ARIZONA STATE LEGISLATURE
Forty-seventh Legislature – First Regular Session

SPECIAL JOINT MEETING OF THE SENATE COMMITTEE ON APPROPRIATIONS AND HOUSE OF REPRESENTATIVES COMMITTEE ON APPROPRIATIONS (P)

Minutes of Meeting
Thursday, January 27, 2005
House Hearing Room 1 -- 1:30 p.m.

Chairman Burns called the meeting to order at 2:35 p.m. and attendance was noted by the secretary.

Members Present

Senators

Cannell	Gould	Waring
Garcia	Johnson	Huppenthal, Vice-Chairman
		Burns R, Chairman

Representatives

Aguirre A	Cajero Bedford	Weiers JP
Biggs	Groe	Mason, Vice Chairman
Brown	Lujan	Pearce, Chairman
Burgess	Tom	

Members Absent

Arzberger	Boone
Giffords excused	Farnsworth
Harper	Gorman
Martin	Knaperek excused

Speakers Present

Justin Narducci, Analyst, Joint Legislative Budget Committee (JLBC)
Bret Cloninger, Economist, Governor’s Office of Strategic Planning and Budgeting (OSPB)
David Petersen, State Treasurer
Jake Corey, Analyst, Joint Legislative Budget Committee (JLBC)
Bob Chapko, Economist, Governor’s Office of Strategic Planning and Budgeting (OSPB
Jan Brewer, Secretary of the State
Monica Seymour, Economist, Governor’s Office of Strategic Planning and Budgeting (OSPB)

Elaine Richardson, Commissioner, Arizona Department of Real Estate
Richard Simmonds, Business Services Director, Arizona Department of Real Estate
John Mangum, Arizona Association of Realtors
Nick Klingerman, Analyst, Joint Legislative Budget Committee (JLBC)
Marcel Benberou, Economist, Governor's Office of Strategic Planning and Budgeting (OSPB)
Margie Emmermann, Director, Arizona Office of Tourism
Bob Hull, Analyst, Joint Legislative Budget Committee (JLBC)
Elliott Hibbs, Director, Department of Revenue
Brian Cary, Analyst, Joint Legislative Budget Committee (JLBC)
Kathleen Pushor, Executive Director, Arizona State Lottery Commission

PRESENTATION ON AGENCY BUDGETS

State Treasurer

Justin Narducci, Analyst, Joint Legislative Budget Committee (JLBC), presented the JLBC's budget for the State Treasurer (Attachment 1). The primary responsibility for the State Treasurer's office is to provide banking, cash management, investment and accounting services for state agencies and various public entities. The State Treasurer is an elected official and serves as the Chief Financial Officer for the State of Arizona. The JLBC budget is only for Fiscal Year (FY) 2006 while the Executive budget provides appropriations for FY 2006 and FY 2007. The JLBC FY 2006 budget is $5.3 million. The Executive and JLBC budgets are essentially the same for FY 2006 with only the technical changes being different.

The first item pertains to the local government investment pools. In FY 2005 the State Treasurer received a $300,000 appropriation to implement two new local government investment pools. Half of that money was appropriated for one-time equipment expenditures and they backed that number out for FY 2006. The Executive backs out the total amount for FY 2007.

The second item pertains to tenant improvements. In FY 2005 the State Treasurer received $150,000 for their space in the Executive Tower which is currently undergoing renovation. They back those monies out for FY 2006 as does the Executive.

The third item pertains to statutory changes. Both the Executive and the JLBC budgets include the continuation of Session Law that modifies ARS §22-117 to decrease the state share of Justice of the Peace salaries from 40% to 38.5% with the counties.

Lastly, the Executive appropriates a slight increase for technical changes from the General Fund and the JLBC does not.

Mr. Narducci discussed the Total Funds chart. The State Treasurer is solely funded by General Fund money with the exception of the $150,000 for their space in the Executive Tower. He offered to answer questions.

Bret Cloninger, Economist, Governor's Office of Strategic Planning and Budgeting (OSPB) stated that they have no measurable differences in their budgets. He offered to answer questions.

David Petersen, State Treasurer, stated that the State Treasurer's office manages a significant amount of dollars for the state agencies and local governments. They are in charge of 8 basis point fees (.008%), which bring in $14 million to the General Fund. They are very appreciative of the fact that they were able to get new technology in the office. They expanded their portfolio managers from three to four. This helps their credit analysis and performance. Beginning February 1st they will receive $50 million from an agency that is going to invest in their two new pools. He added that it is a longer term duration and they expect a better return. Their goal is to have close to $300 or $400 million by the end of the calendar year. He invited the committee members to come to their temporary offices and see their trading room. He offered to answer questions.

Mr. Petersen stated that opening the two new pools will be a big accomplishment. He added that within three to five months they should be on-line. He added that another important issue for them is the State Land Trust issue.

Secretary of State

Jake Corey, Analyst, Joint Legislative Budget Committee (JLBC) stated the Fiscal Year (FY) 2006 JLBC budget provides $2.9 million from the General Fund and $22.4 million from Other Funds (Attachment 2). The Other Funds represents the election systems improvement fund which is related to the Help America Vote Act (HAVA) and federal legislation to improve voting processes in the state. The Executive budget provides $3 million from the General Fund in FY 2006 and $10.9 million from the election systems improvement funds in FY 2006. He added that in FY 2007 the Executive provides a budget but JLBC does not.

Mr. Corey stated that there are three components to the Secretary of State's office. The first component is Elections. The Secretary of State's office certifies state candidates, initiatives and referendums. It also distributes the publicity pamphlet. The second component is the Business Services Division. This Division processes UCC filings as well as trade names, trademark and partnership registrations. The third component is the Public Services Division which produces a number of publications including the Arizona Administrative Code and Arizona Blue Book.

Both JLBC and the Executive reduce the General Fund budget by $2.8 million to eliminate funding for the 2004 state elections. That funding will need to be restored in FY 2007 for the 2006 election cycle.

