band, 700 MHz, trunked voice radio system using a Project 25 standards-based architecture. As well as PSCC's focus at this time on the Public Safety Interoperable Communications (PSIC) Program involving the development of a Statewide Communications Interoperability Plan (SCIP).

Additional meetings have been conducted with individuals from Arizona State University (ASU) and the City of Peoria to encourage and foster a partnership with them in the future, and possibly allow their systems to become elements of a larger system with PSCC, the Phoenix/Mesa system, the Yuma Regional Communications System and eventually the system being developed for Pima County. Ongoing discussions most likely will take place in the future.

Mr. Knight has met twice with the Governor's staff and state agency heads to keep them apprised of the progress on our interoperability efforts. Ongoing meetings will be taking place in the future.

MILESTONE 6 – IDENTIFY SHORT-TERM FUNDING SOLUTIONS:

On June 4, 2007, Mr. Knight and Mr. Miner met with the Government Information Technology Agency to clarify the need to develop a Project Investment Justification (PIJ) for the demonstration project since procurement of equipment would be by the Cities of Phoenix and Mesa, and Yuma with local contracts currently in place. It was determined a demonstration project-type PIJ would be developed by PSCC regardless of how equipment for the demonstration project is purchased. The possibility of using IGAs to pass through monies to both the City of Phoenix and Yuma are recognized as a possible means to advance the demonstration project.

Federal Engineering (FE) continues its focus on gathering information to complete the PIJ document for the demonstration project. The PIJ will be tailored to include information about the entire conceptual project with a focus on the financials of the demonstration project. FE has made good progress in the terms of determining assumptions of the radio coverage needs, radio types and the design relative to the number of major system components to be incorporated into the statewide design.

MILESTONE 9 – IMPLEMENT SHORT-TERM OPERATIONAL STANDARDS:

Ninety (90) public safety agencies throughout Arizona have signed a Memorandum of Understanding to use the AIRS network as part of an overall interagency communications solution. The following is a breakdown of the various organizations:

Law Enforcement	29
Fire Service	28
Emergency Medical Service	8
State Government Agencies	6
Federal Agencies	3
Emergency Management	2
Tribal Governmental Agencies	2
Other Agencies	12

MILESTONE 10 – ESTABLISH TECHNICAL STRATEGY FOR LONG-TERM OBJECTIVES:

At the PSCC quarterly meeting on April 24, the Commission formally adopted the technical standards to be adhered and the direction to be taken for Arizona's statewide interoperable solution. The technical standard chosen for Arizona is based on a single-band, 700 MHz, trunked voice radio system using Project 25 standards-based architecture. With the direction now defined, the PSCC can concentrate on establishing partnerships with existing, established systems to further our interoperability capacity and capability, as well as work on the demonstration project direction and complete our conceptual design.

FE met with several major manufacturers during the first part of June for exploratory discussion in regards to technology, specifically the Inter-Subsystem Interface (ISSI). The ISSI standard allows disparate systems to be "seamlessly" used as one from the users prospective. When fully implemented, the ISSI standard is anticipated to be a major element of how the PSCC advances the long-term solution for statewide interoperability.

Ongoing project status meetings between PSCC staff and FE continue to take place on a bi-monthly basis for discussion of project-related progress, action items needing to take place and updates from PSCC and FE.

On April 12, 2007, Mr. Knight, along with other DPS personnel, met with our Mexican counterparts from the state of Sonora, Mexico regarding a proposal for our consideration to enhance cross-border communications between our two states. The purpose and focus of this meeting was to share with us their proposed technology solution based on current ongoing work between our two federal governments to establish a cross-border microwave network among our ten states collectively.

MILESTONE 11 – IMPLEMENT SHORT-TERM TACTICAL RECOMMENDATIONS

FE is focusing on the conceptual design and business case. The business case will be similar to the regional work completed for the state of Oregon. FE will forward the boilerplate for the conceptual design to Mr. Miner, PSCC for his review.

MILESTONE 12 – ESTABLISH GOVERNANCE MODEL AND APPROACH TO OWNERSHIP:

Information on governance models is still in the gathering stages. Currently, FE is concentrating most of their efforts on the details for the PIJ. FE will provide updates on their progress during the future PSCC project meetings.

MILESTONE 13 – IDENTIFY LONG-TERM, DEDICATED FUNDING SOURCE(S):

The State is eligible to receive $17.7 million in funding through the Public Safety Interoperable Communications Program.

The Statewide Interoperability Executive Committee (SIEC) is preparing, and will submit the rough draft to Interoperable Communication Technical Assistance Program (ICTAP) for suggested revisions on September 30, 2007. The final plan is due December 3, 2007. The PSCC board will meet monthly through the finalizing of the plan.

FUTURE PSCC MEETINGS:

Tuesday, September 25, 2007 at 1:00 p.m.
City of Peoria Council Chambers
8401 West Monroe Street
Peoria, Arizona

Tuesday, October 23, 2007 at 1:00 p.m.
City of Peoria Council Chambers
8401 West Monroe Street
Peoria, Arizona

BUDGET:

FY2007 fourth quarter expenditures in the Operating Funds totaled $417,560.28 and the Non-lapsing Funds totaled $106,578.76. The substantial increase in expenditures from the Operating Funds was due to the indirect cost transfers for services provided by the AZ DPS and utilization of vacancy savings to partially-fund obligations to FE.

PUBLIC SAFETY COMMUNICATIONS COMMMISSION BUDGET FY 2007

FY 07 Quarterly Expenditure
Allocated Funds

	ALLOCATED AMOUNT	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	REMAINING BALANCE
PERSONAL SERVICES	$ 737,300.00	$ 118,126.82	$ 79,639.72	$ 95,767.80	$ 149,676.63	$ 294,089.03
ERE	$ 230,100.00	$ 20,070.70	$ 13,907.84	$ 18,819.75	$ 17,851.32	$ 159,450.39
PROFESSIONAL/OUTSIDE SVCS *	$ -	$ 30.00	$ 30.00		$ 206,798.85	$ (206,858.85)
TRAVEL (IN STATE)	$ 41,400.00	$ 385.61	$ 381.06	$ 216.17	$ 672.57	$ 39,744.59
TRAVEL (OUT OF STATE)	$ 26,600.00	$ 2,530.93		$ 1,170.90	$ 912.17	$ 21,986.00
AID TO OTHER ORGANIZATIONS	$ 55,000.00				$ -	$ 55,000.00
OTHER OPERATING	$ 244,600.00	$ 47,110.45	$ 9,382.83	$ 6,197.89	$ 8,482.51	$ 173,426.32
BUILDINGS/BUILD IMPROVEMENT	$ -				$ -	$ -
CAPITAL EQUIPMENT	$ -				$ 11,067.13	$ (11,067.13)
NON CAPITAL EQUIPMENT					$ 22,099.10	$ (22,099.10)
INDIRECT COSTS					$ -	$ -
	$ 1,335,000.00					**$ 503,671.25**
QUARTERLY EXPENDITURES TOTALS		$ 188,254.51	$ 103,341.45	$ 122,172.51	$ 417,560.28	
				FY 07 TOTAL EXPENDITURES	**$ 831,328.75**	

FY 07 Quarterly Expenditure
Non Lapsing Funds

	ALLOCATED AMOUNT	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	REMAINING BALANCE
PERSONAL SERVICES	$ -	$ -	$ -	$ -	$ -	$ -
ERE	$ -	$ -	$ -	$ -	$ -	$ -
PROFESSIONAL/OUTSIDE SVCS *	$ 646,530.00	$ 65,690.00	$ 181,110.42	$ 125,072.85	$ 106,578.76	$ 168,077.97
TRAVEL (IN STATE)	$ -	$ -	$ -	$ -	$ -	$ -
TRAVEL (OUT OF STATE)	$ -	$ -	$ -	$ -	$ -	$ -
AID TO OTHER ORGANIZATIONS	$ -	$ -	$ -	$ -	$ -	$ -
OTHER OPERATING	$ -	$ -	$ -	$ -	$ -	$ -
BUILDINGS/BUILD IMPROVEMENT	$ -	$ -	$ -	$ -	$ -	$ -
NON CAPITAL EQUIPMENT	$ -	$ -	$ -	$ -	$ -	$ -
CAPITAL EQUIPMENT		$ -	$ -	$ -	$ -	$ -
INDIRECT COSTS	$ -	$ -	$ -	$ -	$ -	$ -
	$ 646,530.00					**$ 168,077.97**
QUARTERLY EXPENDITURES TOTALS		$ 65,690.00	$ 181,110.42	$ 125,072.85	$ 106,578.76	
				FY 07 TOTAL EXPENDITURES	**$ 478,452.03**	

4TH QUARTER EXPENDITURES

OBJECT CODE	DATE	VENDOR		EXPENDED	SUB TOTAL
	PERSONAL SERVICES				$ 149,676.63
6011	4/6/2007	SALARY		$15,446.13	
6011	4/20/2004	SALARY		$15,446.12	
6011	5/9/2007	SALARY		$15,276.37	
6011	5/23/2007	SALARY		$15,615.90	
6011	5/30/2007	DPS TRANSFER TO ASD	ANNUAL -INDIRECT COSTS	$57,000.00	
6011	6/1/2007	SALARY		$15,446.03	
6011	6/15/2007	SALARY		$15,446.08	
				$149,676.63	**$ 149,676.63**
	EMPLOYEE RELATED EXPENSES				$ 17,851.32
6100	4/6/2007	ERE		$3,002.47	
6100	4/20/2007	ERE		$3,002.45	
6100	5/9/2007	ERE		$2,872.23	
6100	5/23/2007	ERE		$2,969.23	
6100	6/1/2007	ERE		$3,002.48	
6100	6/15/2007	ERE		$3,002.46	
				$17,851.32	**$ 17,851.32**
	PROFESSIONAL/OUTSIDE SERVICES				$206,798.85
6231	5/21/2007	FEDERAL ENGINEERING	PROF SVCS & REIMB EXPENSE	$68,282.48	
6231	6/15/2007	FEDERAL ENGINEERING	PROF SVCS & REIMB EXPENSE	$69,988.40	
6231	7/5/2007	FEDERAL ENGINEERING	PROF SVCS & REIMB EXPENSE	$68,367.97	
				$206,638.85	**$ 206,638.85**
6299	4/13/2007	TCH ENTERPRISES	RECYCLE CONTAINER	$30.00	
6299	5/11/2007	T EZELL ENT.	POLYGRAPH-J JAME	$100.00	
6299	6/15/2004	TCH ENTERPRISES	RECYCLE CONTAINER	$30.00	
				$160.00	**$ 160.00**
	TRAVEL IN-STATE				$672.57
6500	4/17/2007	M KINCHELOE	TRVL REIMB-LAUGHLIN	$315.37	
6500	4/17/2007	J MINER	TRVL REIMB-LAUGHLIN	$357.20	
				$672.57	**$ 672.57**
	TRAVEL OUT-OF-STATE				$912.17
6600	4/3/2007	C KNIGHT	TRVL REIMB-APCO CONF CA	$912.17	
				$912.17	**$ 912.17**
	AID TO OTHER ORGAINZATIONS				$0.00
6800					
				$0.00	**$ -**
	OTHER OPERATING EXPENSES				$8,482.51
7179	4/10/2007	VERIZON WIRELESS	CELL PHONE -KNIGHT/MINER	$177.42	
7179	3/31/2007	DPS TRANSFER TO WSB	PBX LONG DISTANCE CALLS NOV-FEB	71.35	
7179	4/9/2007	DPS TRANSFER TO WSB	PBX LONG DISTANCE CALLS MAR	$31.72	
7179	6/4/2007	VERIZON WIRELESS	CELL PHONE -KNIGHT/MINER	$347.46	
7179	5/2/2007	DPS TRANSFER TO WSB	PBX LONG DISTANCE CALLS MAR	$38.65	
7179	6/11/2007	DPS TRANSFER TO WSB	PBX LONG DISTANCE CALLS MAY	$24.90	

4TH QUARTER EXPENDITURES

OBJECT CODE	DATE	VENDOR		EXPENDED	SUB TOTAL
7179	5/24/2007	DPS TRANSFER TO WSB	ASNET SVC 8 SEATS - MAR 07	$448.88	
7179	5/31/2007	DPS TRANSFER TO WSB	ASNET SVC 8 SEATS - APR 07	$448.88	
7179	5/31/2007	DPS TRANSFER TO WSB	ASNET SVC 8 SEATS - MAY 07	$448.88	
7179	6/1/2007	VERIZON WIRELESS	CELL PHONE -KNIGHT/MINER	$169.16	
7179	6/26/2007	DPS TRANSFER TO WSB	ASNET SVC 8 SEATS - JUN 07	$448.88	
7179	6/27/2007	DPS TRANSFER TO WSB	4TH QTR - PAGER BILLING	$8.35	
7179	7/1/2007	VERIZON WIRELESS	CELL PHONE -KNIGHT/MINER	$169.14	
7179	7/12/2007	DPS TRANSFER TO WSB	PBX LONG DISTANCE CALLS JUN	$22.80	
				$2,856.47	**$ 2,856.47**
7229	4/19/2007	CITY OF PHX	MTG RESERVATION/PERMIT	$250.00	
				$250.00	**$250.00**
7270	6/7/2007	SOFTWRIGHT LTD LIABIL	1-YR MAINT SUB TAP 6.0	$2,374.52	
				$2,374.52	**$2,374.52**
7321	4/30/2007	AMERICAN EXPRESS	CHARGES - E. JABLONSKI	$1,268.41	
7321	4/26/2007	DPS TRANSFER - ASD	REIMB FOR OFFICE SUPPLIES-FEI	$61.06	
7321	5/30/2007	AMERICAN EXPRESS	CHARGES - E. JABLONSKI	$166.10	
7321	5/25/2007	DPS TRANSFER - ASD	REIMB FOR OFFICE SUPPLIES-MA	$186.90	
7321	5/25/2007	DPS TRANSFER - ASD	REIMB FOR PRINTER SERVICES	$5.33	
7321	5/31/2007	DPS TRANSFER - ASD	REIMB FOR OFFICE SUPPLIES-API	$195.69	
7321	6/1/2007	AMERICAN EXPRESS	CHARGES - E. JABLONSKI	$105.22	
				$1,988.71	**$1,988.71**
7361	5/31/2007	DPS TRANSFER - ASD	REIMB FOR FUEL CHARGES-FEB	$0.18	
7361	6/6/2007	DPS TRANSFER - ASD	REIMB FOR FUEL CHARGES-MAR/	$208.17	
				$208.35	**$208.35**
7381	6/14/2007	R LARSON	REIMB FOR OVERNIGHT SHIP	$31.26	
				$31.26	**$31.26**
7455	6/4/2007	AZ MEX COMMISSION	EMRGNCY MNGMT MTG-MURPHY	$455.00	
				$455.00	**$455.00**
7481	4/26/2007	DPS TRANSFER-ASD	REIMB FOR POSTAGE CHARGES-FEB	$9.39	
7481	5/25/2007	DPS TRANSFER-ASD	REIMB FOR POSTAGE CHGS - MAR	$76.38	
7481	5/31/2007	DPS TRANSFER-ASD	REIMB FOR POSTAGE CHGS - APR	$90.99	
				$176.76	**$176.76**
7511	5/30/2007	CURT KNIGHT	REIMB FOR 75YR MEDALLIONS	$30.00	
				$30.00	**$30.00**
7541	5/31/2007	AZ CAPITOL TIMES	SUBSCRIPTION	$99.00	
				$99.00	**$99.00**
7599	5/23/2007	AZ DEPT OF REVENUE	OUT OF STATE TAXES	$9.30	
7599	6/25/2007	AZ DEPT OF REVENUE	OUT OF STATE TAXES	$3.14	
				$12.44	**$12.44**
	CAPITAL EQUIPMENT				$11,067.13
8461	3/26/2007	MOTOROLA INC	DIGITAL MOBILE RADIO	$8,519.06	
8461	3/26/2007	MOTOROLA INC	2-WAY RADIOS/ATTACHMENTS	$1,517.12	
8461	3/26/2007	MOTOROLA INC	2-WAY RADIOS/ATTACHMENTS	$1,030.95	

4TH QUARTER EXPENDITURES

OBJECT CODE	DATE	VENDOR		EXPENDED	SUB TOTAL
				$11,067.13	**$11,067.13**
	NON CAPITAL EQUIPMENT				$22,099.10
8551	4/13/2007	APPLE COMPUTER INC	COMPUTER-MARKETING SPEC	$4,275.85	
8551	6/7/2007	HEWLETT PACKARD	HP JETDIRECT EN3700	$299.44	
				$4,575.29	**$4,575.29**
8561	6/1/2007	VERIZONA WIRELESS	BLACKBERRY REPLCMT	$162.14	
				$162.14	**$162.14**
8581	5/31/2007	DPS TRANSFER - CJSD	DEPT SUPPORT EXPS-ANNUAL	$17,000.00	
				$17,000.00	**$17,000.00**
8583	6/7/2007	ASAP SOFTWARE	VLA VISIO & VLA ACROBAT 8 PR	$361.67	
				$361.67	**$361.67**
	INDIRECT COSTS				$0.00
9000					
				$0.00	**$0.00**
		TOTALS		**$417,560.28**	**$417,560.28**

STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Leah Ruggieri, Fiscal Analyst

SUBJECT: Attorney General – Review of Allocation of Settlement Monies

Request

A footnote in the General Appropriation Act requires the Attorney General (AG) to receive Joint Legislative Budget Committee review before allocating or expending monies from a settlement of $100,000 or more that are not deposited directly into the General Fund. Pursuant to this footnote, the Office of the Attorney General (AG) has notified the Committee of the allocation of monies received from the Guidant Corporation consent judgment. The AG will receive $815,000 as a result of the settlement. The actual cost of the litigation is estimated to be no greater than $125,300.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the allocation plan from the Guidant Corporation consent judgment. The allocation plan is consistent with A.R.S. § 44-1531.01, which relates to the distribution of monies recovered as a result of enforcing consumer protection or consumer fraud statutes.

