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1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 542-5491

FAX (602) 542-1616

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JOINT LEGISLATIVE BUDGET COMMITTEE
Tuesday, June 28, 2005
9:30 a.m.
House Hearing Room 4

MEETING NOTICE

- Call to Order

- Approval of Minutes of May 11, 2005.

- DIRECTOR'S REPORT (if necessary).

- EXECUTIVE SESSION
  - A. Arizona Department of Administration, Risk Management Services - Consideration of Proposed Settlements under Rule 14.
  - B. Consideration of JLBC Staff Director Salary pursuant to A.R.S. § 38-431.03.

1. AHCCCS - Review of KidsCare Behavioral Health Capitation Rate Changes.

2. DEPARTMENT OF ECONOMIC SECURITY
   - A. Review of Transfer of Appropriations for TANF Cash Benefit Monies.
   - B. Review of Transfer of Appropriations between Child Care Subsidy Line Items.
   - C. Review of Expenditure Plan for Discretionary Workforce Investment Act Monies.

3. DEPARTMENT OF HEALTH SERVICES - Review of Children's Rehabilitative Services Capitation Rate Changes.

4. DEPARTMENT OF REVENUE - Review of Ladewig Expenditure Plan.

5. ARIZONA STATE RETIREMENT SYSTEM - Review of FY 2006 Information Technology Expenditure Plan.

6. DEPARTMENT OF CORRECTIONS
   - A. Report on Employee Overtime Pay and the On-Call Pay Settlements.
   - B. Report on Monthly Bed Plan Update.

The Chairman reserves the right to set the order of the agenda.
06/21/05

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DATE: June 16, 2005

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

THRU: Richard Stavneak, Director

FROM: Stefan Shepherd, Assistant Director

SUBJECT: AHCCCS – REVIEW OF KIDSCARE BEHAVIORAL HEALTH CAPITATION RATE CHANGES

Request

Pursuant to a footnote in the General Appropriation Act, the Arizona Health Care Cost Containment System requests review of Behavioral Health capitation rates for the KidsCare (including parents) program. The proposed rates are on average 5.1% above FY 2005 rates, and are virtually identical to budgeted levels for FY 2006.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the requested rate increase. The proposed rates are virtually identical to budgeted levels for FY 2006.

Analysis

The KidsCare program provides AHCCCS coverage to children up to 200% of the Federal Poverty Level (FPL) who are not eligible for the regular AHCCCS Title XIX program. In turn, the KidsCare - Parents program provides services to parents of children up to 200% FPL. While the Behavioral Health component of the regular Title XIX Medicaid program is funded in the Department of Health Services (DHS), the behavioral health component of the KidsCare programs are funded in the AHCCCS budget.

The rates AHCCCS is proposing for the KidsCare programs are based in part on the rates developed for the regular Title XIX program. For children in KidsCare, the requested rates represent an increase of 6.7% above the FY 2005 rates; for the parental population, the requested rates represent a 2.1% increase above the FY 2005 rates. In total, the requested rates represent a 5.1% increase above the FY 2005 rates. *Table 1* details the average FY 2005 rates and the proposed rates for FY 2006. These rates represent increases above FY 2005, but are virtually identical to budgeted levels for FY 2006.

Table 1

	Current FY 2005	Proposed FY 2006	% Change
KidsCare			
Children	$15.16	$16.20	6.9%
SMI	21.64	22.06	1.9%
Average			6.7%
KidsCare Parents			
SMI	22.75	23.83	4.7%
GMH/SA	10.58	10.19	(3.7)%
Average			2.1%
Weighted Change			5.1%

RS/SS:ym

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DATE: June 21, 2005

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

THRU: Richard Stavneak, Director

FROM: Eric Jorgensen, Fiscal Analyst

SUBJECT: Department of Economic Security – Review of Transfer of Appropriations from TANF Cash Benefit Special Line Item.