HAVA is federal legislation which came about as a result of the problems in the 2000 Presidential election. This federal legislation requires the states replace all punch cards and lever machines, institute voter registration and voter grievance systems and implement new voting systems. These systems allow the voter to verify the ballot, change the ballot before it is cast and are accessible to individuals with disabilities. In FY 2006, JLBC has a $4.6 million reduction to appropriated money. They have funding to match the expected expenditure level of $22.4 million. Since the release of the JLBC budget the Secretary of State has indicated that they expect to spend about $40 million in FY 2007. In FY 2005 they appropriated $27 million. They only spent $3 or $4 million so that money will need to be reappropriated or the fund made non-lapsing. The Executive provides $10.9 million in FY 2006.

Both JLBC and the Executive have a $1.4 million reduction to eliminate the HAVA state match. This federal legislation requires that states provide five percent matching funds. Since there are no new federal dollars expected in FY 2006 there would be no corresponding state match required. JLBC will continue the footnote from the past year's budget requiring the Secretary of State to report actual expenditures, as well as current and next year estimated expenditures.

The Executive recommends about $60,000 for two Business Services positions in both FY 2006 and FY 2007. The Executive provides $200,000 one time in FY 2007 to replace a high speed copier in the Secretary of State's office.

JLBC reduces the budget by $14,500 for those employee related expenditures standard changes. The Executive has about a $50,000 increase. The majority of the increase is due to a Risk Management claim that was settled which dealt with election law.

Mr. Corey discussed the Total Funds budget, which moves up and down from year to year due to election cycles.

Bob Chapko, Economist, Governor's Office of Strategic Planning and Budgeting (OSPB) highlighted four areas of difference that are of concern. The Executive recommendation contains $3.2 million from the General Fund to pay for the cost of the 2006 general and primary elections. The JLBC budget does not contain that amount because they only did a Fiscal Year (FY) 2006 recommendation. Based on the expected expenditures regarding the Help America Vote Act (HAVA), their agency showed a decrease in federal funds from the $27 million to $10 million on their budget request. The agency is getting an additional amount of money which would take their availability in 2006 to $40 million. If OSPB had known about the additional money they would have supported it and put it in their budget.

Regarding the high speed copier that is requested, the current machine is 12 years old and has done 55 million copies. It is in very bad repair and the vendor has indicated that it would be hard to find parts for this machine. They have recommended $200,000 to replace this old machine.

Regarding the two FTEs that have been requested, the agency's workload has increased and these people are vitally needed.

Jan Brewer, Secretary of the State thanked JLBC and OSPB for working with the Agency and coming up with a budget that will enable them to accomplish the mandates of the Legislature. She stated they requested four FTEs, two for Elections Division and two for Business Services Division. Currently, the Elections Division is only staffed with eight people, which is not enough to handle the amount of work that goes through that office. The Business Services Division continues to be inundated with a heavy workload. In the year 2000, that office administered 122,300 trade names and today they administer over 350,000 trade names. The number of applications is continually increasing. They receive 2,100 trade name and trademark applications each month. She urged the committee to increase their FTEs so that they can continue to meet their mandates.

Secretary Brewer also discussed the importance of the office receiving funds to get a new high speed copier. She urged the committee to approve the money to replace the old machine. She also discussed their need of $45,000 for microfiche equipment. They also need $5,000 for air transportation because of the increase in cost of using Department of Public Safety's (DPS) aircrafts. They have to fly to every county around the state before and after an election to verify the equipment is working properly and that the votes are counted accurately.

Secretary Brewer also discussed HAVA. They receive a lot of money for this federal act. She pointed out that Arizona was the second state in the nation to submit their HAVA state plan to the federal government. She is very proud of that accomplishment. Arizona was one of eleven states not to ask for a two year waiver for compliance with the voter registration requirements contained in HAVA. Also, Arizona was one of the first states to completely replace all the punch card equipment with the scan equipment. She further discussed their on-line voter registration. They implemented the military and overseas program for voting. They researched new state of the art voting technology. They conducted their voter outreach and education programs that HAVA mandated. They also conducted the election official and poll worker training program. They implemented a statewide provisional ballot process. They implemented the first phase of the grievance/voter fraud tracking system. Arizona was the first state in the country to utilize the auto-mark voting devices which allow the blind and visually impaired to vote independently. After a year of collecting data her office completed the Brewer Voter Action Plan. This plan is the most comprehensive study and analysis of their election technology and the procedure. They need to implement an accessible voting system in every precinct in the state. They need to enhance the statewide voter registration system. They need to fully implement their grievance and voter fund tracking system. They need to make sure that they stay on track to meet all the HAVA requirements. She asked that the committee consider a two year authorization of the $40 million of this fund as they continue to make strides in implementing all of the requirements.

Secretary Brewer discussed a risk management issue. She stated that JLBC did not provide funds to offset the increase in the Secretary of State's risk management costs. These increases are due to prior risk claims after the Attorney General lost the 2002 redistricting case which increased the cost of the risk insurance. She asked that they consider taking the Executive's recommendation increasing the amount they will be able to spend on this insurance.

Senator Gould asked what the life expectancy is of the high speed copier. Secretary Brewer stated she believed it was eight years.

Mr. Pearce asked if they have the ability to audit each vote that is cast. Secretary Brewer stated that the new scanning equipment has an audit trail and digital recording devices. Mr. Pearce further asked if they were prepared to implement the voter eligibility and verification law. Secretary Brewer stated that they are doing everything that can be done. They have contacted every election officer in all fifteen counties to tell them exactly what it is that needs to be done. They have contacted the Attorney General and asked for an opinion regarding the issue of driver licenses and whether they can use that number on the registration. They also have to submit a procurement procedures manual to the Department of Justice who have up to sixty days to give clearance. Mr. Pearce stated that the integrity of the elections is critical. He discussed his concern that past election disparities might be repeated. Secretary Brewer pledged that she will do everything possible to ensure the elections are fair and equal and that every eligible vote will be counted properly.

Real Estate Department

Justin Narducci, Analyst, Joint Legislative Budget Committee (JLBC), discussed the Real Estate Department's responsibilities (Attachment 3). They are responsible for the regulation and supervision of the real estate industry in the state. This includes licensees, developers, sub-dividers and the regulation of real estate schools. He highlighted the JLBC and Executive budgets. For Fiscal Year (FY) 2006 and FY 2007 both JLBC and the Executive appropriate $3.5 million. Their additional appropriations relative to FY 2005 are similar.