Analysis

The Attorney General's office recently entered into a multistate settlement agreement with Guidant Corporation as a result of allegations that the company continued to sell a specific model of Implantable Cardioverter Defibrillators (ICDs) after a potentially dangerous malfunction was discovered in early 2002. An ICD is a medical device that physicians surgically implant into a patient's chest to monitor for abnormal heart rhythms. Guidant Corporation failed

(Continued)

to notify doctors and patients until June 2005 that the ICDs contained a potentially dangerous malfunction, and that modifications were made to the product's design to prevent such malfunctions.

As a part of the settlement agreement, Guidant Corporation will pay $16.8 million to litigating states, of which Arizona will receive $815,000. This amount will be deposited into the Consumer Fraud Revolving Fund to fund future consumer fraud cases. A.R.S. § 44-1531.01 requires the AG to deposit civil penalties recovered as a result of enforcing consumer protection or consumer fraud statutes into the Consumer Fraud Revolving Fund. Based on the $200 hourly rate awarded by the courts for attorney time, the amount of time spent by the AG attorneys on this case would cost approximately $125,300.

Additionally, Guidant Corporation will conduct a warranty program that will allow consumers to replace their ICDs with a new device and be reimbursed up to $2,500 for out-of-pocket expenses associated with the replacement. The litigating states will use up to $1.0 million of the multistate settlement monies to reimburse consumers for expenses incurred above $2,500.

RS/LR:sls

Terry Goddard
Attorney General

Office of the Attorney General
State of Arizona

Jennifer A. Boucek
Consumer Protection &
Advocacy Section

September 12, 2007

The Honorable Timothy S. Bee
President of the Senate
1700 West Washington Street
Phoenix, AZ 85007

The Honorable James P. Weiers
Speaker of the House
1700 West Washington Street
Phoenix, AZ 85007

The Honorable Russell K. Pearce
Chairman, Joint Legislative Budget Committee
1700 West Washington Street
Phoenix, AZ 85007

RECEIVED
SEP 13 2007
JOINT BUDGET COMMITTEE

Re: State v. Guidant Corporation

Dear Gentlemen:

Arizona, along with 35 other states and the District of Columbia, entered into a consent judgment with Guidant Corporation, a wholly owned subsidiary of Boston Scientific and one of the world's top three manufacturers of Implantable Cardioverter Defibrillators (ICDs). An ICD is a medical device that physicians surgically implant into a patient's chest to monitor for abnormal heart rhythms. An ICD works as either a pacemaker to normalize the heart's rhythm or as a defibrillator to deliver an electrical shock to the heart muscle so that the heart returns to a normal beating rhythm. If an ICD fails to deliver a shock when needed, the heart's normal rhythm cannot be restored, and the patient might die.

Guidant manufactured and sold an ICD known as the Ventak Prizm 2 DR Model

1275 West Washington, Phoenix, Arizona 85007-2926 • Phone 602-542-7701 • Fax 602 -542-4377

1861 ("Prizm"). In February, 2002, Guidant discovered a potentially dangerous malfunction due to the Prizm's design: 1) the Prizm's polyimide insulation could degrade; and, 2) Guidant placed a positively charged "feed through wire" too closely to a negatively charged "backfill tube header." If the insulation degraded, the "feed through wire" and the tube came into contact, causing a short circuit (an "arc") that could prevent the Prizm from delivering a lifesaving shock to the patient's heart.

In an attempt to correct the arcing problem, Guidant made design changes to the Prizm on April 16, 2002, and again in November, 2002. Despite making these potentially lifesaving modifications to the Prizm, Guidant made a business decision after April 16, 2002 to continue to sell approximately 4,000 unmodified Prizms out of its existing inventory, inventory in the possession of its sales representatives, and inventory in hospitals.

Guidant did not disclose to doctors or to approximately 4,000 patients who received the unmodified Prizms that the ICD had been modified to prevent a potentially dangerous malfunction. Guidant did not disclose to doctors or many thousands of patients who had received the Prizm ICDs <u>before</u> April 16, 2002, that they might consider ICD replacement because their Prizms contained a potentially dangerous malfunction. Guidant did not even distinguish between the Prizms they manufactured before and after April, 2002, and continued to call both the unmodified and modified Prizms the "Ventak Prizm 2 DR Model 1861."

Guidant did not disclose the defect and the potentially lifesaving modifications until

May 23, 2005, when Guidant learned that the *New York Times* was planning to publicly disclose the Prizm's defect and Guidant's continued sale of the unmodified Prizms. Guidant did not formally inform physicians and patients about the defective Prizms until June 14, 2005, when Guidant and the FDA issued a nationwide Class 1 recall of the Prizms.

Pursuant to the consent judgment, Guidant is required, among other matters, to do the following:

*Establish a patient safety advisory board consisting of independent experts to evaluate data concerning ICD performance;

*Establish a patient safety officer position, staffed by a physician whose primary responsibility is to advance ICD patient safety;

*Clearly disclose and disseminate to the public specific information on a quarterly basis, including worldwide failure data, survival probability estimates, and current information in the event of an FDA recall of any ICD;

*Post a notice on its website within 30 days of any modification to any of its ICDs to correct a failure pattern;

*Solicit the return of out-of-service ICDs; and,

*Maintain a data system to track the serial numbers, implant dates and explant dates of all ICDs Guidant distributes in the United States.

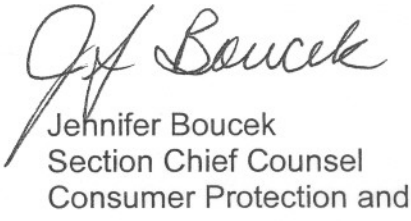
Under the consent judgment, Guidant agreed to pay the states a total of $16,750,000. Arizona, which was one of the lead states in the multistate investigation, will receive $815,000. Guidant is conducting a warranty program to provide consumers who wish to replace their Prizms with a new device and reimburse consumers up to $2,500 for out-of-pocket expenses associated with the replacement. Guidant has agreed to extend

this warranty program for an additional six months. The States will use up to $1,000,000 of the $16,750,000 payment to reimburse warranty program participants for expenses they incurred beyond $2,500. Arizona's share of the settlement will be used to fund consumer fraud investigations, consumer education and enforcement of the Consumer Fraud Act.

This recovery will be placed in the Consumer Fraud Revolving Fund pursuant to A.R.S § 44-1531.01. Our notification to you of this settlement is made without prejudice to this office's long-standing position that it is not under any legal obligation to provide notices of settlements to the Joint Legislative Budget Committee. We are providing this notification to you as a courtesy so that you will be aware of this important settlement.

Thank you for your consideration of this matter. If you have any questions, please telephone me at (602) 542-7714.

Sincerely,



Jennifer Boucek
Section Chief Counsel
Consumer Protection and Advocacy Section

JAB/sp
cc: The Honorable Robert L. Burns
The Honorable Marsha J. Arzberger
The Honorable Phillip M. Lopes
Mr. Richard S. Stavneak
Ms. Leah B. Ruggieri
Mr. Timothy A. Nelson
Ms. Sheryl A. Rabin
Mr. John T. Stevens, Jr.

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DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Leah Ruggieri, Fiscal Analyst

SUBJECT: Arizona State University – Review of Downtown Phoenix Campus Operational and Capital Plans

Request

The FY 2008 Higher Education Budget Reconciliation Bill (Laws 2007, Chapter 265) requires Arizona State University (ASU) to submit for review to the JLBC its operational and capital plans for the ASU Downtown Phoenix Campus (DPC). ASU last provided an update on the DPC in November 2006, at which time the Committee gave ASU's plans a favorable review.

The highlights of the DPC update from the November 2006 review include:

- The College of Letters and Sciences opened in fall 2007 under the auspices of the University College and will offer liberal arts classes and a bachelor's degree in interdisciplinary studies.
- According to 21st day counts for the fall semester of 2007, 3,377 students are enrolled in one or more courses at the DPC, an increase of 22% from the prior year.
- ASU entered into an agreement with Capstone Development to construct student housing for 1,200 to 1,300 students set to open in August 2009. The Committee favorably reviewed this agreement in May 2007.
- City of Phoenix expenditures from the $223 million bond issuance for campus construction and development of civic space now total $130.7 million.
- By FY 2012, ASU projects operational expenses will be $90.6 million and will support 790 FTE Positions and 7,600 students enrolled in at least one course downtown.
- By fall 2008, the City of Phoenix will develop civic space for public events.

(Continued)

Recommendation

The Committee has at least the following options:

1) A favorable review.

2) An unfavorable review.

Analysis

Academic Accommodations and Enrollment
The Downtown Phoenix Campus includes several buildings in various locations bounded by Central and 7th Street and Filmore and Van Buren Street. Starting in the fall of 2006, the College of Nursing and Healthcare Innovation, the College of Public Programs, and the University College became headquartered at this site. In the fall of 2007, the College of Letters and Sciences opened under the auspices of the University College and will offer liberal arts classes and a bachelor's degree in interdisciplinary studies.

Student enrollment in one or more courses at the DPC increased from 2,766 in the fall of 2006 to 3,377 in the fall of 2007, or by 22%. Enrollment will increase by an additional 2,600 students to around 6,000 students in FY 2009 when the Walter Cronkite School of Journalism and Mass Communication moves to the downtown campus. By FY 2012, the number of students enrolled in at least one course at the DPC will grow to almost 7,600 students. ASU anticipates that planned campus development through FY 2012 will contain sufficient capacity to support this level of enrollment.

The total number of degrees awarded by colleges headquartered at the downtown campus is estimated to increase from 1,748 in FY 2008 to 2,668 in FY 2012, or by 53%. These figures include students cross-enrolled at other campuses. In each year from FY 2007 through FY 2012, the University College will award the most undergraduate degrees and the College of Public Programs will award the most graduate degrees.

Organizational Partnerships
ASU's primary partner in the development of the DPC is the City of Phoenix. In March 2006, the citizens of Phoenix approved $223 million in bond funds, of which $188 million has been dedicated for campus construction projects and $35 million has been designated for the development of civic space and street improvements within the campus district. The City of Phoenix will take responsibility for the cost of the debt service and transfer ownership of the facilities to ASU at no cost once the bonds are paid off. ASU is not required to make any lease payments on the bond financed facilities. After 2012, ASU and the City have only committed to discuss that option. In the meantime, from FY 2008 through FY 2012, ASU will contribute $2 per square-foot per year to a reserve and replacement fund that will support any necessary repairs to facilities, or $1.5 million per year. ABOR and ASU will transfer ownership of the Downtown Center/Mercado property to the City of Phoenix in 2024.

ASU recently entered into an agreement with the private firm Capstone Development to construct student housing that will accommodate between 1,200 and 1,300 students. To finance this project, Capstone will issue $116.6 million in bonds. The Committee favorably reviewed this agreement in May 2007. As the housing development is not scheduled to open until August 2009, ASU is temporarily leasing the former Ramada Inn for student housing accommodations.

DPC Expenditures to Date
In FY 2006, ASU expended a total of $2.2 million, of which $953,000 was expended from non-appropriated fund sources for the one-time interest payment for temporary financing from the City of Phoenix and $1.2 million was expended primarily from appropriated funds for the administrative costs

(Continued)

associated with establishing a new downtown campus. In FY 2007, ASU expended $56.7 million for operating expenses, of which $46.2 million came from appropriated funds and $10.5 million were from non-appropriated funds. Expenditures increased dramatically between FY 2006 and FY 2007, as FY 2007 was the first year the expanded DPC enrolled students.

The City of Phoenix has expended $130.7 million of the bond proceeds for the acquisition of land and buildings for the campus, the rehabilitation of buildings into academic space, and the cost of new construction. As part of their agreement with the city, ASU will cover $20 million in Furniture, Fixtures and Equipment costs, of which $10.2 million has been expended.

Operational and Capital Plans: FY 2008 – FY 2012
ASU plans to expend $62.3 million from appropriated and non-appropriated fund sources in FY 2008 for campus operations, which includes support for 609 FTE Positions. The General Fund commitment in this year is $34.9 million. In FY 2012, ASU projects operational expenses will increase to $90.6 million, of which $40.6 million would come from the General Fund, and 790 FTE Positions. Part of this increase is due to the transfer of the Walter Cronkite School of Journalism and Mass Communications to the campus in FY 2009.

As specified in their last update to the JLBC in November 2006, ASU is on track to open the School of Journalism and Mass Communication in the fall of 2008. Additionally, planning for expansion space for the College of Nursing and Health Innovation began in fall 2007, which is expected to be occupied in fall 2009.

By the fall 2008, civic space will be developed with proceeds from the Phoenix bond election in which public events such as concerts, seminars, and readings will be held. According to ASU's agreement with Phoenix, the university will pay for its proportional use of this space and maintenance costs. ASU may also potentially share the cost of police services for this area, though no specific agreement has been made to date. Additionally, historical renovation of the England Motors Buildings will be completed and will include retail space.

Beyond FY 2012
The 20-acre campus is expected to reach build out by FY 2014 and will include up to 1.5 million square-feet of academic buildings, student housing, retail and residential development, cultural programs and entertainment venues. Enrollment will reach 15,000 students with an anticipated residential student population of 4,000 students. No specific commitments to financing this level of growth have been made.

RS/LR:sls

ARIZONA STATE UNIVERSITY

RECEIVED
OCT 03 2007
JOINT BUDGET COMMITTEE

October 1, 2007

Richard Stavneak
Joint Legislative Budget Committee
1716 West Adams
Phoenix, Arizona 85007

Dear Mr. Stavneak:

Pursuant to House Bill 2791, attached is the required report on the Downtown Phoenix Campus operational and capital plans. Please call me if you have any questions.

Sincerely,

Charles Miller
Deputy Vice President
Office of Public Affairs

cc: Joel Sideman/ABOR
Michael Crow

Office of Public Affairs
PO Box 877305, Tempe, AZ 85287-7305
(480) 965-4980 Fax: (480) 965-9233

Report to the Joint Legislative and Budget Committee

on the operational and capital plans for

The Arizona State University Downtown Phoenix Campus

as required by HB 2791.

Submitted by Arizona State University
through the Arizona Board of Regents
Dated October 1, 2007

ARIZONA BOARD OF Regents

ASU
ARIZONA STATE UNIVERSITY

The Arizona Board of Regent's Report to the
Joint Legislative and Budget Committee
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I. Overview

The ASU Downtown Phoenix campus opened successfully in Fall 2006 with an opening enrollment of 2,766 students enrolled in one or more classes at the campus. Spring enrollment increased to 3,118 students and faculty spent the year getting settled and embracing the new urban campus. Progress continued and ground was broken on the new building for the Cronkite School of Journalism/KAET 8 building as well as the third party financed residence hall, both to open in Fall 2008.