Request

Pursuant to a FY 2005 General Appropriation Act footnote, the Department of Economic Security (DES) requests Committee review of a Federal Temporary Assistance to Needy Families (TANF) Block Grant fund transfer of $12 million from the TANF Cash Benefit Special Line Item (SLI). Of this amount, $3 million would be transferred to the Division of Benefits and Medical Eligibility (DBME) operating budget, $1.2 million to the Adoption Services SLI and $7.8 million to the Children Services SLI. These amounts are displayed in *Table 1*.

This $12 million transfer addresses part of the department's $20.8 million shortfall. DES would resolve the remaining $8.8 million shortfall with options that do not require Committee review. The Department has identified $9.4 million in possible options to fill the $8.8 million remaining shortfall.

Table 1

DES Projected Shortfalls (in millions)

		Funding Source	
Division/Line Item	Projected Shortfall	Proposed Transfer	Other Sources
DBME			
Operating Budget	$ 3.0	$ 3.0	$ --
DCYF			
Adoption Services	2.5	1.2	0.5
Children Services	14.9	7.8	8.9
Perm. Guardianship	0.9	--	--
Subtotal	17.8	9.0	9.4
Total	**$20.8**	**$12.0**	**$9.4**

Recommendation

JLBC Staff recommends that the Committee give a favorable review to the department's request to transfer $12 million from the TANF Cash Benefit SLI with the provision that DES use non-appropriated fund sources and savings first to mitigate the projected shortfalls.

Analysis

The department reports a total shortfall of $3 million in DBME and $17.8 million in Division of Children, Youth and Families (DCYF).

TANF Cash Benefit Surplus
Based on year-to-date spending, JLBC Staff concurs that approximately $12 million is available from surplus monies in the TANF Cash Benefits SLI. This is the result of declining caseloads, which are being seen across the country as the economy improves. As of March 2005, caseloads were 16% lower than the previous year. DES also asserts that the decline is due in part to a program to divert would-be benefit recipients by providing a one-time cash benefit to overcome immediate obstacles to work, as well as providing more intensive case management services.

DBME Operating Shortfall
DES requests that $3 million of the surplus be transferred to the DBME operating budget to cover a projected $3 million shortfall. According to DES, the reason for the $3 million shortfall is three-fold. First, contract costs for processing electronic transactions have increased $800,000 over the amount the budget can currently support. Second, DES reports that it has hired additional FTEs to fill vacant positions, adding approximately $150,000 for DES' TANF share of those workers' costs. Third, the remaining shortfall, about $2 million, is due to "additional eligibility worker time required for diversion of applicants from TANF cash assistance," as mentioned above, measured in the Arizona Random Moment Sample (ARMS) survey. This requires increased resources in the eligibility interview process to determine why an applicant is unable to work.

Adoption Services Shortfall
DES requests that $1.2 million be transferred to the Adoption Services SLI to partially cover a projected shortfall of $2.5 million. Based on year-to-date spending patterns, JLBC Staff concurs with this estimate. DES cites caseload growth as the reason for the shortfall. During FY 2005, caseload has grown by about 8.3% over FY 2004. The FY 2005 budget provided no funding for caseload growth. The remaining shortfall will be addressed by adoption bonus funds ($500,000) and other sources yet to be identified ($800,000).

Children Services Shortfall
DES requests that $7.8 million be transferred to the Children Services SLI to cover part of a projected $14.9 million shortfall. The reason for the shortfall is two-part. First, the department reports caseload growth in in-home and out-of-home cases. DES estimates a $3 million shortfall due to this growth. Based on year-to-date spending patterns, JLBC Staff concurs with this estimate. DES has not indicated a specific plan for eliminating this $3 million shortfall.

Second, in FY 2004 the Governor provided $11.9 million additional funding through a line item veto of a lump sum reduction. In FY 2005, the Governor did not recommend a continuation of the $11.9 million appropriation created by her line item veto. Instead, she directed the department to find efficiency savings and other one-time funding sources to continue the funding. The department's request to transfer $7.8 million of surplus DBME TANF Cash Benefit monies to the Children Services SLI is part of their plan to find new one-time sources.