The first issue pertains to the Investigation Division. The JLBC budget provides approximately $120,000 in FY 2006 and slightly less in FY 2007 to fill three vacant investigator positions. The Investigation Division is responsible for investigating illegal activity, fraud and misrepresentation light circumstances within the real estate industry. This funding would decrease the average caseload quantity for investigators from 74 to 55. The Executive budget provides a slightly smaller appropriation for both fiscal years.

The second item pertains to the Subdivisions Division, which is responsible for issuing a public report (a disclosure document that is required before new home sales can be made in subdivisions). The JLBC budget provides $77,000 in FY 2006 and slightly less in FY 2007 to fill two vacant FTE positions. The intent is to decrease the processing time associated with the issuance of a public report. The Executive provides a slightly smaller appropriation for both fiscal years.

The third item pertains to the License Division which is responsible for processing new and renewal licenses. The JLBC budget provides approximately $50,000 for both fiscal years to fund 1.5 vacant FTE positions. The Executive budget provides significantly higher appropriation for both fiscal years.

The fourth item pertains to a statutory change. The Real Estate Department has an issue where the revenue to appropriation ratio exceeds 110%. The JLBC budget and the Executive budget provide the continuation of the statutory suspension that requires the fee revenues to remain within the 95% and 110% ratio with the Department's appropriation. For FY 2006 and FY 2007 they project the fee revenues to exceed the appropriation by approximately 140%.

Lastly, the JLBC budget does not include additional appropriations for technical or standard changes while the Executive budget does provide additional appropriations for such changes. Mr. Narducci also discussed total expenditures for the Department of Real Estate, which have remained fairly constant over the few years. They have grown slightly as projected to FY 2006.

Senator Cannell asked if they were going to let the Department spend more money that they are collecting or whether they are going to decrease fees. Mr. Narducci stated that this is a continuation of a statutory change that is already in place. The statute says that the Department's previous year's revenue to their current year's appropriation has to be within 95% and 110%. Right now, the revenues for the Department of Real Estate are increasing dramatically. The JLBC budget does include an increase of appropriation. The gap is about $900,000. In order to get within the revenue cap they would have to appropriate an additional $900,000 to what they already have in this budget. The statute provides that the Director of the Department can adjust fees in the future years if the revenue to appropriation ratio isn't within that range.

Senator Huppenthal asked if JLBC adequately covered the homebuilder's issue relating to service levels making sure that these were staffed adequately. Mr. Narducci stated that this might be a better question for the Director of the Department.

Mrs. Groe stated that she has concerns regarding the licensing fees being so high. Mr. Narducci stated that the Department of Real Estate receives revenue, it's deposited straight to the General Fund and it is appropriated out. The difference in revenue goes straight to the General Fund and is used for General Fund expenditures. Mrs. Groe further stated that when these fees are paid they are not only paying for the services that they receive from the Department of Real Estate but are also subsidizing the General Fund. Mr. Narducci stated that that is essentially what is happening. Mrs. Groe asked if the increase in FTEs is specifically designated positions that are going to be fulfilled. Mr. Narducci stated that this funding is to fill vacant FTE positions. The Department has a lump sum budget. In order to make these FTEs specific for those divisions they would have to make those special line items.

<u>Monica Seymour, Economist, Governor's Office of Strategic Planning and Budgeting (OSPB)</u>, stated that the OSPB and the JLBC recommendations are not substantively different. The Executive recommendation does include funding for standard adjustments. They are including $14,400 for rent space the agency occupies in Tucson at 400 West Congress. Arizona Department of Administration's (ADOA) lease payment is going up by $14,400 in Fiscal Year (FY) 2006 and FY 2007, as well as a $3,000 risk management standard adjustment. Regarding the funding for the vacant positions, their recommendations are not dramatically different. OSPB recommendations are $8,200 less in FY 2006 and $16,800 less in FY 2007. The difference is the direction of that funding. OSPB's recommendation is exclusively for personal services. JLBC's recommendation does have some funding for some onetime equipment that gets backed out in FY 2007. The Executive recommendation provides funding for

approximately two more licensing positions than the JLBC recommendation. Regarding Mrs. Groe's question about the statutory requirement, Ms. Seymour stated that the only reason why the General Fund is collecting those revenues at this time is because they have made a special provision in terms of passing the budget to carry on that provision. This provision has been in place since 2002 when the budget was going through difficult fiscal times. Prior to that the fees that the industry was charged were appropriate for the services being rendered and the appropriation that the Department received.

Elaine Richardson, Commissioner, Arizona Department of Real Estate, commented that they have been extremely innovative at the Department of Real Estate. She added that she is on the verge of failing and she does not want that to happen. She asked that the committee look at the numbers and that they take them seriously. Mr. Pearce stated that last year the agreement they had to fulfill the needs that Department had, failed only because the budget was high-jacked.

Richard Simmonds, Business Services Director, Arizona Department of Real Estate, compared Fiscal Year (FY) 2000 with FY 2005. The appropriation in FY 2000 was $3,136,000. The appropriation in FY 2005 is $3,208,400. The revenue generated in FY 2000 was $3,272,000. The revenue that will be collected in FY 2005 is $5,125,000. The staff that they had in FY 2000 was 65. The staff in FY 2005 is 57. The number of licensees that they had FY 2000 was 50,372. As of today they have 69,513 licensees. The number of applications that their licensing staff processed in FY 2000 was 49,900. This year they are projecting over 73,000 applications. The staff that the Licensing Division had in FY 2000 was 15. The staff in the Licensing Division now is eight. In the Investigations Division in FY 2000 they processed 342 complaints. This year it will be over 1100. The FTEs in the Investigations Division in FY 2000 were ten. The FTEs in the Investigations Division today are nine. Their Subdivisions area in FY 2000 processed 1915 applications. This year it will be over 2200. In FY 2000 they had 13 staff members. Today there are seven. He urged the committee to take these numbers into consideration.