Planning for the second phase of the College of Nursing and Health Innovation began as well in Fall 2007 and the building is scheduled to open in the Fall of 2009 allowing for the complete relocation of Nursing faculty and researchers to the downtown campus.

Another important occurrence was the opening of The University of Arizona College of Medicine – Phoenix in partnership with Arizona State University that enrolled its first class of 24 students in the Fall of 2007. ABC 1 (Arizona Biomedical Collaborative Building 1) also opened housing the ASU program in Biomedical Informatics which enrolled 13 students for Fall 2007.

The full capacity enrollment goal for the downtown campus is 15,000 students with an anticipated residential student population of 4,000 students. The time required to reach this goal will depend upon the further development of programs on the campus, the expansion of facilities, and the pace of development of downtown Phoenix. Once the 20-acre campus is built to full scale, it will include up to 1.5 million square feet of academic buildings, student housing, retail and residential development, cultural programs and entertainment venues to foster an active environment.

ASU has witnessed a substantial growth in enrollment, and demographic projections suggest that this growth will continue for the foreseeable future. The university continues to believe that the State of Arizona will be best served by providing affordable and convenient educational pathways for Arizona residents, as well as providing geographically and academically diverse program offerings.

The downtown campus will make a significant contribution to the City of Phoenix's commitment to building a vital downtown urban core that is already serving as a magnet for new residential life, expanded recreational opportunities for neighborhood residents, and new commercial development, dining and entertainment opportunities. The addition of academic space, students, faculty, and staff to the downtown environment will contribute towards building the critical mass of activity needed for expanded economic progress.

Colleges and Programs

With the opening of the campus in Fall 2006, the Colleges of Public Programs, Nursing and Healthcare Innovation, and University College became headquartered on the campus. Construction is under way for new facilities to open in Fall 2008 that will establish new

homes for the Walter Cronkite School of Journalism and Mass Communication and Eight/KAET TV.

The Cronkite School of Journalism/KAET-TV 8 building is 223, 000 GSF and will house facilities that will serve as teaching newsrooms for the students as well as a full TV studio for KAET that will allow the station to increase its ability to produce live studio presentations and public fundraising drives. The building's program also includes university classrooms and retail on the first floor.

New Initiatives- School of Letters and Sciences

An exciting addition to the Downtown Phoenix campus in Fall 2007 is the College of Letters and Sciences that will offer a core of liberal arts classes and a bachelor's degree in interdisciplinary studies. The new school is under the auspices of University College and will offer instruction in humanities, social sciences and natural sciences for Downtown Phoenix campus students.

Through the development of integrated coursework for students in the College of Nursing & Healthcare Innovation, the College of Public Programs, and the Walter Cronkite School of Journalism and Mass Communication, the school will continue to advance interdisciplinary inquiry and offer the Bachelor of Interdisciplinary Studies (BIS) degree. It is estimated that the size of this school along with University College will grow to 8000 undergraduates at full build out.

Current demographics

During Fall 2006, 6,229 students were enrolled in courses funded by the Downtown Phoenix Campus (based on official 21st day counts). Of those, 2,766 were enrolled in one or more classes at the campus, which surpassed the 2,000-2,500 planning targets used in development plans. Spring 2007 enrollment was 3,118 which also surpassed the spring planning targets.

For Fall 2007, 21st day counts indicate that 6,595 were enrolled in courses funded by the Downtown Phoenix Campus. Of those 3,377 were enrolled in one or more courses at the campus, representing a 22% increase in enrollment.,

II. Development Planning and Management Structure

The responsibility for the development of the Downtown Phoenix Campus is shared jointly by the City of Phoenix and Arizona State University.

Overview

Planning and development of the downtown campus is a joint effort by ASU and the City of Phoenix with ASU responsible for overall planning and design including development of a master plan, and the City of Phoenix responsible for providing approval of the planning and for construction management.

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Summarized in the report last year, the project is to be funded almost entirely from $223 million in bond funds provided by the City of Phoenix. Of these funds, $188 million is specifically for the acquisition of property, construction of new facilities, and renovation of existing space to establish the campus, and $35 million is earmarked for the development of civic space and street improvements to create a campus district. ASU is responsible for providing the equipment and furniture needed on the campus. ASU was responsible for 50% of the interest-only costs on up to $100 million in temporary financing used by the city for property acquisition and renovation prior to the bond election. The relationship is governed by an intergovernmental agreement (IGA), signed by both parties in June 2005. Current estimates for cost have not changed.

Summary of costs and business terms contained within the IGA

The terms summarized below have not changed from those reported in the October 2006 report.

City of Phoenix:

Capital costs during 2005 and 2006 needed to acquire property (approximately twenty acres of land and buildings within the downtown redevelopment area), renovate facilities, and improve the civic infrastructure and amenities in preparation for the Fall 2006 opening were approximately $100 million. The City of Phoenix agreed to invest up to $100 million prior to the 2006 City bond election (March 2006) to acquire all of the property needed to develop the campus and its supporting amenities and to renovate acquired properties to be used for ASU programs.

The City of Phoenix included sufficient funds in the 2006 City bond package to continue development of the downtown campus during the 2006-2011 timeframe. Funds will be used to repay the short-term funding sources of $100 million and to construct an additional 250,000 SF of academic space and to accelerate development of campus amenities. Total funding for academic facilities and land is expected to reach $188 million in this time frame, excluding the city-managed investments in civic space and street improvements within the campus district.

The City of Phoenix and ASU agreed that development of the campus to reach full capacity of 15,000 students will require substantial additional funding over the period following 2011. This will be accomplished by using established methods for university facility expansion used in the past on other ASU campuses. It will include establishing relationships with developers, identifying opportunities for private fundraising, and the potential use of debt service supported by tuition. In addition, ASU will work with the City on the potential for added funding via future bond elections and through other appropriate development initiatives, and those terms would be subject to a subsequent IGA.

ASU

ASU will lease the academic facilities from the City for the period of Phoenix' indebtedness. The master lease governing the transaction was approved by the Arizona Board of Regents

in April 2006 and signed in June 2006. ABOR and ASU have rights and responsibilities for the day-to-day management of the academic facilities and for the control of access

ASU is responsible for the costs of operating the academic programs at the campus. This includes the day-to-day academic and support unit personnel and operating costs, academic facilities operating and maintenance (O&M) costs, and one time investments in furniture, fixtures and equipment.

ASU retains all tuition and other revenues generated from academic operations.

ABOR and ASU agreed to transfer ownership of the Downtown Center/Mercado property to the City of Phoenix once the existing indebtedness is repaid by ASU (currently scheduled for 2024). The City of Phoenix is permitted to purchase the property sooner for the amount of the then outstanding indebtedness provided that planned new academic facilities have been provided by Phoenix.

Student Housing
ASU is responsible for developing needed student housing. ASU negotiated a lease with City Center, LLC to lease the former Ramada Inn for a period of two years, located at 1st Street and Polk. The property has been converted to the Residential Commons, providing housing for up to 267 students. ASU is responsible for annual rent and property taxes of $805,000. This cost is to be offset by housing fees collected from student residents of the Commons. The facility is part of the overall residential life program and costs will be covered within that larger auxiliary budget.

The property was intended to provide housing on an interim basis.

By Fall 2008, ASU anticipates the need to accommodate 750 to 800 students at the Downtown Phoenix campus. ASU has identified a private developer, Capstone Student Development, who will build the first phase of student housing to be open in conjunction with the opening of the Cronkite School of Journalism and KAET/8 building.

ASU and the Developer are approaching student housing on the Downtown Phoenix Campus on a phased basis The phased growth of student housing will allow the Developer and ASU to work together to plan for appropriate student housing as the need materializes. The first phase will be 700-750 beds oriented toward freshman and planned for occupancy in August, 2008. The second phase will be 500-550 beds oriented towards upperclassmen and planned for occupancy in August 2009. The primary terms negotiated between ASU, the City and the Developer are summarized on page six.

Civic Space
ASU agreed to pay for informal use of the new civic space that will be built as part of the campus plan. The cost to ASU will be determined by its proportional use, the actual costs of its activities, and will include an allocated share of maintenance costs. ASU agreed to discuss the possibility of sharing costs associated with police services within the campus

area if the costs can be tied directly to University activities. There have been no agreements to date for ASU to pay any such costs.

ASU agreed to engage in development activities to support the campus such as fund-raising for capital costs. ASU also agreed, to the extent permitted by law, to support legislative advocacy for appropriate measures that offer opportunities for further development of the campus.

Construction Self-Management Intergovernmental Agreement

In June 2006, the City of Phoenix and ASU executed a Construction Self-Management Intergovernmental Agreement. As part of that agreement, ASU and Phoenix agreed to the terms under which ASU could act as construction manager on new construction projects funded by bond proceeds, should the City and ASU choose to manage a project in that manner. Under the terms of the agreement, there was no change in financial responsibility for the costs of the renovation; they were borne by the City of Phoenix. There has been no decision nor is there a plan to pursue projects on this basis to date.

III. Project Phasing

The development of the Downtown Phoenix Campus is structured in phases. Funding for land and building acquisition, renovation and construction for Phases I and II came from the bonds approved by Phoenix voters in March 2006. Funding for expansion beyond Phases I and II is not definitively planned or committed. Additional expansion will be accomplished by using established methods for university facility expansion used in the past on other ASU campuses. It will include establishing relationships with developers, identifying opportunities for private fundraising, and the potential use of debt service supported by tuition. In addition, ASU will work with the City on the potential for added funding via future bond elections and through other appropriate development initiatives, and those terms would be subject to a subsequent IGA. Any future expansion will not be committed until funding is clearly identified to support the campus expansion.

Phase I

ASU relocated current programs in the Colleges of Public Programs, Nursing & Healthcare Innovation, University College, and ASU Downtown Phoenix Campus administrative offices from the Tempe campus to the downtown campus for Fall 2006.

Targeted properties (411 North Central, the Post Office, and Park Place) were acquired and renovated by the City during late 2005 and early 2006 in order to meet the timeline set forth by ASU. Student housing was provided by contracting with the owners of the Ramada Inn for a two-year period to create the Residential Commons, during which time permanent housing would be designed and built through private development.

Enrollment in the initial phase of the downtown campus exceeded initial projections. Initial projections assumed approximately 2,000-2,500 students; total students enrolled in one or more classes in Fall 2006 totaled 2,766. Fall 2007 numbers are 3,377.

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Phase II

Further expansion of the campus is planned for Fall 2008 and Fall 2009 using proceeds from the City bond program that was approved by the electorate of Phoenix in March 2006. Further expansion will include renovation of the historic Post Office as well as the addition of two new academic buildings, which will house the Cronkite School of Journalism and KAET and the other will provide expansion space to the College of Nursing & Healthcare Innovation. The Cronkite School of Journalism and KAET/8 building will open in the Fall 2008 and the expansion space to the College of Nursing & Healthcare is expected to be occupied for Fall 2009. Expected capacity resulting from Phase I and Phase II combined will allow enrollment capacity to grow to 7,000 to 8,000 students.

Phase II will also include the development of the Civic space and the England Motors Building, located at 424 North Central. Scheduled completion is during the fall of 2008. Suggested activities in the public space include but are not limited to concerts, seminars, and readings open to the public. The England Motors Building historic renovation will also include some retail that will enliven the space and draw people into the park. This development will afford opportunities for the local residents to integrate with the University community on a daily basis.

Planning and design have begun for the second phase of the College of Nursing Healthcare and Innovation. This building will serve as expansion space and allow the College to relocate the remaining faculty and researchers from the Tempe Campus. The City of Phoenix and ASU are currently working to define the scope and budget of this phase. The City of Phoenix and ASU are evaluating methods to maximize resources to gain as much additional space for the campus growth.

Third party developers, Capstone Development Corporation, have broken ground and started construction on the first phase of student housing on the Downtown Phoenix Campus. An approximate 700 - 750 bed Residence Hall is planned to be open for Fall 2009. This facility will house students, provide a dinning hall for the campus and offer retail opportunities. The location of the development is on Taylor Street between First Street and Second Street.

The site is comprised of land acquired by the Developer as well as land owned by the City of Phoenix. Under the proposed terms, the Developer's land will be gifted to the City and the parcels will be consolidated into a single parcel for purposes of building permits for the development. The City of Phoenix will then lease the entire parcel to ASU for a 40 year term.

The City will receive lease payments from the Developer that are contingent upon the success of the project as the lease payments terms mirror the terms of the bonds that the Developer will be receiving as its compensation. At the end of the term of the ground lease or once there are no outstanding bonds, whichever is earlier, title to the property shall be granted to ASU at no cost.

Sub-lease:
ASU will sub-lease the property to the Developer for a 40 year term. Under the terms of the sublease, ASU will agree to lease a certain percentage of beds in the project during the first four years of the project's operations, ranging from 15% in the first year to 5% in the fourth year, should they be available. There are no continuing ASU lease obligations beyond this period. Should funds be available later in the project period, the Developer will make annual contributions to ASU Campus Residential Life Program up to $3.4 million

Development Agreement:
Under the Development Agreement, Capstone Development is responsible for providing 100% of the capital financing for the project without ASU involvement. This will be accomplished via bonds issued by Downtown Phoenix Student Housing, LLC, an Arizona not-for profit LLC selected by the Developer. Downtown Phoenix Student Housing LLC will serve as the Owner of the project. Capstone Development will be contractually obligated to the LLC and to ASU to construct the project and to deliver on time for the scheduled opening.

Capstone Management Corporation will be hired by the Owner and will be responsible for the day-to-day operations of the Project. ASU will work with Capstone in developing and providing academic support, student life and residential life activities. Under the proposed terms, ASU has a significant role in the annual evaluation of the manager and in decisions concerning replacement of managers.

Phase III and beyond

While not specifically included in the IGA, it is the goal of the City and ASU to continue to develop the campus over the 2010-2014 five-year period by adding academic and student support space which will allow the campus to grow to its target size of 15,000 students with a residential student population of 4,000. There are neither specific commitments to a timetable nor requirements for specific facility additions or target enrollments.

IV. Financial Plan

Financial planning for the development and operation of the Downtown Phoenix Campus has been focused on needed investments to accomplish Phases I and II of the development plan. ASU is responsible for the annual operating costs associated with the campus as well as one time FF&E costs, while the City of Phoenix is responsible for acquiring and developing the land and facilities needed for the academic space on the campus.

Expenditures prior to FY08

The Downtown Phoenix Campus was established in FY07 with the transfer of three existing colleges from the Tempe Campus to the Downtown Campus (College of Public Programs, College of Nursing & Healthcare Innovation, and University College). The state operating budget was established for the Downtown Phoenix Campus primarily through the transfer of funding for those programs from Tempe, but also through incremental investment to support administrative and growth needs. Operating funding for the Downtown Phoenix Campus was not established as such until the FY07 fiscal year, which began on July 1, 2006.

Operating Expenditures

Operating expenditures for FY07 are shown in Figure 1. The total expenditure authority was $46,208,500.

Capital Expenditures

The City of Phoenix has expended $130.7 million for the acquisition of land and buildings for the campus, the required rehabilitation of those buildings into academic space, and the costs of new construction.

Under the terms of the IGA, ASU is responsible for covering the campus' FF&E costs needed to equip the Downtown Phoenix Campus office, classroom, lab and meeting room space needs. Through FY 07, ASU has expended $10.2 million.

Capital expenditures are summarized in Figure 2.

FY08-12 Budget Plan

Operating Budgets

Operating budget plans are developed using very specific investment criteria for the first year in the planning cycle, while years beyond that are based on reasonable assumptions that guide the university's thinking about growth and support needs. The University considers only the first year of the 5-year plan to be a commitment. Figure 1, below, summarizes the 5-year state budget plan for the Downtown Phoenix Campus. Budgets for auxiliary enterprises are not included, but are expected to be self-supporting.