To solve the remaining $7.1 million shortfall ($14.9 million less $7.8 million TANF Cash transfer), DES has identified $8.9 million in solutions. In this transfer request, as well as the Monthly Financial Status

Report dated May 31, 2005, the department indicated that the remaining $4.1 million would come from an estimated $1.6 million savings associated with shifting children to the Title XIX behavioral health system, $1 million of one-time food stamp recoupment monies, and $1.5 million of Title IV-B part 2 prior year funds. The department also recently requested a $4.8 million transfer from the Healthy Families SLI in the DCYF budget to the Children Services SLI to address the remaining shortfall. For the FY 2005 budget, the department requested and received an increase of $8.7 million from the General Fund to double the size of the Healthy Families program. However, as of May 27 less than $3.4 million of these funds had been spent or encumbered, leaving $5.3 million available.

Permanent Guardianship Subsidy

DES has also identified a $0.9 million shortfall in the Permanent Guardianship subsidy line; however, they have not yet identified a source of funding to cover the shortfall. This shortfall is due to a projected caseload growth of 25.4% over FY 2004. The FY 2005 budget provided no funding for caseload growth. While year-to-date spending patterns do indicate a potential shortfall, the trend would suggest a shortfall of about $0.5 million.

RS/EJ:ck

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DATE: June 20, 2005

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

THRU: Richard Stavneak, Director

FROM: Eric Jorgensen, Fiscal Analyst

SUBJECT: Department of Economic Security – Review of Transfer of Appropriations Between Child Care Subsidy Line Items

Request

Pursuant to a FY 2005 General Appropriation Act footnote, the Department of Economic Security (DES) requests Committee review for a Federal Child Care Development Fund (CCDF) Block Grant transfer of $4 million from the Day Care Subsidy Special Line Item (SLI) to the Transitional Child Care SLI.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the agency request. Funds are kept within the Division of Employment and Rehabilitation Services and are used to provide the same services for a more limited caseload.

Analysis

The department reports that by the end of FY 2005, caseloads in the Transitional Child Care SLI will have grown by 13.3% over the prior year while the caseloads in the Day Care Subsidy SLI will have decreased by 3.7%, based on current projections. This change in caseload is due to an overall decrease in those receiving TANF Cash Assistance. Recipients of TANF Cash Assistance are eligible for the Day Care Subsidy; however, once a family leaves the program they continue to be eligible for Transitional Child Care for two years. As more families are leaving the TANF Cash Assistance program, the Transitional Child Care caseload grows.

The department reports that the shift away from TANF Cash Assistance is due to increased efforts to provide recipients with a one-time benefit, which allows them to overcome immediate obstacles to employment.

If expenditures for the last quarter of FY 2005 match previous quarters, the surplus in the Day Care Subsidy program should be around $7 million. The projected shortfall in the Transition Child Care program would be between $2 million and $3 million dollars, based on the same data.

RS/EJ:ck

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DATE: June 20, 2005

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

THRU: Richard Stavneak, Director

FROM: Eric Jorgensen, Fiscal Analyst

SUBJECT: Department of Economic Security – Review of Expenditure Plan for Discretionary Workforce Investment Act Monies

Request

Pursuant to a footnote in the General Appropriation Act, the Department of Economic Security (DES) is submitting an expenditure plan for an additional $184,900 in FY 2005 from discretionary federal Workforce Investment Act (WIA) monies received by the state for Federal Fiscal Year (FFY) 2004 to be spent on the Jobs for Arizona Graduates (JAG) program. Unlike most Federal Funds, the WIA monies are subject to legislative appropriation due to federal requirements. These monies are in excess of the original FY 2004 appropriated amount and cannot be spent until an expenditure plan has been reviewed by the Joint Legislative Budget Committee. To date the Committee has favorably reviewed $4.9 million for FY 2005.

Recommendation

The JLBC Staff recommends a favorable review of the request with the provision that the department provide performance measures related to the program by September 1, 2005.