Senator Huppenthal asked how many hours it takes to process a subdivision application. Ms. Richardson stated that it takes anywhere from one to three years to train a subdivision representative. Right now, they have one representative that is fully trained and two that have been in training for a couple of months. This Division has a Director and Deputy Director who are both doing subdivision work. She added that it is not only how long it takes but it is also the training involved. Senator Huppenthal asked for a brief summary of the subdivision application process. Mr. Simmonds stated that an application comes in with all the legal documents, the indications of what they are going to provide for that subdivision and their time frame. Their staff member reviews the file and produces a public report, which tells the public what is in the subdivision, what schools are nearby, what water companies are going to supply the water and whether there is a hundred year water supply, etc. This is all required by state statute. Senator Huppenthal stated that builders have come to him and asked if there was a way to speed up this process. Ms. Richardson stated that she would like the committee members to come to their agency and spend an hour. They would see that their system has been streamlined to such a point that their mission is to protect the public interest.

Ms. Mason stated that she would like to meet with Ms. Richardson and receive an explanation as to what is being done on the state level for getting subdivisions built. She wants to make sure that they are not creating a cumbersome situation for either the agency or the builders. Mr. Simmonds stated that what they do is more of a disclosure to the public as opposed to an approval for the developer.

Ms. Cajero Bedford asked if what this agency does is the same as what is done at the county and city level. Ms. Richardson stated that they have no duplicative efforts. What the cities do is for the city. The disclosure that is done for the cities, counties, etc. is different. She added that they would prepare a paper for the committee so they will be able to see the importance of having a Subdivisions Division.

John Mangum, Arizona Association of Realtors stated that the reason they are here is to make sure they understand what is happening in this agency. They think it is very important for the committee to understand exactly the way this agency is funded. He added that each year the Legislature determines a funding amount and that money is the budget for the Department of Real Estate. The licensees pay their fees for licenses and examinations and that money is sent to the General Fund. The statute says that they are not supposed to collect as much as they are collecting. The fees are supposed to be set in a range between 95% and 110% of the budget. If the fees are set higher, the statute says that the next year the fees are supposed to be reduced. Since 2002 there has been a note put in Omnibus Budget Reconciliation bills which says that notwithstanding the provision of the 95-110 act they are not going to reduce the fees next year. He added that every time they vote on this issue they are taxing just the 69,000 licensees to help run other state agencies. In 2002, it was 111% of the budget. In 2003, it was 125% of the budget. In 2004, it was 150% of the budget. He stated that they should let the Department reduce the fees or give the agency enough money so it can do a better and faster job of processing licenses and examinations. He added that they could also do a faster and more complete job of handling investigations. It is important for the real estate industry that people feel confident that they are not being misrepresented when buying houses.

Mr. Pearce stated that he and Senator Burns are putting forth a new bill regarding truth in budgeting and accounting to stop these kinds of practices and to do a better job in complying with the statutes. He believes that the agency deserves some consideration of more money to do their job and do it well.

The Chairman called upon Diane Zipley to make a presentation. She was not in attendance.

Office of Tourism

Nick Klingerman, Analyst, Joint Legislative Budget Committee (JLBC), presented the budget of the Office of Tourism (Attachment 4). The Office of Tourism is responsible for promoting tourism within the state. In Fiscal Year (FY) 2006, the JLBC budget includes an operating budget of $12.8 million from the General Fund. This represents an increase of $880,900 above FY 2005 levels. The Executive budget for FY 2006 is slightly higher than the JLBC budget. It represents an increase of $988,700. For FY 2007, the JLBC does not include a budget. For FY 2007, the Executive includes funding at $13.8 million from the General Fund which represents an increase of $1.8 million above the FY 2005 funding levels.

The first issue is statutory adjustments for the statutory funding formula. The Office of Tourism receives funding through a formula that provides revenues from taxes on lodging, entertainment activities and restaurants. The JLBC estimates that this formula provides the Office of Tourism an additional $880,900 from the General Fund to fully fund the Office of Tourism formula. The Executive recommends in FY 2006 that the Tourism funding formula will provide an additional $981,500 from the General Fund. In FY 2007 the Executive estimates that the Tourism funding formula will provide an additional $1.8 million from the General Fund.

The next issue is the rural development grant program. The Executive recommends that the Office of Tourism designate $500,000 of their allocation for this grant program. These monies would be used to support rural community's efforts to promote tourism. The JLBC does not include this issue.

The Executive is recommending the elimination of the Department of Commerce's $296,500 General Fund budget in FY 2006 and FY 2007 for the Film and Motion Picture program and is requiring the Office of Tourism refund this expense from their existing Tourism fund allocation.

Finally, the Executive recommends a $7,200 General Fund increase in FY 2006 and a $12,000 General Fund increase in FY 2007 for standard changes. JLBC does not include this amount.

Since the Office of Tourism is funded through a statutory formula, this agency will not appear in the General Appropriations Act. He also discussed the total funding charts for the Office of Tourism. In FY 2002 and FY 2003, the Tourism fund was appropriated. Beginning in FY 2004 the Tourism fund is not appropriated. In FY 2006, the JLBC estimates that the Office of Tourism will receive $12.8 million from the General Fund through the statutory funding formula. This represents 56% of their budget. The remaining funding is from Proposition 302 and Proposition 202. He further discussed the numerical representation of where the funding comes from for the Office of Tourism. He stated there is one budget option requiring proportional local contributions to the Tourism fund which would provide a savings of $3.3 million for the General Fund. This would not impact the Tourism fund.

Mr. Biggs asked where he could find the Tourism funding formula in statute. Mr. Klingerman stated that it is ARS §42-5029. He added that it includes 3.9% of the gross revenues from lodging taxes, 3% of the gross revenues from amusement taxes and 2% of the gross revenues from restaurant taxes.

<u>Marcel Benberou, Economist, Governor's Office of Strategic Planning and Budgeting (OSPB)</u>, stated that a lot of good things are happening in the State of Arizona. He stated that investing in tourism is a wise choice for this state. Tourism is an excellent vehicle for economic development and a vital business to many communities. In 2004, the Travel Industry

Association of America named the Arizona Office of Tourism an Odyssey award which is one of the highest honors given in the U.S. tourism industry. This award recognizes excellent and exceptional achievement in travel promotion and public and community services. He stated that the two budget recommendations are essentially the same with respect to the Tourism fund transfer. He highlighted the formula funding which was formulated by the Legislature and endorsed by the voters of this state (Attachment 5). The Office of Tourism is charged to promote Arizona as a domestic and international travel destination and to stimulate and expand the volume of tourism related expenditures through tourism promotion and development.