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October 1, 2007

Figure 1: Downtown Phoenix Campus Operating Budget Plan, FY07-FY12

AGENCY NAME & AFIS CODE: ARIZONA STATE UNIVERSITY AT THE TEMPE CAMPUS (ASA)
COST CENTER/PROGRAM NAME: DOWNTOWN PHOENIX CAMPUS
FUND NAME & AFIS NUMBER: General Fund - 1000; Collections/Other - 1411
($thousands)

FY07-12 STATE OPERATING BUDGET PLAN

AFIS OBJ CODE	CATEGORY	ACTUAL FY 2007	BUDGET FY 2008	ESTIMATED[1] FY 2009	ESTIMATED FY 2010	ESTIMATED FY 2011	ESTIMATED FY 2012
	EXPENDITURE DETAIL:						
	FTE Positions	600.48	609.00	703.00	731.00	760.00	790.00
6000	Personal Services	29,813.4	32,785.1	37,945.4	39,463.2	41,041.7	42,683.40
6100	Employee Related Expenditures	7,846.2	8,831.7	10,217.0	10,625.7	11,050.7	11,492.70
	All Other Operating Expenditures						
6200	Professional and Outside Services	2,169.3	2,518.4	2,644.3	2,776.5	2,915.3	3,061.1
6500	Travel In State	57.8	51.1	53.7	56.4	59.2	62.2
6600	Travel Out of State	367.6	21.2	22.3	23.4	24.6	25.8
6700	Food						
6800	Aid to Organizations and Individuals						
7000	Other Operating	4,328.2	5,024.9	6,120.0	7,038.0	8,093.7	9,307.8
	Library Acquisitions						
8400	Equipment	1,626.0	1,887.8	2,500.0	2,500.0	2,500.0	2,500.0
	Total All Other Operating Expenditures	8,548.9	9,503.4	11,340.3	12,394.3	13,592.8	14,956.9
	Subtotal	46,208.5	51,120.2	59,502.7	62,483.2	65,685.2	69,133.0
	Total Below the Line						
	TOTAL EXPENDITURE AUTHORITY	46,208.5	51,120.2	59,502.7	62,483.2	65,685.2	69,133.0
	Collections/Other Receipts	(13,767.6)	(16,240.6)	(21,468.9)	(23,615.8)	(25,977.4)	(28,575.1)
	Balances Forward						
1000	TOTAL GENERAL FUND	32,440.9	34,879.6	38,033.8	38,867.4	39,707.8	40,557.9
2000	Federal Funds	650.6	715.7	784.9	824.1	865.4	908.6
	Other Non Appropriated Funds	9,884.9	10,536.8	19,944.8	20,144.2	20,345.7	20,549.1
	Total Non Appropriated Funds	10,535.5	11,252.5	20,729.7	20,968.4	21,211.0	21,457.8
	TOTAL EXPENDITURES	56,744.0	62,372.7	80,232.4	83,451.6	86,896.2	90,590.8

1. Includes move of Cronkite School of Journalism and KAET effective Fall 2008

It is important to note that the majority of the state operating budget for the Downtown Phoenix Campus is derived from existing base state operating budgets for Colleges and Programs formerly located on the Tempe Campus. The budget plan assumes that the state will continue to support both the base operations of the campus as well as providing support for future enrollment growth

The budget plan assumes that state collections increase 10% annually from the combination of enrollment growth and tuition increases. It also includes an increase in Fall 2008 (FY09) resulting from the transfer of the Walter Cronkite School of Journalism and Mass Communication to the campus. KAET is also transferred; however nearly all of KAET funding comes from local sources.

Capital Development Plans

Capital development plans have been established for the Downtown Phoenix Campus for Phases I and II, which are planned to be complete by FY10 (Fall 2009). The financial plan calls for the investment from the City of Phoenix for Phases I and II, and the private development of a student housing complex through ASU. Investments beyond those have

not been clearly defined since they will depend upon the pace of the campus' expansion and would occur beyond the three-year Capital Improvement Plan horizon.

The long term vision for the campus will require further development and capacity expansion. This will be accomplished by using established methods for university facility expansion used in the past on other ASU campuses. It will include establishing relationships with developers, identifying opportunities for private fundraising, and the potential use of debt service supported by tuition. In addition, ASU will work with the City on the potential for added funding via future bond elections and through other appropriate development initiatives, and those terms would be subject to a subsequent IGA.

The planned costs for the capital development of the Downtown Phoenix Campus are included in Figure 2, below.

Figure 2: Planned Capital Expenditures for the Downtown Phoenix Campus

($millions)	FY06	FY07	FY08	FY09	Planned Funding	FY10-25
Phase I						
Property and land acquisition	$ 40.9	$ 15.1	$ 1.3		$ 57.3	
Renovations	39.4	0.8	-		40.2	
Other	4.5				4.5	
Phase II						
Construction of facilities for Cronkite and Nursing		30.0	44.0	12.0	86.0	
FF&E		10.2	9.2	5.4	24.8	
Total Committed Funding	84.8	56.1	54.5	17.4	212.8	
Student Housing Development (Private Sector Funding)		25.0	56.4	32.1	113.5	
Total Planned Funds	$ 84.8	$ 81.1	$ 110.9	$ 49.5	$ 326.3	
Other Expansion						TBD as funding allows and as need requires

FUNDING SOURCES:	
Phoenix Bond	$ 188.0
ASU FF&E (State and Local)	24.8
Private Development	113.5
Total	$ 326.3

In addition, the City of Phoenix will provide $35 million in parks and street scape not included above. They are planned for the campus district but are not in or a part of ASU facilities.

V. Enrollment Projections

Figure 3, below provides projections for students enrolled in one or more classes at the Downtown Phoenix Campus. It is important to note that the enrollments increase significantly in Fall 2008, reflecting the planned move of the Cronkite School to the Downtown Phoenix Campus. Estimates of the number of graduates to be produced by each school are also included. Please note that students may be cross-enrolled at other campuses; the degrees awarded represents the total number of degrees to be awarded by the colleges headquartered at the Downtown Phoenix Campus.

Figure 3: Enrollment and Graduation Estimates by College

	Fall 06 actual	Fall 07 actual	Fall 08 estimated	Fall 09 estimated	Fall 10 estimated	Fall 11 estimated
Enrollment at DPC Campus						
Nursing	790	1,069	1,375	1,600	1,700	1,800
Public Programs	913	1,097	1,350	1,450	1,650	1,800
Cronkite School	25	30	1,700	1,750	1,900	1,975
University College	312	372	750	850	975	1,200
Other Colleges	726	809	800	800	800	800
Total	2,766	3,377	5,975	6,450	7,025	7,575
Degrees Awarded (Academic Year)	**2006 actual**	**2007 actual**	**2008 estimated**	**2009 estimated**	**2010 estimated**	**2011 estimated**
Undergraduate						
Nursing	272	346	375	440	500	560
Public Programs	187	219	227	240	255	270
University College	745	826	856	887	919	965
Cronkite School			340	354	368	386
Subtotal	1,204	1,391	1,798	1,921	2,042	2,181
Graduate						
Nursing	53	50	55	61	67	74
Public Programs	250	307	319	332	345	380
Cronkite School	0	0	20	25	30	33
Subtotal	303	357	394	418	442	487
Total Degrees Awarded	1,507	1,748	2,192	2,339	2,484	2,668

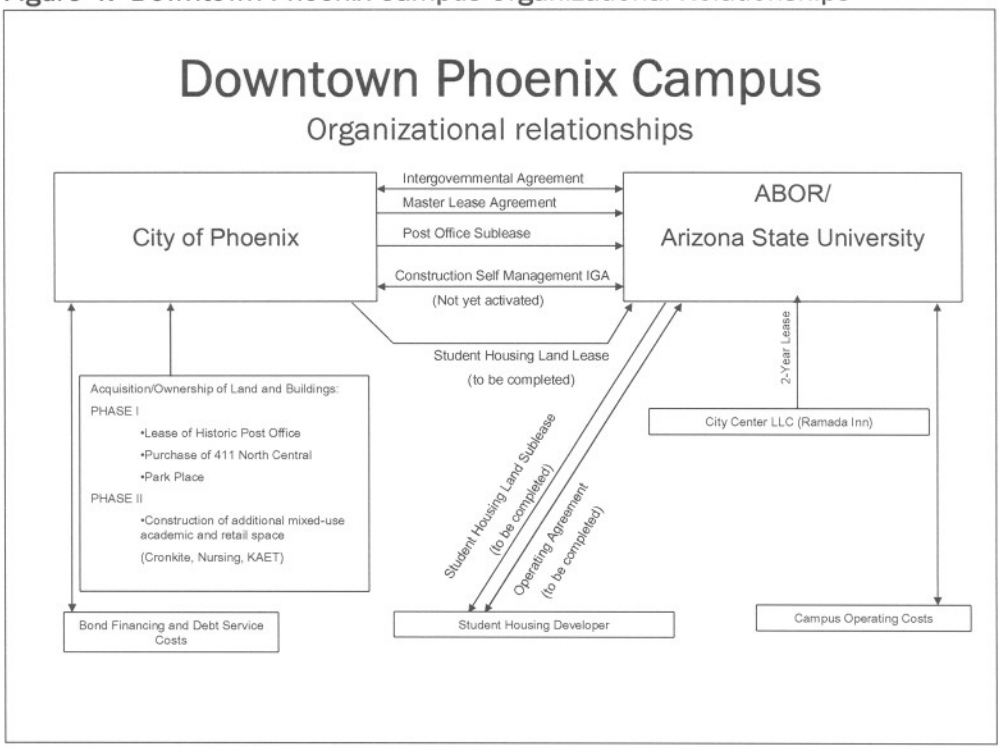
The planned campus development through Phase II is expected to support between 7,000 and 8,000 students. Current estimates indicate that sufficient capacity will exist to support the student enrollments during the 5-year planning period. The University will continue to monitor enrollment capacity.

VI. Organizational Relationships

Arizona State University's partner in the development of the Downtown Phoenix Campus is the City of Phoenix. Funded from a bond approved by the citizens of Phoenix in a vote in March 2006, the city is providing $188 million in funding for construction projects for the campus, plus $35 million for the development of civic space and street improvements within the campus district, which is managed by the City of Phoenix separately from the Campus Development project.

The following graphic details the relationships between the City of Phoenix, ABOR and Arizona State University, and third party providers. These relationships have not changed from last year.

Figure 4: Downtown Phoenix Campus Organizational Relationships



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STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Bob Hull, Principal Research/Fiscal Analyst

SUBJECT: Department of Revenue – Review of Business Reengineering/Integrated Tax System Contract Amendment

Request

DOR requests review of a proposed additional $4 million contract amendment, which includes $288,000 for 4 enhancements to individual income tax, and $3.7 million for vendor operational support of implemented BRITS systems through June 2008. Laws 2006, Chapter 350 requires DOR to submit for Committee review any BRITS contract extensions or modifications that change the dollar value of the contract.

These contract amendments permit DOR to expend BRITS-related General Fund revenue collections without an appropriation.

Recommendation

The Committee has at least the following 2 options:

1) A favorable review of the proposed $4 million contract amendment. The Information Technology Authorization Committee (ITAC) has approved DOR's proposed $288,000 for individual income tax enhancements. ITAC has taken no formal action on DOR's proposed $3.7 million proposal for vendor operational support through June 2008.

2) An unfavorable review, since foregone General Fund revenue is used to pay for the amendment and ITAC has taken no formal action on the $3.7 million portion of DOR's $4 million proposal. If the Committee selects this option, DOR would likely proceed with the amendment. If DOR pursues this contract amendment, the JLBC Staff recommends that DOR report the final cost of the amendment to the Committee.

(Continued)

Analysis

Background

BRITS is the computer system being implemented by DOR to further automate and integrate their separate tax systems, including the transaction privilege tax, and corporate and individual income taxes. BRITS was designed to improve enforcement and ultimately increase revenues to the state. BRITS is being paid for through a gain-sharing arrangement, which pays the vendor 85% of tax enforcement revenues above an established baseline amount until the project is paid for. The state receives the remaining 15%. Enforcement revenue represents collections received through the tax audit and collection processes.

The Committee gave an unfavorable review at its October 24, 2006 meeting to the Department of Revenue's (DOR) $14.9 million contract amendment with a vendor to finish converting individual income tax collections to the Business Reengineering/Integrated Tax System (BRITS). This was followed by a favorable Committee review at its February 26, 2007 meeting of DOR's $2.2 million contract amendment to continue operation of the BRITS data center through September 2008.

DOR's proposed $3,971,700 contract amendment includes $288,000 for 4 scope changes to the BRITS individual income tax implementation and $3,683,700 for ongoing Accenture (the BRITS vendor) operational support of implemented BRITS systems from December 2007 through June 2008. DOR reports that the 4 scope changes are critical functions that must be done manually if they are not available on BRITS. The following table shows the 4 scope changes and their costs.

BRITS Individual Income Tax Scope Changes

Capture external vendor data entry performance statistics and report 1/	$ 31,000
Additional SSN format validation based on new interface to SSA 2/	65,000
Access to BRITS for Attorney General's Office 3/	18,000
Automated non-scheduled conversion process 4/	174,000
Total	**$288,000**

1/ To verify the accuracy of subcontractor invoices, and evaluate data entry activities and vendor performance.
2/ To reduce fraudulent and/or erroneous refunds.
3/ To reduce manual tax information interchange and speed updates to the AG's Office.
4/ To make legacy tax return data available to BRITS to process amended returns.

DOR's proposed $3.7 million amendment would extend the current funding for Accenture operational support of implemented BRITS systems from December 2007 through June 2008, since the current BRITS contract only has sufficient funding for this item through November 2007.

Including the current contract and DOR's current support, the $3.7 million amendment would bring the total cost to $7.3 million in FY 2008. For comparison, the total cost of BRITS operational support was $4.5 million in FY 2007.

Cost of Operational Support of Implemented BRITS Systems
$ in Millions

	FY 2007 Actual	FY 2008 Estimate
Current Contract - Accenture 1/	$4.5	$2.2
Proposed Amendment - Accenture 2/	0.0	3.7
DOR Operating Budget	0.0	1.4
Total	**$4.5**	**$7.3**

1/ FY 2008 through November 2007, when this funding runs out.
2/ December 2007 through June 2008.

(Continued)

The lower cost of $4.5 million in FY 2007 versus $7.3 million in FY 2008 is due to several factors, including the following:

- Accenture charged a reduced rate through August 31, 2007 in compensation for earlier delays and cost overruns in the transaction privilege tax system.
- DOR placed a hard freeze on operational support changes preceding the corporate income tax implementation in FY 2007, which used fewer Accenture resources.
- More operational support will be needed with the FY 2008 implementation of individual income tax. DOR's operating budget was increased by $1.4 million and 16 FTE Positions from the General Fund beginning in FY 2008 for ongoing BRITS operational support of the implemented BRITS systems.

ITAC Review

ITAC is the Government Information Technology Agency's (GITA) oversight committee, which reviews and approves information technology projects with development costs over $1 million. Laws 2007, Chapter 259, also amended statute to require ITAC approval or disapproval of contract amendments to these $1 million projects. At its September 26, 2007 meeting, ITAC approved DOR's proposed $288,000 contract amendment for 4 individual income tax scope changes, with the following 2 conditions:

- DOR will limit issuance of task orders related to the current contract amendment to only those essential items noted above and limited to the estimated additional cost of $288,000.
- Since 2 components of the original project, namely document imaging and "customer relationship management" have been excluded from the contract amendment, implementation of these items shall be postponed until such time as DOR has assumed operation, maintenance and support functions of the BRITS system.

At its September 26, 2007 meeting, ITAC also received a presentation on DOR's proposed $3,683,700 contract amendment. ITAC took no formal action on DOR's proposal, since it was viewed as a decrease in cost from a previously estimated $172 million cost for the 7-year lifecycle of the BRITS project from FY 2003 through FY 2009. GITA and DOR have not indicated whether ITAC approval would be sought in the future for this amendment. ITAC has approved previous contract amendments.

To date, the BRITS project (excluding document imaging and "customer relationship management") cost $153.7 million prior to the current $4 million proposed amendment. DOR notes that BRITS has generated new revenues above the BRITS baseline sufficient to offset the cost of the proposed $4 million amendment. DOR reports $327 million of revenues above the BRITS baseline through August 2007. It is difficult, however, to evaluate how much in additional revenues can be directly attributed to BRITS, as other factors unrelated to BRITS affect the level of collections. JLBC Staff has previously reported on this issue to the Committee. (Please see Item 2 in *Attachment A* and *Attachment B*, for more information regarding the outside review of BRITS revenue estimates.)

Currently, individual income tax is on schedule for implementation in December 2007. In its "green-yellow-red" project status report, the Government Information Technology Agency (GITA) shows BRITS with a "green" status.