Margie Emmermann, Director, Arizona Office of Tourism thanked the committee for their continued support for full formula funding in Fiscal Year (FY) 2006. The incremental increases that they have received from formula funding are paying and will continue to pay dividends to the state's economy. Their domestic overseas and Canadian overnight visitation has increased by 850,000, which brings the total of annual visitors to 29 million. These are high value visitors whose spending in Arizona reduces the tax burden of every household by $683.73. This industry, which has been reeling from the effects of September 11, the recession and international issues such as SARS and the war on terror, has finally moved into a recovery phase and Arizona's tourism industry is leading the way in this upturn. Tourism indicators for the first three quarters of 2004 indicate that Arizona is on track to have its strongest performance since 2000, which is widely considered to be a benchmark year in the tourism industry. Through the first three quarters of 2004, hotel occupancy levels in Arizona increased to 64% and statewide airport passenger traffic increased more than 5%, bringing more than 33 million passengers through our gateways. The estimated tourism related taxes generated by our state's visitors have increased 8.9% to almost $350 million. These numbers are an indication of a strong, healthy economy which benefits every single Arizonan. She stated that Arizona Office of Tourism is committed to fulfill their obligation to Arizona's taxpayers by executing a research driven, precisely targeted advertising campaign ensuring that each advertising placement has maximum return on investment. According to a study by Longwoods International, Arizona Office of Tourism has gone above and beyond this commitment. For every dollar spent on the 2004 advertising campaign there was a return on investment of $9.02 in taxes. These figures can be attributed to a variety of programs. One of the most successful programs last year was their target cities campaign. She further discussed advertising campaigns that helped tourism in Arizona. Arizona posted an 8.8% increase last year in overnight leisure travel which outpaced the growth of the leisure market nationwide.

Arizona Office of Tourism used the FY 2005 budget increase to invest in the rural communities. Funding for the Matching Grant program and regional marketing partnership was increased to $1.7 million. For the first time since the inception of the Teamwork for Effective Arizona Marketing (TEAM) grant program, tourism organizations in all fifteen Arizona counties received a matching grant from the Arizona Office of Tourism. No other Arizona industry can claim to have such a pervasive presence that they impact every Arizona county. They also increased the number of tribal entities receiving funds to better market their tourism assets. Last year, eight Native American communities participated in the program receiving more than $340,000 in TEAM awards. The Arizona Office of Tourism provides these communities with technical assistance and tourism marketing education programs to develop effective marketing plans. For the first time they are implementing international consumer marketing in three countries to enhance already established media relations and travel industry marketing programs. Consumer advertising will appear in Canada, Mexico and the United Kingdom each with a message tailored to the needs of the market. The most extensive program will premier in the United Kingdom this April when they bring the Grand Canyon IMAX film to six cities reaching more than 8000 consumers. In response to the trend of travelers staying closer to home and taking shorter trips, the Arizona Office of Tourism is launching its first large scale in-state marketing campaign aimed at educating Arizonans about their state and encouraging them to explore the diversity this summer. Promoting Arizona's culture and heritage continues to be a top priority for the agency. In a joint venture with the Arizona Humanities Council they are launching the design and development of a new interactive, itinerary-building website on Arizona's heritage travel. In addition, they have added a full-time Native American Tourism Development Manager to their staff who has already made incredible progress in creating an open forum of communication with their tribal partners. They are looking forward to enhancing and expanding these programs in FY 2006. This can't be done without full formula funding. One of the new initiatives this will allow them to support is a $500,000 rural tourism development grant program. The reinstatement of formula funding for the Arizona Department of Tourism has given them a competitive edge, but the challenge will be to continue working hard as other destinations utilize increasingly effective funding techniques to enhance their budgets.

Discussion ensued regarding the proposal that the Office of Tourism help fund the Film and Motion Picture program at the Department of Commerce.

Mr. Tom asked what portion of the agency's funding is used in District 2. He also asked if there were any plans for Route 264 as far as their tribal outreach program. Ms. Emmermann stated that she could contact him after this meeting and discuss these issues.

Mr. Pearce asked what is being done to promote the activities such as the Fiesta Bowl and events at the Phoenix International Raceway which bring in huge amounts of visitors and revenue. Ms. Emmermann stated that they are a sponsor of the Fiesta Bowl every year. She further discussed events that they are involved in sponsoring.

Department of Revenue

Bob Hull, Analyst, Joint Legislative Budget Committee (JLBC), compared the JLBC and Executive budget recommendations (Attachment 6). JLBC recommends $62.7 million General Fund and $2.3 million Other Funds which is a slight decrease of $148,000 in General Fund and a slight increase of $11, 300 Other Funds. The Executive recommends $1 million increase in General Fund to $63.8 million and $400,000 increase in Other Funds to $2.8 million in Fiscal Year (FY) 2006. For FY 2007 the Executive recommends about the same for General Fund and $300,000 increase in Other Funds. JLBC only recommends for FY 2006. He noted that the FY 2006 and FY 2007 Executive recommendation as presented does not include the $18.8 million in General Fund spending that they would add by a proposed new revenue generating plan. JLBC recommends a one-time equipment decrease of $148,000 from the General Fund. Regarding risk management, the Executive adds $855,700 which is mostly General Fund money. JLBC recommends continuation of the current FY 2005 appropriation for risk management of $368,100 which is mostly General Fund money. The increase for the Executive deals with the Governor vetoing the appropriation for the Ladewig Settlement in FY 2004. After the Department paid the $2 million for attorneys' fees in 2004 they were reimbursed $2 million by Risk Management. The increase that the Executive is recommending for risk management helps reimburse Risk Management for that money paid for the Ladewig Settlement. JLBC has a footnote which limits the Risk Management payment to $368,100. As in the prior budget, JLBC continues the Attorney General legal services money in the operating budget. The Executive breaks it out as a special line item. The Executive adds $110,800 General Fund money for the Taxpayer Information staff in FY 2006 and $97,000 in FY 2007. The Executive recommends $29,500 General Fund and $384,800 from the unclaimed property fund for seven FTE positions in FY 2006 and a slight decrease in FY 2007. The JLBC does not include these funds. JLBC has a small Other Fund increase for standard changes and the Executive has small General Fund increases in FY 2006 and FY 2007.