RS/BH:ym
Attachments

Attachment A

Joint Legislative Budget Committee
Staff Memorandum

1716 West Adams
Phoenix, Arizona 85007

Telephone: (602) 926-5491
Facsimile: (602) 926-5416

DATE: March 23, 2007

TO: Members, Joint Legislative Budget Committee

FROM: Richard Stavneak, Director RS

SUBJECT: AGENCY RESPONSES TO REQUESTS FOR INFORMATION

Attached are the following letters from agencies responding to questions raised at prior JLBC meetings.

1. BRITS - Document Imaging / Customer Relationship Management

At its October 24, 2006 meeting, the JLBC requested that the Department of Revenue (DOR) report back on their detailed rationale for document imaging and customer relationship management for the Business Reengineering/Integrated Tax System (BRITS) by January 31, 2007. Both the JLBC and the Information Technology Authorization Committee (ITAC) have asked that DOR not pursue BRITS contract amendments for these 2 components until the individual income tax is implemented.

DOR expects to complete their detailed rationale for document imaging and customer relationship management by the end of calendar year 2008. DOR proposes to report their progress through the BRITS monthly status report, and to provide a final report.

The October 24th BRITS review also required Government Information Technology Agency (GITA) and DOR to provide joint monthly status reports including the perspective of an outside contractor. The report states that individual income tax is on schedule for implementation in December 2007. However, the contractor estimates that implementation of the BRITS desk audit system will be delayed 3 to 6 months beyond the planned implementation date of February 2008. The report includes information on the status of the 7 conditions that the Information Technology Authorization Committee (ITAC) established to improve their oversight of the BRITS project. GITA reports that work is in process on 4 of the conditions and has not yet started on the remaining 3 conditions.

2. BRITS - Outside Review of Revenue Estimates

In addition to these requirements, at its October 24th BRITS review, the JLBC asked that outside experts review claims of BRITS' net gains. JLBC Staff subsequently developed a summary of the issue and asked DOR to review the summary. JLBC Staff found that BRITS has had a positive impact on increasing enforcement revenue, but it is difficult to determine how much of an effect it had compared to other factors not related to BRITS. DOR generally agreed with the JLBC Staff findings, but commented that "under any sound calculation method, BRITS will clearly generate enough revenues to pay for the project over the ten-year contract period."

JLBC Staff provided the attached memorandum summarizing the BRITS baseline methodology to Peter Burns, former director of the Governor's Office of Strategic Planning and Budgeting, and Alan Maguire, an Economic Estimates Commission member. Staff asked Mr. Burns and Mr. Maguire, to provide their perspective on the BRITS baseline calculation and the effects of automation versus an improving economy on the increased level of collections. Mr. Burns and Mr. Maguire reviewed the initial baseline methodology.

(Continued)

Both Mr. Burns and Mr. Maguire reported that the JLBC Staff analysis of the issue was a fair assessment of the issue. Mr. Burns did provide additional comments that the baseline was not perfect and had to balance some level of precision with ease of administration. Mr. Burns also stated that BRITS would continue to provide the state with benefits for a number of years after the contract ends.

3. DES Adoption Services - Family Preservation Projects Performance Measures

At its December 18, 2006 meeting, the JLBC asked that the Department of Economic Security (DES) provide performance measures for the Adoption Services - Family Preservation Projects program. DES has established 8 performance measures. Of the 8, all have a workload component, 2 also have a customer service component, and 1 had an outcome component. The specific measures are included in the attached letter.

4. DEQ Water Quality Fee Fund Appropriation

At its February 6, 2007 meeting, the JLBC requested a response from the Arizona Department of Environmental Quality (DEQ) on the department's rationale for not using a FY 2007 allocation of $200,000 from the Water Quality Fee Fund for additional contract permitting staff.

Due to the number of hours DEQ devotes to contractor oversight, the department reports that it did not expend the $200,000 Water Quality Fee Fund allocation in order to devote Water Quality Division staff resources to processing permits rather than training and oversight. The agency states that if it were to contract for additional Water Quality Permits, existing staff would be diverted from permit writing, which would increase the time required to process applications already in process. However, DEQ indicated it would obligate the $200,000 prior to the end of FY 2007.

5. DEQ Vehicle Emission Inspection Program in Other States

At its February 6, 2007 meeting, the JLBC requested information from DEQ on the types of Vehicle Emissions Inspection (VEI) programs used by other states and the benefits and costs of emissions programs with multiple vendors. Programs in operation in other states can be described as centralized or decentralized. They can be further characterized as being state-owned and run or operated by one or more vendors. The attached letter provides information on the programs in other states.

Arizona's VEI program has been a centralized, single vendor program since its inception. DEQ anticipates retaining this format under the new contract which is to be awarded on July 1, 2007.

6. Department of Commerce, Commerce and Economic Development Commission – Wunsch Auction Systems Uncollectible Debt

At its February 6, 2007 meeting, the JLBC requested additional information about a $3.4 million uncollectible loan issued by the department in 1992 to Wunsch Auction Systems to develop software for an Arizona Stock Exchange. The loan was made under the Direct Assistance to Business Program by the Commerce and Economic Development Commission (CEDC). The source of funding for the loan was the CEDC Fund.

The department confirmed the CEDC did not secure any personal guarantees from the business owner to pledge his personal assets toward repaying the loan in the event of default, but could not find any information explaining why personal guarantees were not secured. In lieu of personal guarantees the department reports the loan documents did include security agreements for the collateral on the CEDC

(Continued)

loan. Uniform Commercial Code (UCC) statements, which are used by a creditor to notify other creditors about its security interest in a debtor's assets, were filed in Arizona, New York, and Minnesota – states where Wunsch Auction Systems had assets – to establish the CEDC's security interest in the loan collateral, which included all of the company's equipment, accounts, and other business property.

The department believes the CEDC was not able to seize the collateral established in the UCC statements in any of the states because creditors with senior claims to the company's assets received them at the time of liquidation. In addition, the CEDC had also required Wunsch Auction Systems to take out Key Man Insurance, a life insurance policy with benefits payable to the CEDC if the company's key executive dies, in the amount of $500,000. The CEDC was never in a position to collect the insurance, as the company's chief executive did not pass away during the insurance policy period.

Regarding the department's current procedures for loan guarantees, the CEDC requires that loans made to private enterprises be secured by a note, deed of trust, and/or personal guarantees. We are currently checking whether the department still permits UCC statements as a part of its loan guarantees. A note is a document issued by a borrower acknowledging a debt to a lender and a deed of trust is an arrangement whereby the borrower transfers the title to real estate to be held in trust by a neutral third party (trustee) that is authorized to sell the real estate on behalf of the lender if the borrower does adhere to the terms of the loan. The critical differences between a deed of trust and UCC statements are that deeds of trust use real estate as collateral and involve transferring the title of the property to a third party until the loan is repaid, whereas UCC statements use business or personal property as collateral and do not involve a trustee.

The CEDC also requires personal guarantees from each individual owning 20% or more of a borrowing company and in certain circumstances Key Man insurance payable to the CEDC may be required as well. The CEDC also requires in most cases a 1:1 match in the dollar value of collateral used to secure CEDC loans, which can include a combination of a note, deed of trust, and/or personal guarantees as a match.

The department states that their current loan practices are consistent with other community development lenders.

RS:lm

xc: Brad Regens, House
Mike Huckins, House
Helena Whitney, House
Chris Kotterman, House
Michael Hunter, Senate
Tim Grubbs, Senate
Greg Ensell, Senate

Attachment B

Joint Legislative Budget Committee
Staff Memorandum

1716 West Adams
Phoenix, Arizona 85007

Telephone: (602) 926-5491
Facsimile: (602) 926-5416

DATE: January 29, 2007

TO: Richard Stavneak, Director

FROM: Bob Hull, Principal Research/Fiscal Analyst

SUBJECT: BRITS BASELINES

According to the Department of Revenue (DOR), Business Reengineering/Integrated Tax System (BRITS) has brought in more revenue than anticipated. As evidence, DOR has attributed $215,700,000 of revenue to BRITS through November 30, 2006, which is $106,100,000 above the $109,600,000 expected at this point in the project. The contractor is paid through a gain-sharing arrangement whereby they receive a portion of increased enforcement revenue above a specified baseline.

The baseline methodology is included as part of the BRITS contract. The baseline calculation was used because of the difficulty of determining which enforcement revenues are attributable to BRITS. The baseline was set at the level of DOR's enforcement goals for FY 2004, adjusting for the revenue generating and the amnesty programs. *(See Attachment for DOR's November 22, 2006 description of the BRITS baseline, the baseline formulas, and the contractor's response to DOR's baseline formulas.)* DOR calculated the baseline by adding the expectations for the revenue generating program, which provided the department with additional audit and collection resources beginning in FY 2003, to their original goal for FY 2004. They then decreased that baseline amount to adjust for revenues from the amnesty program, which provided a window of time for non-filers to come forward and pay outstanding taxes without incurring certain penalties.

The baseline calculation was not available at the time of the October 24, 2006 Joint Legislative Budget Committee meeting on the BRITS contract amendment. At the meeting, the Committee sought additional information on whether the revenue above the baseline was due solely to BRITS or other factors. As a result, the Committee asked that JLBC Staff with DOR and OSPB jointly convene an outside panel to evaluate the BRITS baseline calculation and provide feedback regarding the effects of automation versus an improving economy on the increased level of collections.

JLBC Staff has now had an opportunity to review the baseline and has developed the following findings. On December 12, we sought OSPB's and DOR's input on the memo. We received DOR's input on December 27, 2006 and have incorporated their comments into the memo. *(See Attachment for DOR's response.)*

JLBC Staff Findings

BRITS has had a positive impact on increasing enforcement revenue, but it is difficult to determine how much of an effect it had compared to other factors not related to BRITS.

(Continued)

Specific observations include the following:

1) At the same time that there was a new computer system, there was also a significant infusion of enforcement staff. The revenue generating program provided DOR with additional audit and collection resources to increase the department's collections beginning in FY 2003. The BRITS baseline was set at the anticipated level of enforcement revenues after the addition of new staff at revenue generating program levels, since the added staff was given to DOR with the expectation that they would increase DOR's enforcement revenue. It is difficult to determine the impact of BRITS versus the new staff. If the enforcement staff generated more new revenue than anticipated, the baseline calculation would make it appear as if BRITS generated the gain.

2) During this period DOR had an abusive tax shelter avoidance enforcement program not associated with BRITS. Due to the baseline calculation, $49 million of enforcement revenue from the abusive tax shelter avoidance program is included in the revenue attributed to BRITS. DOR concluded that the abusive tax shelter avoidance program differed from other audit programs only in the amount of dollars generated, and that the baseline methodology required attributing the abusive tax shelter avoidance program revenues to BRITS. DOR agrees that the revenues from the abusive tax shelter avoidance enforcement program are not attributable to BRITS, but felt that they could not treat this revenue differently from other audit programs without violating the contract.

3) The baseline was not adjusted for growth in either the population or the economy, since the baseline calculation as included in the contract prohibits such adjustments. This made it easier to exceed the BRITS baseline. An argument could be made that the baseline should have been adjusted for population and a factor for "normal" economic growth.

4) The baseline was reduced by $(66.2) million for taxpayer amnesty payments, which assumed that most of the $73 million of amnesty revenue was just accelerated future collections that would have eventually been paid. While DOR assumed that most of the amnesty revenue was accelerated future collections, it is unclear whether or not this was the case. If more than $6.8 million of the amnesty revenue would not have been collected in the absence of the program, the amnesty adjustment made it easier to exceed the baseline than it should have been.

The BRITS contract includes interest payments to the contractor for the length of time to pay the contract. If the baseline is not exceeded during a given period, then payment must wait until the baseline is exceeded, but DOR is charged interest on the balance. It is our understanding that BRITS is a 10-year contract so that the contractor has time to get paid in case BRITS revenue is less than estimated. While it is not clear if BRITS itself has generated as much revenue as determined by the baseline calculation, the formula calculation has helped to reduce interest payments below what they would have been in the absence of adjustments discussed above.

DOR Perspective

DOR generally agrees with these findings, and has the following perspective on the overall project:

"While the degree to which BRITS has contributed to the current level of benefits is being reviewed, the Department believes that it is important to recognize that BRITS has generated significant on-going benefits for the state, counties and cities. Under any sound calculation method, BRITS will clearly generate enough revenues to pay for the project over the ten-year contract period."

BH:ym
Attachment

STATE OF ARIZONA

Department of Revenue
Office of the Director
(602) 716-6090

Janet Napolitano
Governor

Gale Garriott
Director

RECEIVED
DEC 27 2006
JOINT BUDGET COMMITTEE

December 27, 2006

Mr. Richard Stavneak, Director
Joint Legislative Budget Committee
1716 West Adams
Phoenix, Arizona 85007

Dear Mr. Stavneak:

Thank you for the opportunity to provide input to the memo from Bob Hull dated December 12, 2006, regarding the BRITS baseline. We look forward to working with the outside panel and will make available to them the same documents that have been provided to JLBC and any additional materials.

Per Mr. Hull's memo, the purpose of the JLBC staff review is to address requests made by the Committee on October 24, 2006 to identify 1) "whether revenue above the baseline was due solely to BRITS or other factors," and 2) "to evaluate the BRITS baseline calculation and provide feedback regarding the effects of automation versus an improving economy on the increased level of collections." As explained in more detail below, the Department is in general agreement with most of the statements and observations made in the memo, but maintain that an adjustment for economic growth is prohibited by the contract.

As communicated in the October 24, 2006 JLBC meeting and in previous discussions with JLBC staff, the Department agrees that the enforcement revenues exceeding the baseline cannot all be attributed solely to BRITS. As concluded by Mr. Hull, it is difficult to determine which enforcement revenues are the result of the new technology. It is because of that difficulty that the baseline methodology was utilized, i.e., if it had been possible to track every efficiency dollar back to a particular BRITS program, there would have been no need to establish a baseline in the first place. Inherent in the very use of a baseline is the acceptance that benefits may include revenues due to factors other than BRITS.

It should be noted, however, that several parties in addition to the Department examined the baseline methodology for its appropriateness. For example, because the baseline methodology was incorporated by both Accenture and AMS in their proposals to the BRITS' Request for Proposal, the evaluation committee reviewed the methodology as part of the procurement process and found it acceptable.

In addition, A.R.S § 41-2559 (D) required that JLBC staff be consulted prior to the contract award in order to evaluate the fiscal impact to the State. The Department met with JLBC staff on June 12, 2002 and August 1, 2002 and provided detailed documents regarding the benefits calculations. I

would respectfully draw your attention to the third page of the document titled BRITS Formulas for Calculating Baselines and Benefits, the second assumption under Compliance Efficiencies which states, "[n]o adjustments will be done for population or economy changes". Following a letter dated August 5, 2002 from then Director Mark Killian, the Department received formal sign-off by JLBC staff on August 7, 2002. Please see the attached documents.

Finally, the contract was awarded by the Department of Administration to Accenture on August 20, 2002 and the baseline methodology became a required component of the contract.

Responses to JLBC observations:

1. The Department agrees with the observation that, "it is difficult to determine the impact of BRITS versus the new staff," on generating revenues above the baseline. As previously discussed, revenues that exceed the baseline cannot be definitively attributed to BRITS versus other factors, which is why a baseline methodology is utilized. As such, the precise impact of any adjustment to the baseline cannot be attributed to any particular factor with absolute certainty.

2. The Department agrees that the revenues associated with the abusive tax shelter avoidance (ATAT) enforcement program were not attributable to BRITS. The Department spent significant time debating whether the ATAT revenues should be included in the benefits calculation. It became clear, however, when comparing ATAT to the numerous other audit programs that are included in the benefits calculation, that ATAT was no different than those other programs except in the amount of dollars generated. Consequently, the Department concluded that selectively excluding the ATAT revenues while not excluding revenues from many other similar audit programs would have been a contractual violation because similar revenue streams would have been treated differently with no rational justification.

3. The Department agrees with the observation that the baseline was not adjusted for population or the economy, as previously noted, and that having a lower baseline makes the baseline easier to achieve. It should be pointed out, however, that the baseline figures used have resulted in Accenture being subject to decreases in enforcement revenues as well. Early in the project and prior to BRITS going live, the Department experienced significant declines in Collections' enforcement revenues, thus substantially lowering or eliminating efficiency benefit payments to Accenture. Between July-December 2003 Collection enforcement revenues were $19.9 million below the baseline. In these cases where the baseline was not met and negative benefits occurred, Accenture was required to first make up for the accumulated negative benefits before qualifying for additional benefit payments.

4. The Department does not agree with the observation that *all* amnesty revenue was treated as accelerated future collections that would have eventually been paid. During the fall of 2003, the Department conducted a tax amnesty program that generated a total of $73 million. Upon completion of the program, the enforcement teams evaluated the payments made through the amnesty program on a case by case basis and estimated how much of the money would have come in at a later date. The monthly efficiency baselines for the next three fiscal years were then reduced by $66 million, not the full $73 million.

While the degree to which BRITS has contributed to the current level of benefits is being reviewed, the Department believes that it is important to recognize that BRITS has generated significant on-going benefits for the state, counties and cities. Under any sound calculation method, BRITS will clearly generate enough revenues to pay for the project over the ten-year contract period.

Under the present calculation BRITS has generated benefits well in excess of the contract cost. Because benefits exceed the cost of the contract, the state, cities and counties will no longer share the benefits with Accenture at the 85% level and will instead retain the full 100% of benefits estimated to be at least $50 million annually for all future years. The total benefits recognized through November 2006 are $215.7 million at the 100% level. This translates into $183 million at the 85% level, well above the current estimate of the total project cost, including the current contract amendment. Of the $183 million available, a total of $117 million has been paid to Accenture through November 2006. DOR is currently paying invoices when received and as such is no longer paying interest on outstanding project costs. The total interest cost of the project of $6.1 million is significantly less than the original estimate of $9-$13 million.

The beginnings of the BRITS project dates back, I believe, as far as 1998 or 8 years ago, when the Government Information Technology Agency provisionally approved the Department's concept and direction for the project. Many of the original participants have since left the Department and we continue to find additional documentation from the project's inception with which we were previously unfamiliar. As we continue to work through issues like the baseline calculation, we appreciate your patience and the opportunity to provide input. As you have further questions, please do not hesitate to ask and we will provide the best information we have available.

Sincerely,

Gale Garriott
Director

cc: Jim Apperson, OSPB
Mathew Busby, OSPB
Bob Hull, JLBC
Bill Bell, ADOA
Chris Cummisky, GITA
Kristine Ward, DOR
Susan Silberisen, DOR
Lynette Nowlan, DOR
Jim Harden, DOR
Elaine Smith, DOR
Reed Spangler, DOR
File

STATE OF ARIZONA

Department of Revenue
Office of the Director
(602) 716-6090

Janet Napolitano
Governor

Gale Garriott
Director

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JOINT BUDGET COMMITTEE

September 28, 2007

The Honorable Russell Pearce
Chairman – Joint Legislative Budget Committee
1700 West Washington
Phoenix, Arizona 85007

Dear Representative Pearce:

In compliance with Laws 2007, Chapter 259, this letter is to serve as the Department of Revenue's notification to the Joint Legislative Budget Committee requesting a review, at JLBC's October meeting, of the Department's intent to modify the current business reengineering/integrated tax system contract.

The table below illustrates the summary of costs related to the amendment request.

BRITS Contract Amendment Summary of Costs

Cost Components	Development Cost
BRITS Project Amendment	
1. Capture External Vendor Data Entry Performance Statistics and Report	$31,000
2. Additional SSN Format Validation Based on New Interface to SSA	$65,000
3. Access to BRITS for Attorney General's Office	$18,000
4. Automated Non-Scheduled Conversion Process	$174,000
	$288,000
Costs for Accenture On-going Operational Support Services for the period December 2007 – June 2008.	$3,683,680
Net Change to BRITS Contract	**$3,971,680**

If you have any questions regarding this request, please contact Reed Spangler (716-6883).

Sincerely,

Kristine Ward
Deputy Director – Arizona Department of Revenue

cc: Senator Bob Burns
Richard Stavneak – Director JLBC
Jim Apperson – Director OSPB
Marcel Benberou – OSPB
Bob Hull - JLBC

STATE OF ARIZONA

Joint Legislative Budget Committee

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STEVE YARBROUGH

DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Caitlin Acker, Staff Intern

SUBJECT: Arizona Commission on the Arts - Review of the Arizona Arts Endowment Fund and Private Contributions

Request

Pursuant to A.R.S. § 41-986F, the Arizona Commission on the Arts requests the Committee review the report on private monies that are donated for use in conjunction with public monies from the Arizona Arts Endowment Fund.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the request. The Commission increased private donations in CY 2006 over CY 2005. The Commission also generated as much in private donations in CY 2006 as they received in public money in FY 2007.

Private contributions decreased from $5.2 million in CY 2004 to $3.2 million in CY 2005 due to staff vacancies and the retirement of the prior director of the agency, which resulted in a lower level of communication with the arts organizations. These issues have since been resolved. In CY 2006, private contributions increased to $4.7 million.

The Committee also has the option of recommending a statutory change to delete this review requirement since the Arts Endowment is now fully funded.

Analysis

Pursuant to A.R.S. § 41-986F, the Committee shall annually review the Commission's records regarding private monies that are donated for use in conjunction with public monies from the Arizona Arts Endowment Fund. The Committee is to compare the level of private contributions to the state's contribution to the Arizona Arts Endowment Fund. There is no statutory requirement that private donations match public appropriations for the Arizona Arts Endowment Fund. At the time of the

(Continued)

endowment's enactment, however, there was an expectation that additional state funding would leverage private contributions.

The public component of the legislation began in FY 1998 and consists of an annual appropriation of up to $2,000,000 to the Arizona Arts Endowment Fund from the General Fund, with the intent that the fund reach a total endowment of $20 million. These monies are then invested by the State Treasurer, who distributes the interest income to the Arts Commission to fund arts programs across the state.

In FY 2007, a total $7 million was appropriated to the fund to reach the $20 million endowment goal. As a result, Laws 2006, Chapter 351 eliminated the statutory requirement to annually appropriate $2 million from the General Fund to the Arts Endowment Fund.

Since FY 1998, the fund has earned approximately $2,971,600 in interest, of which nearly $1 million was earned in the past year, due in large part to the large increase in the endowment. Of the total interest earnings, $1,849,800 has been expended. In FY 2008, the Commission has committed $1,080,000 of these monies in the form of grants.

The private component of the legislation allows the Arts Commission to partner with non-profits such that the non-profit may receive, invest, and manage private donations: 1) to its own endowment, 2) to the endowment of other arts organizations, or 3) to the non-designated portion of the Arizona Arts Endowment Fund. Donors who wish to support endowments of a specific arts organization, such as the Phoenix Symphony, may do so. Such donations are administered by the individual arts organization but must conform to the rules adopted by the Arts Commission to qualify as a contribution to the Arizona Arts Endowment Fund. Several smaller arts organizations have arranged for the Arizona Community Foundation to administer endowments on their behalf. The Arizona Community Foundation is a tax-exempt charitable organization, which manages more than 700 funds with 11 affiliate organizations across the state.

Donors who wish to endow the arts generally, without designating a particular arts organization, may do so by giving to the private non-designated portion of the Arizona Arts Endowment Fund. The Arts Commission receives the interest income from these non-designated donations and distributes the earnings according to its policy.

The table on the next page summarizes private contributions that have been collected since the establishment of the Arizona Arts Endowment Fund. Private contributions were less from 2001 to 2003 than in previous years due to the slowing economy. Contributions increased in CY 2004 due to the improving economy and better communication practices by the Arts Commission with their arts organizations. Private contributions decreased in CY 2005 due to a decrease in communications with the arts organizations because of staff vacancies; however, the agency is now fully staffed and contributions increased in CY 2006.

(Continued)

Private Donations to the Arizona Arts Endowment Fund, by Calendar Year

	1996 [1/]	1997	1998	1999	2000	2001
Designated	$1,682,700	$2,973,200	$5,799,600	$3,887,300	$6,559,000	$2,044,000
Non-Designated	0	76,500	545,300	475,900	69,300	(24,400) [2/]
Totals	**$1,682,700**	**$3,049,700**	**$6,344,900**	**$4,363,200**	**$6,628,300**	**$2,019,600**

	2002	2003	2004	2005	2006	Total
Designated	$2,728,500	$1,819,200	$5,066,600	$3,099,900	$4,666,000	$40,326,000
Non-Designated	(44,500) [2/]	191,000	162,100	140,200	0	1,591,400
Totals	**$2,684,000**	**$2,010,200**	**$5,228,700**	**$3,240,100**	**$4,666,000**	**$41,917,400**

1/ 1996 reporting period is from April 15, when the legislation was passed, to December 31.
2/ Losses in 2001 and 2002 were a result of overall losses in investments at the Arizona Community Foundation.

RS/CAc:ym

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Arizona
Commission
on the Arts

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OCT 03 2007
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October 1, 2007

Representative Russell Pearce, Chairman JCCR
Arizona House of Representatives
1700 West Washington Street
Phoenix, AZ 85007

RE: Request for Placement on Joint Committee on Capital Review Agenda – November 2007

The Arizona Commission on the Arts respectfully requests placement on the November 2007 agenda of the Joint Committee on Capital Review to review the report on private monies that have been donated for use in conjunction with public monies from the Arizona Arts Endowment Fund.

Information for this item is attached.

Sincerely,

Robert C. Booker
Executive Director

Attachment: Arizona Artshare Summary of Endowment Contributions by Calendar Year

CC: Richard Stavneak, Director, JLBC
Caitlin Acker, Budget Analyst, JLBC

dsm/RCB

ARIZONA ARTSHARE

Summary of Endowment Contributions by Calendar Year

updated: 9/25/07

Arts Organization	1996*	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
Arizona Opera	11,642	7,207	25,350	5,070	69,376	231,870	0	0	0	245,809	265,629	861,953
Ballet Arizona	50,000	50,000	--	--	--	--	0	0	100,000	1,544,802	0	1,744,802
Flagstaff Symphony	--	--	16,085	--	--	--	200	0	4,020	12,895	2,275	35,475
Heard Museum	329,591	1,880	817	2,742	35,845	6,309	0	0	266,000	8,000	**0**	651,184
Museum of Northern Arizona	--	15,000	--	--	1,165,645	--	0	100	0	838,903	263,976	2,283,624
Orpheus Male Chorus of Phx	--	--	--	--	--	33,674	39,806	16,450	70,000		**0**	159,930
Phippen Museum	--	--	--	--	420,000	--	0	0	0	0	0	420,000
Phoenix Art Museum	549,000	1,116,635	718,230	559,912	122,244	416,000	35,000	1,379,524	4,209,945	321,500	3,482,604	12,910,594
Phoenix Boys Choir	--	--	818,673	--	143,057	184,067	86,094	0	9,462	0	**0**	1,241,353
Phoenix Symphony	30,000	--	3,125,000	1,311,680	3,363,968	418,890	2,413,395	66,707	148,122	46,000	170,000	11,093,762
Scottsdale Cultural Council	275,651	375,390	1,008,277	1,661,490	1,111,585	3,005	0	0	5,000	13,000	**0**	4,453,398
Sierra Vista Symphony Assc.	--	--	--	--	--	9,817	0	80,775	550	850	**0**	91,992
Tucson Arizona Boys Chorus									50,000	22,562	23,368	50,000
Tucson Museum of Art	5,500	33,131	42,109	27,910	32,298	19,139	34,684	5,000	36,840	24,597	19,500	280,708
Tucson Symphony	23,455	316,380	41,500	223,500	95,027	228,282	90,296	170,652	156,755	20,962	438,616	1,805,425
Subtotal:	**1,274,839**	**1,915,623**	**5,796,041**	**3,792,304**	**6,559,045**	**1,551,053**	**2,699,474**	**1,719,208**	**5,056,694**	**3,099,880**	**4,665,968**	**38,084,200**

Community Foundations	1996*	1997	1998*	1999*	2000	2001*	2002	2003	2004	2005	2006	Total
Arizona Community Foundation	407,846	957,622	3,592	95,045	**0**	492,951	0	100,000	0	0	0	2,057,056
Community Foundation for Southern Arizona	--	100,000	**0**	**0**	**0**	**0**	29,000	0	9,888	0	0	138,888
Subtotal:	**407,846**	**1,057,622**	**3,592**	**95,045**	**0**	**492,951**	**29,000**	**100,000**	**9,888**	**0**	**0**	**2,195,944**
Arizona ArtShare							**					
(designated)		**76,481**	**545,336**	**475,921**	**69,266**	**(24,446)**	**(44,518)**	**190,968**	**162,130**	**140,188**	**0**	**1,591,374**
TOTALS:	**1,682,685**	**3,049,726**	**6,344,969**	**4,363,270**	**6,628,311**	**2,019,558**	**2,683,956**	**1,910,176**	**5,228,712**	**3,240,068**	**4,665,968**	**41,871,517**

nr= not reported

*1996 reporting period is from April 15 to December 31; Orpheum Theatre,Cross Culture Dance Resources, Bead Musuem, Pickard Arts & Culture Fund

*1998 Atlatl

*1999 Sun Cities Art Museum, Sun Cities Chamber Music, Sun Cities Symphony

*2001 Grand Canyon Music Festival, Herberger Christmas House Funds, Orpheus Sound Investments, Scottsdale Artists School, Sonoran Arts League

**Investment losses through 12/31/2004

UPDATED 2005 INFO. 8/31/2006

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE
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STEVE YARBROUGH

DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Dan Hunting, Fiscal Analyst

SUBJECT: Arizona Department of Administration – Review of Risk Management Deductible

Request

A.R.S. § 41-621 provides that the Arizona Department of Administration (ADOA) Director may impose deductibles of up to $10,000 per risk management loss on state agencies. Such deductible amounts are subject to annual review by the Joint Legislative Budget Committee (JLBC). ADOA proposes to keep the deductible at the $10,000 limit.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the $10,000 deductible amount.

In the past, Committee members have expressed concern that the deductible was not actually imposed. ADOA as recently issued a $10,000 deductible to the Department of Economic Security (DES) with regard to a Child Protective Services (CPS) case, but will not actually collect from DES until a settlement or judgment has been reached.

Analysis

ADOA has changed its policy regarding the imposition of this deductible. Previous department policy called for charging the deductible when workers' compensation claims were not filed in a timely manner, or when agencies failed to file either their agencywide or Rule 14 required loss prevention plans. The deductible was never actually assessed against an agency under this system.

Current policy is that ADOA may charge a $10,000 deductible for each claim of $150,000 or more unless the agency implements an ADOA approved plan to limit or eliminate similar future losses. ADOA may also impose the deductible in cases where there have been significant violations of agency policy and procedures. ADOA maintains the right to waive any deductible for just cause or in the best interests of

(Continued)

the state. Additionally, ADOA will begin assessing this deductible earlier in the claim process, rather than waiting until a final settlement has been established. Actual payment of the deductible will be deferred until the final settlement has been reached, which could allow ADOA to reduce or eliminate the payment based on the outcome of the claim.

In September 2007, ADOA charged this deductible to an agency for the first time. The $10,000 assessment was against DES for a case involving CPS where the agency failed to follow policies and procedures. ADOA reports that this is one of several similar claims against CPS. ADOA could elect to not collect this deductible based on the outcome of this claim.

RS/DH:ym

JANET NAPOLITANO
GOVERNOR

WILLIAM BELL
DIRECTOR

ARIZONA DEPARTMENT OF ADMINISTRATION
RISK MANAGEMENT SECTION
100 North 15th Ave., Suite 301
PHOENIX, ARIZONA 85007-2635
(602) 542-2182 FAX (602) 542-1473

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JOINT BUDGET COMMITTEE

October 2, 2007

The Honorable Russell K. Pearce
Arizona House of Representatives
1700 West Washington
Phoenix, AZ 85007

Dear Representative Pearce:

Pursuant to ARS 41-621E, the Director of the Department of Administration may impose on state departments, agencies, boards and commissions a deductible of not more than ten thousand dollars per loss that arises out of a property, liability or workers' compensation loss pursuant to this subsection. Deductible amounts established by the Director shall be subject to annual review by the Joint Legislative Budget Committee.

The deductible amount established by the Director is $10,000 and has not changed for at least the last five years. Risk Management has used the deductible program as an incentive for state agencies to provide an adequate mitigation plan for large civil liability settlements or judgments. Since our last presentation, a deductible of $10,000 has been issued to the Arizona Department of Economic Security.

We do not plan to make any changes to the deductible amount.