For the Ladewig Settlement, JLBC recommends $58.3 million General Fund for the second year of payments required by the court settlement. This includes $51.6 million for taxpayer payments, $1.8 million for administrative costs and $4.9 million for plaintiff/attorney fees. The Executive does not include the General Fund cash payment. They would have a sell and lease package to generate $58.4 million for taxpayer payments, attorney fees and administrative costs in FY 2006. These payments would begin in FY 2007 and JLBC estimates the FY 2007 lease payments would be $7 million over a ten year period.

The Revenue Generating Program II, which the Executive is recommending, is projected to generate $11.4 net General Fund in FY 2006, $52.1 million net General Fund in FY 2007 and $62 million net General Fund in FY 2008. These are based on the gross revenues of $30.2 million, $70.6 million and $80.5 million General Fund and spending of $18.8 million and $18.5 million in ensuing years. The Revenue Generating Program I added 153 FTE positions for Tax Enforcement/Collections implemented in FY 2003. It was supposed to produce $52.3 million gross General Fund revenue at a cost of $6.6 million General Fund in FY 2004. Revenue General Program I was $28.6 million below the $53.2 million target in FY 2004 and it is $18.7 million below the first quarter target in FY 2005. Elliott Hibbs will testify that Revenue Generating Program I exceeded their target in FY 2004. Mr. Hull stated that he will have to meet with Mr. Hibbs to find out what data they are using to reach their numbers. He added that what they are reporting to the committee is what the Department reported to them and what they reported to the JLBC as the FY 2004 year end results.

Mr. Hull discussed the Business Reengineering/Integrated Tax System (BRITS) which is the new computer system that is supposed to integrate separate tax systems, improve enforcement and pay for itself through increased revenue. The contract was awarded in August 2002. This system's revenue was $6.9 million below target through the first quarter of 2005. They are waiting for the year-end results to get the first half of FY 2005.

The Revenue Generating Program I includes $6.8 million as a special line for the JLBC to implement the Revenue Generating Program plan from FY 2003. The Executive transfers the funding for the operating budget and does not break it out as a special line.

Mr. Hull also discussed the total funds table for the Department and stated that most of their funding is General Fund revenue. He discussed the Ladewig Settlement, which was approved by the Tax Court in December 2002. The basis for this lawsuit was preferential tax treatment of dividends from Arizona corporations. Prior to 1990 dividends from out-of-state corporations were taxed, while in-state dividends were not. The State's total liability was capped at $350,000,000 including interest and the Department's administrative costs and attorney fees. Fifty percent of the refunds were to be paid in FY 2005, twenty-five percent in FY 2006 and twenty-five percent in FY 2007. The attorneys were paid at the same time as their clients except for $2 million advances in FY 2003 and FY 2004. Unused monies that are set aside for administrative costs or attorney fees are to be added to the taxpayer payments in FY 2007. He gave an overview summary of the Ladewig Settlement costs. It is estimated that $308.5 million is the liability. In FY 2003 and FY 2004 they only had Department of Revenue's administrative costs and attorneys fees. The total for these was $10.6 million and $5.7 million for each of those two years. In FY 2004, the Governor vetoed the Ladewig Settlement appropriation. In FY 2005 the total was $134.7 million including $125.7 million for taxpayer payments which is in August 2004. Mr. Hull broke out the figures for the requested $58.3 million for FY 2006.

Senator Johnson asked Mr. Hull to elaborate on what is involved in the Department of Revenue's administrative costs. Mr. Hull discussed the $1.8 million Department costs for FY 2006. $400,000 is for staff which includes $300,000 for personal services and $100,000 for ERE. $400,000 is for professional and outside which includes temporary staff, IT costs, imaging costs and the special master. $500,000 for postage and $400,000 for the printing and mailing vendor. Senator Johnson requested more details to be given to her by JLBC.

Mr. Biggs asked how many claimants have responded to the Ladewig Settlement. Mr. Hull stated that the original number was 650,000.

Mr. Hull further discussed the Business Reengineering/Integrated Tax System (BRITS). This contract was awarded in August of 2002 to integrate separate tax systems, improve enforcement and increase revenues to the state. It is supposed to pay for itself through increased revenue. There were problems with the transaction privilege tax conversion in January of 2004. The withholding conversion in October 2004 went well. The revenues were $6.9 million below target through September 2004. They do not have the year-end report yet to see whether the revenues improved. They have heard some comments that this system may be in trouble. The agency will have more comments regarding this system and whether or not it is in trouble with its converting implementation.

The Revenue Generating Program I began in FY 2003. The first full year was FY 2004. The cost is $6.6 million and there are 153 FTE positions. They would like to add more collection and audit staff. The Executive projected that the added staff would generate $53.2 million in Other Fund revenue. The General Fund revenues were $28.6 million below target in FY 2004 based on the information they had and reported. In the first quarter of FY 2005 they were $2.7 million below target. The Revenue Generating Program II would add 280 FTE positions and $18.8 million General Fund. This represents a thirty percent increase in the Department's overall budget and over fifty percent increase in audit and collections staff. This includes $3,000 pay raise for auditors and collectors.

Mr. Hull discussed the line item and fund source comparisons between the Executive recommendation and JLBC for FY 2006 and FY 2007.

Bret Cloninger, Economist, Governor's Office of Strategic Planning and Budgeting (OSPB) addressed three issues (Attachment 7). The first is the Governor's Revenue Enhancement Proposal. They propose adding 280 FTE positions in the collections and audit functions in the Department of Revenue. These positions are expected to bring in, net of their costs, approximately $15.3 million in FY 2007 and $56.8 million in FY 2007.