Sincerely,

Ray Di Ciccio
State Risk Manager

xc: Charlotte Hosseini, ADOA Deputy Director
Paul Shannon, ADOA Assistant Director
Dan Hunting, Budget Analyst, JLBC
Matt Gottheiner, Budget Analyst, OSPB

STATE OF ARIZONA

Joint Legislative Budget Committee

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STEVE YARBROUGH

DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Dan Hunting, Fiscal Analyst

SUBJECT: Rule 14(3)(P) – Report on Loss Prevention Plans

As requested by members of the Committee, the JLBC Staff presents revisions to the format of the loss prevention plans required under Rule 14 of the Joint Legislative Budget Committee Rules and Regulations.

Rule 14 of the JLBC Rules and Regulations outlines the Committee's process for approving settlements covered by the Risk Management Self-Insurance Fund. At its February 6, 2007 meeting, the Committee amended Rule 14(3)(P) to require that the Arizona Department of Administration (ADOA) and the agency submit an approved loss prevention plan. Previously, the agency was only required to submit a statement detailing what actions had been taken in response to the loss.

In a recent submission, the agency loss prevention plan began with a 12-page history of the incident. This response largely replicated material in the settlement proposal report, rather than directly addressing risk reduction. In response to this and other similar submissions, Senator Burns asked that JLBC Staff provide recommendations for improving the format of the loss prevention plan.

JLBC Staff analyzed recent loss prevention plans and compiled a list of suggestions to clarify and formalize procedures under Rule 14. This list was refined with input from ADOA Risk Management staff.

Revisions

JLBC Staff recommends that agencies follow these guidelines when submitting loss prevention plans to the Committee:

(Continued)

- The executive summary required by Rule 14(3)(A), should include an explicit statement to indicate whether or not ADOA approved the agency loss prevention plan, as required by Rule 14(3)(P)(3).

- If there is not an approved loss prevention plan, ADOA should explain why one has not been approved and include a timetable for its approval and adoption, as required by Rule 14 (3)(P)(3).

- The loss prevention section should be a 2-3 page summary outlining the changes intended to limit future liability. The summary should include the following:

    - A brief summary of the loss prevention plan approved by ADOA, or an explanation of why a plan has yet to be approved, with a timeline for submitting an approved plan.
    - A table listing individual actions and the expected date of implementation (similar in format to the Auditor General's semiannual follow-up reports).

  Additional materials may be submitted by the agency or ADOA if necessary, but they should be submitted as an attachment to the loss prevention summary.

- The loss prevention plan should focus on the specific actions taken to reduce future risk to the state and should not restate the facts of the case, except as needed to illustrate the loss prevention plan.

- The response should address specific procedural and administrative changes, not broad policy goals.

- ADOA Risk Management should work jointly with the agency to assure the loss prevention section addresses a plan to prevent similar events from happening in the future, rather than an explanation of the event.

- The agency should include an attachment with a brief description of any disciplinary actions taken against employees as a result of the incident.

RS/DH:sls

STATE OF ARIZONA

Joint Legislative Budget Committee

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STEVE YARBROUGH

DATE: October 11, 2007

TO: Representative Russell Pearce, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Leatta McLaughlin, Fiscal Analyst

SUBJECT: JLBC Staff – Consider Approval of Index for School Facilities Board Construction Costs

Request

A.R.S. § 15-2041D.3c requires that the cost-per-square-foot factors used in the School Facilities Board (SFB) building renewal and new school construction financing "shall be adjusted annually for construction market considerations based on an index identified or developed by the Joint Legislative Budget Committee (JLBC) as necessary but not less than once each year."

The SFB Staff is requesting that the Committee approve an adjustment for FY 2008 based on an average of 2 Phoenix Metropolitan marketplace indices developed by a project management firm and a construction-consulting group. The SFB Staff is also requesting the Committee to consider revisiting the inflation level again in January 2008.

This is the same memo as was prepared for the September meeting.

Recommendation

The Committee has at least 2 options to consider:

1. Approve a 5.53% increase in the cost-per-square-foot factors as requested by SFB Staff and based on the Committee's 2006 methodology. This adjustment is based on an average of Phoenix construction costs indices developed by a project management firm (2.2%) and an international construction-consulting group (8.9%). Approving this adjustment may generate $24.1 million in additional cost through FY 2012 for new construction authorized in the FY 2008 approval cycle. About 5% of these additional costs would be incurred in FY 2008.

   The adjustment would increase the building renewal formula cost by $10.5 million in FY 2009. Formula increases, however, do not occur automatically and are subject to legislative appropriation.

(Continued)

2. Approve an adjustment based on one of the two indices described above.

Table 1 lists the current dollar per square foot amounts and options 1 and 2.

Table 1

Dollars per Square Foot Amounts for Each Option

	K-6	7-8	9-12
Current Amount	$131.10	$138.40	$160.25
Option 1- Consensus average (5.53%)	$138.35	$146.05	$169.11
Option 2- PinnacleOne only (2.2%)	$133.98	$144.44	$163.78
Rider only (8.9%)	$142.77	$150.72	$174.51

SFB has the statutory authority to fund projects above these square foot amounts if a district cannot build a school within the New School Facilities (NSF) formula amount. In FY 2006, SFB funded 38% of projects over the formula amount for total additional funding of $20.4 million. In FY 2007, SFB funded 86% of projects over the funding amount for total additional funding of $33.4 million. This averages to $1.4 million in additional funding per project.

Analysis

This section includes background information regarding the SFB inflation index, details on rising construction costs, an explanation of the options available for the current adjustment, discussion on SFB's guidelines for funding new school construction projects, and other adjustments SFB has requested this coming session.

Background Information

The original Students FIRST legislation (Laws 1998, Chapter 1, 5th Special Session) established funding amounts per square foot of space for new construction and building renewal (e.g., $90 per square foot for Grades K-6). It required, however, that those amounts be adjusted periodically for inflation. The latter provision states that the funding amount per square foot "shall be adjusted annually for construction market considerations based on an index identified or developed by the JLBC as necessary but not less than once each year" (A.R.S. § 15-2041D.3c). SFB also has statutory authority to modify a particular project cost per square foot for geographic factors or site conditions above the approved amounts.

Prior to 2002, the Committee used the Marshall Valuation Service (MVS) construction cost index for Class C structures (masonry bearing walls) for Phoenix. At the August 2002 meeting, the Committee elected not to approve an adjustment in the cost-per-square-foot factors. Due to the decision not to approve an adjustment for that year, 5 school districts brought suit against the Committee, claiming the Committee had failed to perform its statutory duty under A.R.S. § 15-2041D.3c to adjust the index not less than once per year. The following year, at the September 2003 meeting, the Committee approved a 2-year adjustment. The adjustment made was based on the Bureau of Economic Analysis (BEA) index for "State and Local Government Investment - Structures." The Committee again approved the BEA index at the September 2004 meeting. At the October 2005 meeting, the Committee approved an adjustment based on a midpoint between the BEA and MVS indices, which was higher than actual prior year inflation under either index, to account for the high rate of growth in construction costs over the past few years. Last year at the October 2006 meeting, the Committee adopted an average of the same 2 indices that the SFB Staff is recommending again this year (see next page).

For building renewal, the inflation adjustment is applied to the *formula* amount. In FY 2008 the state funded $86.3 million of the $190.2 million building renewal formula amount. An inflationary adjustment, therefore, would increase the full formula amount to at least $194.4 million (based on the PinnacleOne index) in FY 2009 prior to any other possible formula adjustments. Adjusting for inflation would not change the existing FY 2008 appropriation.

(Continued)

Construction Costs
Even though the prices of construction cost inputs are still increasing, they are not rising as much when compared to the previous few years. According to the U.S. Bureau of Labor Statistics, the costs of construction inputs have risen by 2.8% in FY 2007 compared to 9.4% in FY 2006. For example, the cost of iron and scrap steel only rose 4.0% in FY 2007 compared to the 69.2% increase in FY 2006. Softwood plywood, copper base scrap, and hot rolled bars are the only construction inputs whose costs increased by over 10% in FY 2007, while copper ores and non-ferrous pipes increased by 100% in FY 2006.

Options for the Current Adjustment
The JLBC Staff has identified possible adjustments that could be considered. *Attachment 1* includes information on each of the 2 indices discussed below.

PinnacleOne and Rider Indices
The SFB Staff has again requested the Committee approve an adjustment based on an average of 2 Phoenix market indices developed by PinnacleOne, a project management firm, and Rider Levett Bucknall, an international construction-consulting group.

The PinnacleOne index reports inflation of 2.2% for FY 2007 and is based on the cost of an elementary school in the Phoenix area. Beginning in January 2006, this index was only developed for Phoenix and is based on the cost to build a 70,000 square foot K-6 school. Input prices are updated each quarter based on conversations with their subcontractors and suppliers. Even though it measures inflation for Phoenix area elementary schools, it does not measure inflation for high schools or schools outside of the Phoenix Metropolitan area.

The Rider index reports inflation of 8.9% and includes all types of Phoenix area construction. This index tracks the bid cost of construction including labor, materials, general contractor and subcontractor overhead costs and fees, and applicable sales and use taxes. Rider develops a construction costs index for 11 major U.S. cities, including Phoenix. This index also does not measure inflation outside of Phoenix.

The average of these 2 indices is 5.53%. The total estimated new construction impact would be $24.1 million cumulatively through FY 2012. The adjustment would increase the building renewal formula cost by $10.5 million in FY 2009. Formula increases, however, do not occur automatically and are subject to Legislative appropriation.

New School Construction Funding Guidelines
SFB provides new construction funding based on the product of the following statutory NSF formula:

No. of pupils x Sq. foot per pupil x Cost per sq. foot = Allocation amount

SFB has the authority to provide additional funding above and beyond the statutory allocation amount to a district if it cannot build a school within the NSF formula amount. A district can prove they cannot build a minimum guidelines school by demonstrating they are building the least expensive school they possibly can but are still over the formula amount.

Since the enactment of Students FIRST, some of these projects have been funded above the formula with SFB monies. In FY 2006, SFB funded 38% of their projects over the formula amount for total additional funding of $20.4 million. In FY 2007, SFB funded 86% of their projects over the funding amount for total additional funding of $33.4 million. This averages to $1.4 million in additional funding per project.

SFB has applied the JLBC adopted inflationary adjustment to projects that are approved subsequent to the Committee's action. As a result, projects that are approved at different times but began construction at the same time might receive different funding amounts from SFB.

(Continued)

Minimum School Facility Guidelines

Minimum guidelines for school facilities were developed by SFB, adopted by the Joint Committee on Capital Review, and became effective in 1999. Since their adoption, no significant changes related to new school construction standards had been made to the guidelines until the board approved SFB Staff's recommendations on how to apply 7 areas of the minimum guidelines for new construction projects in February 2007. Those 7 areas include: indoor flooring, gym flooring, millwork (cabinetry), exterior lighting, canopies, playground structures and canopies, and landscaping. These newly adopted guidelines could raise the NSF formula by about $7 per square foot. Note that this is not part of the inflation adjustment increase that SFB Staff is currently requesting.

School Safety Features Adjustment

At the August 2 board meeting, the board adopted SFB Staff recommendations for incorporating 10 safety features into new school construction. SFB came up with these recommendations as a result of the Governor's office asking them to evaluate school security issues and make recommendations on these issues that might be incorporated into new school construction. These 10 features include:

1. Exterior security lighting
2. Administrative office locations
3. Classroom door locks
4. Student interior restroom configuration
5. Vestibule entry
6. Windows next to doors
7. Perimeter fencing
8. Security alarms
9. Security cameras
10. In-classroom telephones

According to SFB, the first 6 items have either no cost or are capable of being funded within current SFB guidelines since these items are design in nature. In their FY 2009 budget submittal, SFB is seeking a 1.6% adjustment to the new construction formula for items 7-10. If this adjustment is approved, SFB estimates it will impact FY 2009 new construction approvals by $6.8 million over 5 years, with an initial year cost of $350,000 in FY 2009. Note that this is not part of the inflation adjustment increase that SFB Staff is currently requesting.

Energy Conservation Adjustment

In their FY 2009 budget submittal, SFB is requesting a 5% adjustment to the new construction formula for school energy efficiency and sustainability. This is in response to the 2005 Governor established goal of building all schools to LEED (Leadership in Energy Efficient Design) silver standards. If this adjustment is approved, SFB estimates it will impact FY 2009 new construction approvals by $21.4 million over 5 years, with an initial year cost of $1.1 million in FY 2009. Note that this is not part of the inflation adjustment increase that SFB Staff is currently requesting.

RS/LMc:ym
Attachment

Attachment

Construction Costs Indices Research

PinnacleOne

- Project management firm (http://www.pinnacleone.com/)
- 2.2% for FY 2007
- Phoenix elementary school index
- Has been in existence since 2005 internally but was finalized in Jan. 2006. The first index they published was for 1st Quarter 2006.
- In January 2006 they used an actual 70,000 sq. ft. K-6 school as a model. They update their cost estimates every quarter by contacting outside contractors and vendors to ask them what kinds of costs they have experienced for the previous 3 months.

Rider Levett Bucknall

- International construction-consulting group (www.riderhunt.com)
- 8.9% for FY 2007
- All types of Phoenix construction-they use a hypothetical building in their model so it's not necessarily a residential or commercial building
- Has been in existence internally since 2001 but was first published in 2002 and is published each quarter.
- Tracks bid costs of construction including labor, materials, general contractor and subcontractor overhead costs and fees, and applicable sales and use taxes. Once a quarter, they contact the same 3 suppliers to ask what material prices they've been incurring the previous 3 months and then average these 3 material costs. They use government websites to get information on labor costs.
- Has the same index for 11 other U.S. cities besides Phoenix

STATE OF ARIZONA
SCHOOL FACILITIES BOARD

Governor of Arizona
Janet Napolitano

Executive Director
William Bell

August 30, 2007

The Honorable Robert Burns
Chairman
Joint Legislative Budget Committee
1716 West Adams
Phoenix, Arizona 85007

Dear Senator Burns,

A.R.S. 15-2041, section 3(C). states in part "...The cost per square foot shall be adjusted annually for construction considerations based on an index identified or developed by the joint legislative budget committee as necessary but no less than once each year."

For FY 2008, SFB staff is requesting the committee adjust the formula by 5.53 percent. This number was derived from two indexes developed specifically for the Phoenix market. The project management firm PinnacleOne developed the first index. This index is based on the cost of an elementary school in the Phoenix metropolitan market and reports FY 2007 inflation at 2.2 percent. The second index was developed by Rider Levett Bucknall an international construction-consulting group. This index includes all types of commercial construction and sets inflation at 8.9 percent. The recommended number of 5.53 percent is the average of these two indexes.

These are the same to indices that the committee relied upon to set the inflation factor for FY 2007. Please note that Rider Levett Bucknall is the new name for Rider, Hunt, Levett, and Bailey.

Table one shows the impact on the cost per square foot of the recommended increase.

Table One

Grade Level	Current Amount	Adjusted Amount
K-6	$131.10	$138.35
7-8	$138.40	$146.05
9-12	$160.25	$169.11

SFB staff believes that this amount adequately reflects FY 2007 inflation. The proposed costs per square foot would have covered the construction costs for the most recent SFB new construction projects.

However, in recent months, new costs, not related to inflation, have entered the program that will not be covered by this inflation increase. First, SFB staff has noted a significant increase in impact fees charged by cities and counties. These fees can be as much as $8.37 per square foot or 6.4% of the

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current cost per square foot of a K-6 school. SFB staff estimates the impact fees levied by Pinal County alone could reach $7 million in FY 2008. The inflation adjustment will not cover these fees.

Second, low property wealth districts are asking the SFB to fund on-site adjacent ways costs. Until recently, the majority of districts funded eligible adjacent ways expenditures, both on and off the school site, from the local adjacent ways budgets. As growth has entered smaller, low property wealth districts, some districts are asking the SFB to fund certain on-site ingress and egress items. In recent projects, these costs have reached $6 a square foot or 4.6 percent of the current cost per square foot in a K-6 school. This shift in cost is not an inflation item, and will not be covered by the proposed adjustments.

In addition to the current increase, SFB staff also recommends that the Committee review the inflation levels in January 2008. The current action before the committee will update the costs per square foot to July 2007 levels. However, the SFB will award the majority of the projects subject to this cost per square foot after January 2008. Therefore the new construction projects are subject to at least six months of inflation that is unaccounted for in the established cost per square foot. In seasons of major inflation, this will dramatically impact the buying power of the formula.