The second issue is the Unclaimed Property staffing. The number of unclaimed properties reported in this state has increased by 171% over the last four years. The Executive recommends seven FTE positions on top of the current staff of 18 to meet the workload increase. They also recommend funding for the unit to relocate. The $29,000 from the General Fund is for the Department to back fill the positions vacated.

The last issue represents an additional 3 FTEs to man the taxpayer information phone lines at Department of Revenue. The wait time averages six minutes which is well above the industry standard of two minutes.

Elliott Hibbs, Director, Department of Revenue apologized to the committee and JLBC regarding the disagreement they have in the results that have been produced from their Revenue Generating Program. He added that if he had known about the discrepancy he would have dealt with it before they appeared before this committee hearing. He stated that there is a great difference of opinion as to whether or not that program is successful. There are three issues that are in the budget regarding this program. There is an increase staffing of three people for taxpayer information and assistance. This is one area that they would like to do better but it is a matter of needing additional resources. There are call wait times that are as long as six to ten minutes during the height of the filing season. As a result of this long wait, many people drop their calls because they can't stay on as long as it takes. Additional staffing would help lower their call response time.

The second issue is unclaimed property. This is not a drain on the General Fund. This is a reflection of the fact that there is a tremendous growth in the unclaimed property area. They have detected areas where there are a number of taxpayers that have not been filing. They have a vigorous audit program that needs to be expanded so that they make sure that all unclaimed property is sent to the state. This will generate $157,000 more to the General Fund in FY 2006 and $235,000 more in FY 2007. These additional seven resources that they are asking for will produce money for the General Fund and will not be a cost to the General Fund. There is a need and opportunity for increased enforcement. The Department of Revenue is a $10 billion business. What they do is very important and critical to state services. In the last fiscal year they produced about $490 million in enforcement revenues. That is about 5% of the money that is produced overall through the Department. This is critical for state services. It is also critical for taxpayers in the manner in which they enforce the tax laws and help people comply. They provide forms for calculating and filing returns and paying taxes. They also provide assistance to people that want to do their taxes right. The vast majority of taxpayers want to file their returns and they want to pay their taxes correctly. It is a complicated system at times and they don't know how to do it. It is critical to have a solid enforcement program. There is a need to have a presence to make sure that people do not disobey the laws, but comply.

He also discussed the historical perspective of the investments in the Department of Revenue and what it returns to the State of Arizona. They exceeded their enforcement objectives for the last two fiscal years. These objectives were based on the revenues they promised they would generate to the legislature with the money that was provided to them. In FY 2005 they are struggling in meeting their revenue generating targets. He stated there are three reasons for these struggles. The Business Reengineering/Integrated Tax System (BRITS) has been slow to evolve. Another issue is salaries and turnover. The fact that they have low pay has a very adverse affect on their ability to attract and retain. Lastly, they have taken almost a $2 million budget hit this year because of unfunded insurance and retirement costs.

The Business Reengineering/Integrated Tax System (BRITS) has had a poor impact on their ability to generate enforcement dollars. This system is going to generate overall efficiencies for the agency. They are going to automate many programs. It is going to help taxpayers interact with the agency more efficiently and effectively. It is going to provide on-line capabilities so that taxpayers can file returns and pay taxes without having added costs. Right now the process has not worked as well and the productivity and efficiency has decreased. Billings and refunds for withholding and transaction privilege taxes have been delayed. At this point, most of those have been released. The system is getting to a point where it is beginning to function as it should, but they are still trying to recover from the fact that it did not work well for so many months. Their license issuance had been slow. They had been to a point where it was taking them an average of ten days, whereas before it was an average of about five days to issue a license. They are now issuing licenses on the same day that they receive an application. One of the biggest areas that they are continuing to have problems in is the collection processes. They have a set process for collections which calls for certain steps to be done in a timely fashion. Some of those should be done by automation. All of the automated functions are not working at this point. They have to do a lot of this manually. There are also account maintenance updates that are not as clean as they should be. They are making progress and are committed to making these systems work as they are intended. He added that they haven't lost any collections but are delaying collections.

Senator Huppenthal discussed companies that did not benefit from using new computer programs. He asked how much of a problem this new program could be and how much help the agency needs to make this work. Mr. Hibbs stated that the contractor is committed to getting this system working right. This is a fixed price contract. They are holding the contractor's feet to the fire and are going to make sure that this works. Mr. Hibbs stated that they are not going to see a disaster with this system.

Mr. Hibbs continued to discuss the reasons they are struggling at this time. He discussed the retention and turnover problem. He discussed a salary comparison between their field auditors versus auditors for the cities or private sector. They have had a thirty percent turnover rate in the last two years in the collections area. They have to continually retrain people. There is a sixteen percent turnover rate in the audit division. As the economy improves they expect that it will be increasingly difficult to attract and retain good staff. They have strategies and ways to deal with this issue.

Mr. Hibbs discussed the budget cuts and how it has added to their struggles.

Mr. Hibbs discussed the need to expand their Enforcement Program. The agency did a study regarding non-compliance in filing taxes. They have estimated that there is a twelve to seventeen percent individual income tax non-compliance which would represent about $300 million to $400 million. He also noted that they have a very active unlicensed business compliance group. Last year they found 4,175 businesses that were not properly licensed and paying transaction privilege taxes and some were not paying and remitting the withholding taxes. He discussed the loss of staff in their Audit Division.

Mr. Hibbs stated that they will be reconciling the discrepancy in the numbers between the Department and JLBC and get that information to the full committee.

Arizona State Lottery Commission

Brian Cary, Analyst, Joint Legislative Budget Committee (JLBC), presented the Lottery Commission's operating budget for Fiscal Year (FY) 2006 and FY 2007 (Attachment 8). The Arizona State Lottery administers games of chance on behalf of several Arizona fund beneficiaries. For FY 2006 JLBC recommends $59.9 million in Other Funds, which is an increase of $1.8 million from FY 2005 or 3.1%. In FY 2007 JLBC recommends $59.8 million. The JLBC recommendation is a full $10.1 million above the Executive. He assured them that they will discover that the recommendations are similar. The differences are technical in the way the special line items have been handled and are tied directly to the percentage of sales. JLBC has recalculated the special line items to reflect estimated increases in lottery sales revenue. The Executive proposal included numbers for the special line items that were tied back to the old FY 2005 appropriation and does not reflect subsequent sales growth. The JLBC is recommending $110,000 to replace one of the Lottery's mid-range computers that are used as a backup to process the Powerball as well as other agency operations. This project and investment justification was approved by the Government Information Technology Agency (GITA) in

October of 2004. It is a one-time expenditure of $110,000 in FY 2006. The Executive concurs with this recommendation.

JLBC is recommending $69,100 in FY 2006 and FY 2007 for replacement of personal computers and related equipment. The Executive also concurs with this recommendation.

JLBC also recommends $58,900 in FY 2006 and $33,600 in FY 2007 to replace desks, cubicles and chairs purchased in 1987. The Executive concurs with this recommendation.

Mr. Cary discussed four special line items that are calculated in the General Appropriations bill as percentages of lottery sales revenue. JLBC recommends an increase $323,200 in FY 2006 and FY 2007 for advertising based on a forecast that increased in sales. The Executive recommendation shows a decrease of $1.6 million in FY 2006 and FY 2007 for advertising. That is because the special line items in the Executive budget were not recalculated to reflect the expected sales growth. JLBC recommends an increase of $288,700 in FY 2006 and FY 2007 for Instant Tickets. This is based on a special line item appropriation which places the appropriation at 3.6% of actual Instant Ticket sales. This appropriation will go up or down depending on the actual level of Instant Ticket sales. The Executive recommendation shows a decline of $1.1 million in the Instant Ticket special line item. JLBC is recommending a 4.99% of on-line ticket sales to be paid to the vendor that actually operates the on-line games on behalf of the lottery. This recommendation is an increase of $197,200 and the Executive recommends a decrease of $1.5 million. JLBC is recommending an increase of $801,900 in retailer commissions which have been appropriated as 6.7% of total ticket sales. The Executive recommends a decrease of $4.1 million because of not recalculating the figures to reflect anticipated sales growth. JLBC also recommends as Session Law to continue to require the Lottery to return 31.6% of Powerball sales to the General Fund up to a maximum of $31 million. Statute requires a minimum of 29% of Powerball sales to be returned to the state. In recent years the amount that goes to the General Fund has increased. The Executive has proposed statutory changes to the Lottery Fund distribution that would return $34 million to the General Fund. JLBC has not been provided with the details of this recommendation. There is a difference of $9,500 in the standard and technical changes. JLBC's recommending a decline of $22,900 in the Lottery budget related to these changes versus a decrease of $13,400 recommended by the Executive.

Mr. Cary stated that 2004 was a record year for ticket sales with a total of almost $367 million. They are calling for small decrease during the current fiscal year because of an anticipated decrease in Powerball sales. To date, they have seen a decline of about 29% in Powerball revenue. During FY 2004 there was an unusual amount of very high jackpots that occurred during the fiscal year which bolstered Powerball sales to high levels. So far, during the first half of FY 2005 that experience has not been repeated. Sales of Instant Tickets and one of the on-line games have been doing well. Lottery revenues are doing a little better than what they have shown in their forecast of $355 million for all of FY 2005. They are calling for increases in both classifications of games and sales in FY 2006 with the total getting back to $367 million. They are not forecasting growth in FY 2007 because they feel it is appropriate to be prudent with respect to any kind of anticipated fund distributions. He noted that in FY 2000 they saw a decline of about $12 million in Lottery revenue.

Mr. Cary discussed the Total Funds for the last few fiscal years as well as the current year. The Lottery does not receive any General Funds or Federal Funds. The Other Appropriated Funds are State Lottery Fund monies that go to the Operating Budget. In FY 2006 JLBC is recommending $59.9 million. The Non-appropriated Funds portion is $220,600,000 in FY 2006. All of that represents the Prize Fund which is what is distributed to people who purchase lottery chances and win. He presented a Budget Option with respect to Powerball sales. He discussed what would happen if they removed the $31 million cap in Session Law and direct all 31.6% to the state. The General Fund would receive an additional $6 million if they were to hold the percentage of Powerball revenue that goes to the state at 31.6%, but removed the $31 million limit. The $6 million that would accrue is currently going to the Local Area Transit Fund.

Mr. Pearce asked why they capped the amount of money going into the General Fund. Mr. Cary stated that it had become customary in prior years to appropriate a fixed amount from the Lottery Fund to the General Fund. That figure was capped as recently as four or five years ago at $21 million. The decision was made during budget deliberations to increase that figure by $10 million and raise the limit to $31 million with the remainder going into the Local Area Transit Fund.

Mrs. Groe asked, regarding the replacement of computers, if there was any communications throughout the government that looks to purchase the necessary equipment together for better rates. Mr. Cary stated that he believes there is some coordination through the Government Information Technology Agency (GITA), as well as the Department of Administration that attempts to negotiate with vendors to get good prices for state owned equipment.

Regarding the Local Area Transit Fund, Senator Johnson asked what the “local” meant. Mr. Cary stated that local means that the funds are distributed to counties and cities around the state based on population. The two largest counties and the cities within them are required to spend those monies on mass transit projects. In the more rural communities where they don’t have mass transit, they have more flexibility in deploying those funds for things such as street improvements. He added that the funds are distributed by a population based formula. Senator Johnson asked how much would be left in the Local Area Transit Fund if the $31 million cap was increased. Mr. Cary stated that it would depend on the Powerball sales in any given year.

Bret Cloninger, Economist, Governor’s Office of Strategic Planning and Budgeting (OSPB), stated that the OSPB and JLBC recommendations are essentially the same on the spending side (Attachment 9). OSPB has included a total distribution to the General Fund of $34 million which is proposed in the Governor’s budget and embodied in HB 2440. This would change the Lottery Distribution Formula. This budget is different from others and appropriations for line items are made on a percentage of sales.

Kathleen Pushor, Executive Director, Arizona State Lottery Commission, stated that she will answer any questions.

Senator Waring asked what was meant by record sales of lottery items. Ms. Pushor stated that there has been growth across the board. A lot of the sales have to do with the growth in population.

Without objection, the meeting adjourned.

Administrative Services Office
February 16, 2005

(Original minutes, attachments, and tape are on file in the Office of the Chief Clerk.)