Fiscal Impacts

The increase will affect both the building renewal and new construction programs. The new construction impact is calculated by multiplying the projected FY 2008 awards by the recommended rate. The conceptual plan adopted in FY 2007 suggests that the SFB will award approximately $435 million in new construction in FY 2008.

Based on $435 million in projected awards, the total fiscal impact of the inflation adjustment would be $24 million. This impact will be spread across fiscal years 2007 through 2011. The FY 2008 impact would be approximately 3 percent of the total amount or $721,665.

For building renewal, there is no FY 2008 impact. However, the estimated FY 2009 impact to the building renewal formula will be approximately $10.8 million.

If you or your staff have any questions regarding this letter, please contact me.

Sincerely,

John Arnold

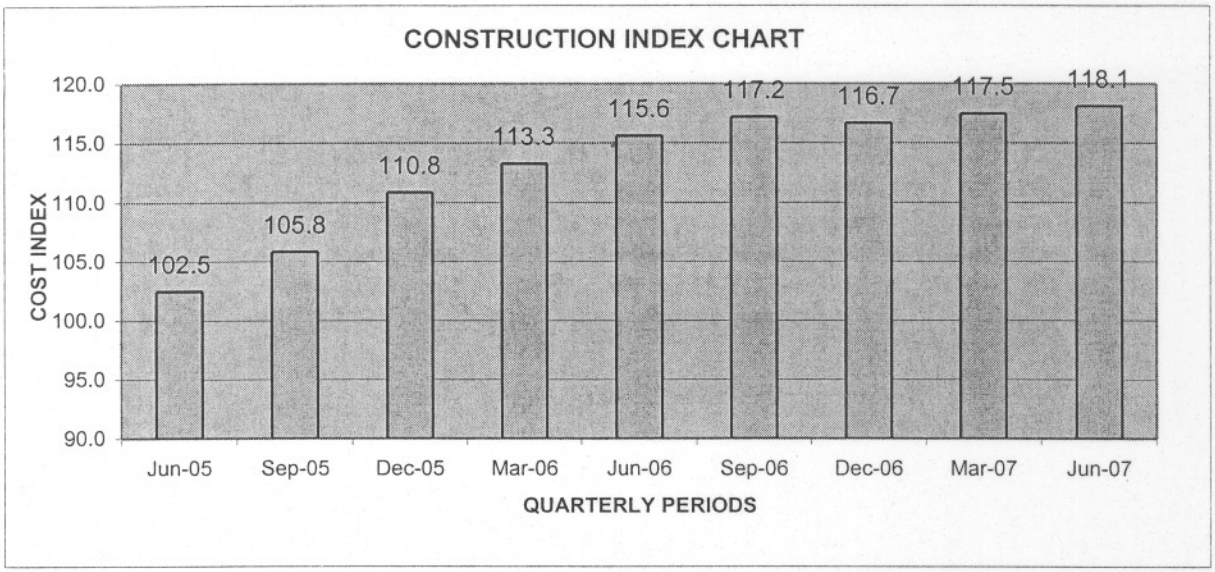
CC
Richard Stavneak
James Apperson
Lauren Kielsmeier
George Cunningham

PINNACLEONE

QUARTERLY CONSTRUCTION COST INDEX FOR METROPOLITAN PHOENIX

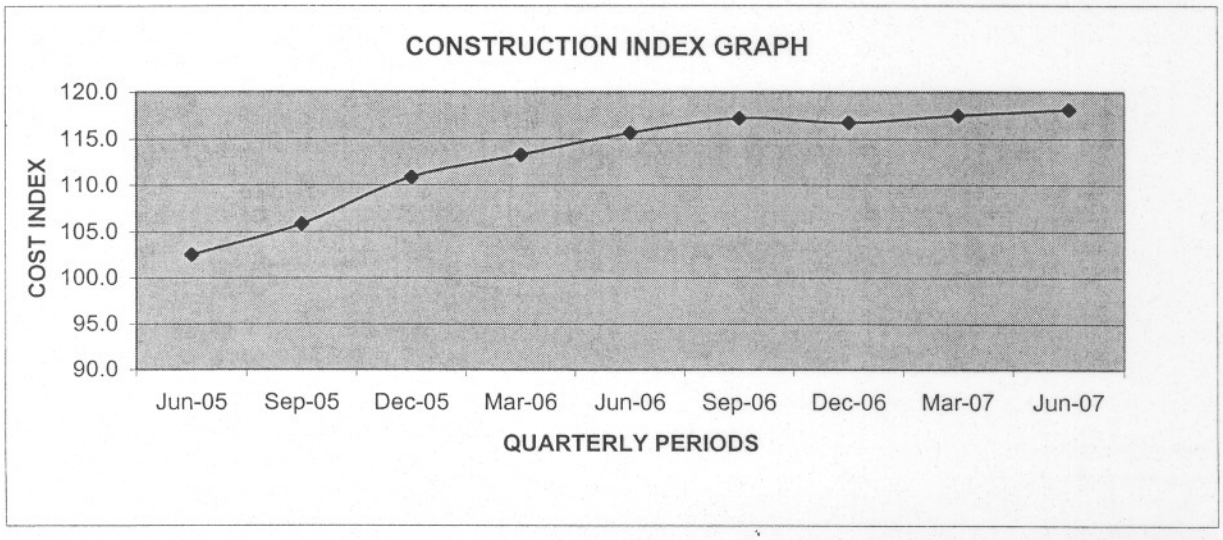
June 2007 Report

At the inception and formation of the PinnacleOne Cost Management Division at the start of 2005, we began to track the bid costs of construction which include labor and material, subcontractor's overhead and profit and general contractor's general conditions, overhead, bonds, taxes and profit. From the 1st Quarter of 2005, we have tracked the changing construction costs in the Phoenix Metropolitan area. Each Quarter, we monitor the cost of construction and this can be found on the graphs shown below.



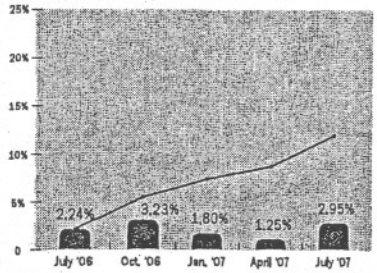
Escalation can be calculated for each Quarter by using the indices.

QUARTERLY ESCALATION			
3rd Quarter 2005 - 4th Quarter 2005	4.8%	3rd Quarter 2006 - 4th Quarter 2006	-0.4%
4th Quarter 2005 - 1st Quarter 2006	2.3%	4th Quarter 2006 - 1st Quarter 2007	0.7%
1st Quarter 2006 - 2nd Quarter 2006	-0.4%	2nd Quarter 2006 - 3rd Quarter 2007	0.6%
2nd Quarter 2006 - 3rd Quarter 2006	-0.4%		



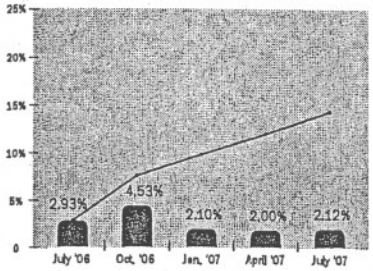
This information is believed to be correct but PinnacleOne accepts no responsibility for the accuracy.

COST INDEX Boston

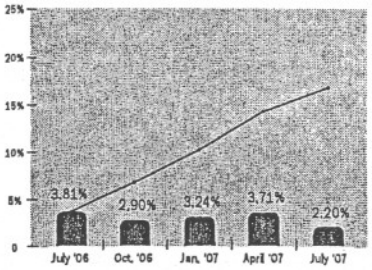


COST INDEX Los Angeles

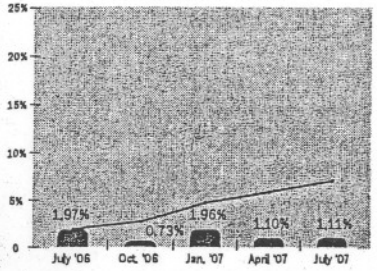
COST INDEX Portland



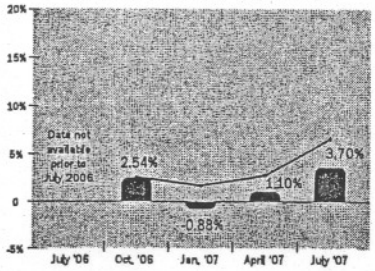
COST INDEX Seattle



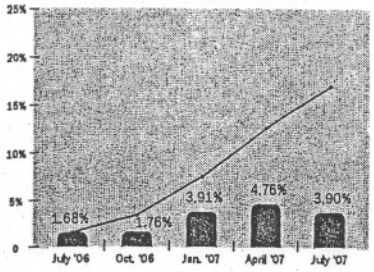
COST INDEX Denver



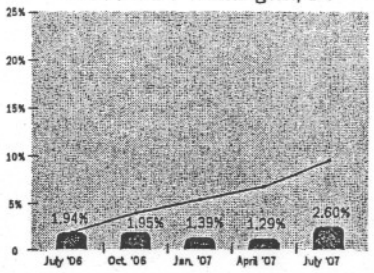
COST INDEX New York Metro



COST INDEX San Francisco

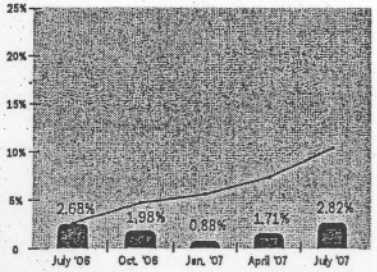


COST INDEX Washington, DC

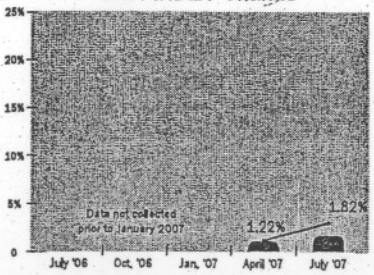


Percentage change per quarter
Cumulative percentage change for the period shown

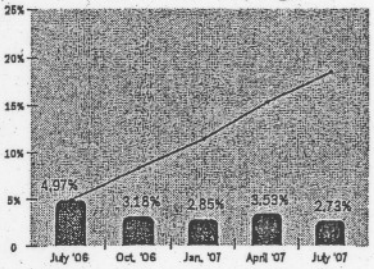
COST INDEX Honolulu



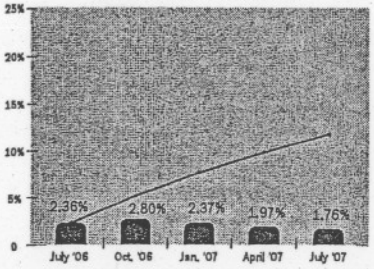
COST INDEX Orlando



COST INDEX Las Vegas



COST INDEX Phoenix



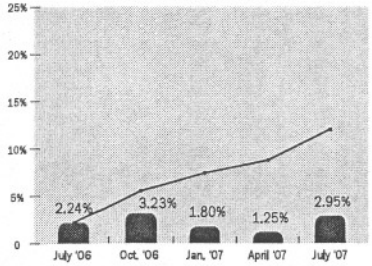
ESCALATION AND INFLATION RATES: Our National Construction Cost Index for July 2007, again, shows strong levels of inflation despite the slow-down in the housing construction market.

We are occasionally asked 'How can construction escalation (inflation) be so high when the 'core' rate of inflation is so low?' It interesting to note that the concept of a 'core' rate of inflation excludes the volatile effects of both food and energy price changes; initially done as a method of 'leveling out' inflation numbers at times when food and energy prices tended to spike high and drop low over a relatively short period of time. While the 'core' rate of inflation remains an interesting and useful concept, its relevance today is somewhat diminished because food and energy prices tend to trend forever upward rather than swing wildly.

For construction escalation (inflation) one really needs to think about it in comparison to the true rate of inflation in the economy, that is the rate of inflation *including* changes in food and energy prices. Why? Simply because the true rate more closely reflects the effect that inflation has on consumers' pockets. It is for this reason that Rider Levett Bucknall measures the so-called 'buy' price and uses the changes in that to calculate construction cost escalation (inflation), rather than tracking only the changes in labor and materials prices, as these are only two components of total construction cost.

This is not to say that understanding labor and materials prices is unimportant; on the contrary, it is very important! However, our clients are typically more interested in knowing what the total effect of inflation will be on their budgets rather than knowing just the impact of price changes for the labor and material inputs.

COST INDEX Boston



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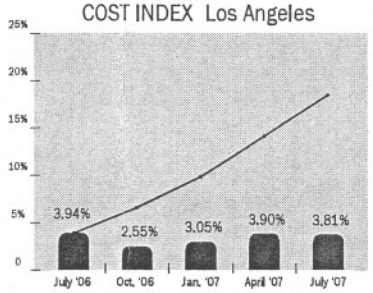

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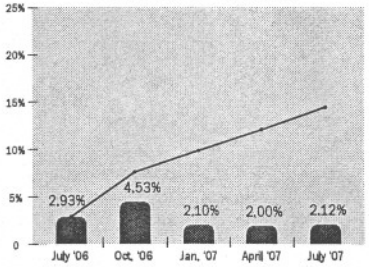

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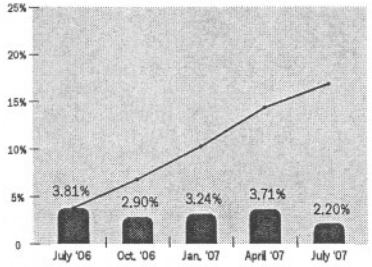

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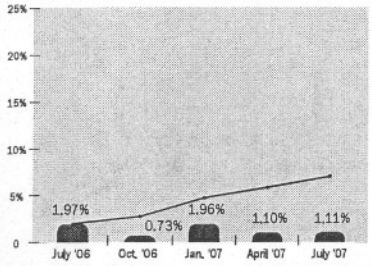

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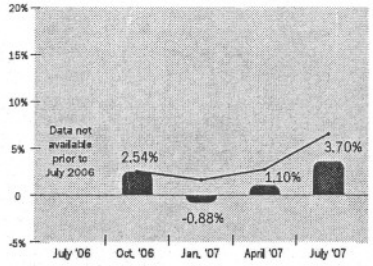

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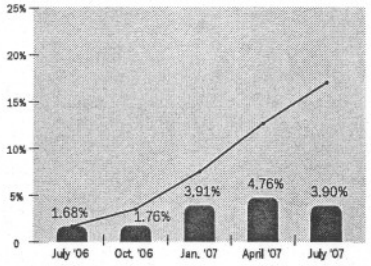

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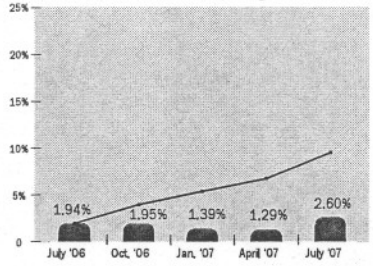

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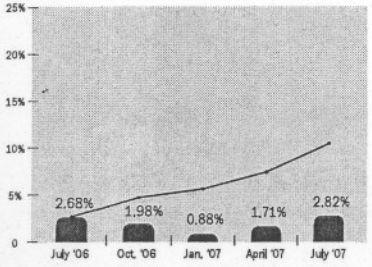

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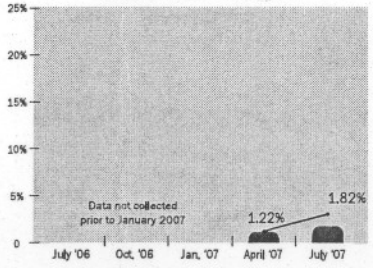

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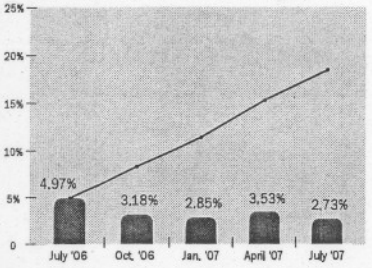

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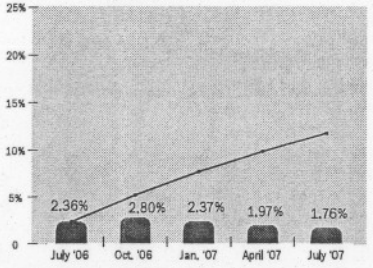

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