Analysis

The DES Workforce Development Administration (WDA) is the state's grant recipient for federal WIA funds from the U.S. Department of Labor. The WIA legislation established block grants to states for workforce development. Funds are delivered to the local level to those in need of services, including job seekers, dislocated workers, youth, veterans, disabled individuals and employers. Services are provided through partnerships between various public and private sector employment and training agencies.

Table 1 at the end of this memo delineates discretionary funding for both FY 2004 and FY 2005. The table includes the expenditure for review as well as funding that was approved at the June 2004 and March 2005 JLBC Meetings.

In June 2004, the Committee favorably reviewed $2,497,000 in other discretionary WIA expenditures for FY 2005. Those monies represented core functions typically funded with WIA dollars. In March

2005, the Committee favorably reviewed a $2,384,000 expenditure plan, which reflected items that are more discretionary.

The Governor's Council has recommended $184,900 of WIA monies be used for the Jobs for Arizona Graduates, a not-for-profit organization. This program provides assistance to students who have dropped out or are in danger of dropping out of school. The program helps them to get a high school diploma or GED, and then find a job that leads to a career or go on to higher education. The program reports a 90% graduation rate and 80% success rate, as measured by the number of participants becoming employed, entering the military or receiving additional education. This program was funded with WIA monies in FY 2004 (as part of the Youth Programs line), but was not contained in the either of the previously reviewed FY 2005 expenditure plans. Outside this request, funding for JAG is $544,600 in FY 2005, which comes from the Arizona Department of Education AIMS Intervention and Dropout Prevention program and through charitable contributions from corporations and other organizations. The department has indicated that it will submit performance measures to the Committee. JLBC Staff recommends that these measures be submitted by September 1.

Table 1 Governor's Council Recommendation of 15% Set-Aside

Programs to be Reviewed	Agency	FY 2004	FY 2005	Net Change
Jobs for Arizona Graduates		$ --	$ 184,900	$ 184,900
Subtotal: Plan to be Reviewed		**$ --**	**$ 184,900**	**$ 184,900**
Programs Favorably Reviewed by Committee				
Training for LWIAs	LWIA	$ --	$ 170,000	$ 170,000
Local Labor Market Information	ADOC	--	180,000	180,000
Early Childhood Educators Scholarships	ADE	--	433,000	433,000
High Tech Education	ADOC	--	250,000	250,000
Master Teacher	ADE	--	450,000	450,000
Postsecondary Preparedness	GOV	--	150,000	150,000
Youth Programs	LWIA	1,000,000[1/]	301,000	(699,000)
Women's Programs	GOV	500,000	450,000	(50,000)
Nursing Programs	CC	510,400	--	(510,400)
Eligible Training Provider List	ADE	214,300	127,000	(87,300)
Incentive Funds for LWIAs	LWIA	500,000	500,000	--
Technical Assistance	LWIA	125,000	250,000	125,000
System Building	LWIA	152,000	300,000	148,000
High Concentration of Youth Activities	LWIA	200,000	200,000	--
Virtual One Stop	DES	325,000	325,000	--
Evaluation	GOV	--	125,000	125,000
Apprenticeship	ADOC	130,000	70,000	(60,000)
ADOC/State Council	ADOC	600,000	600,000	--
Subtotal: Plan Already Reviewed		**$4,256,700**	**$4,881,000**	**$ 624,300**
TOTAL 15% SET-ASIDE		**$4,256,700[2/3/]**	**$5,065,900[4/]**	**$ 809,200**

Legend

ADE	Department of Education	LWIA	Local Workforce Investment Areas
GOV	Governor's Office	ADOC	Department of Commerce
DES	Department of Economic Security	CC	Community Colleges

1/ Includes funding for Master Teacher Program
2/ Of this total, $974,900 was not expended in FY 2004
3/ Includes $2,010,400 in programs not continued in FY 2005
4/ Includes $974,900 in prior year funding not expended in FY 2004

RS/EJ:ck

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DATE: June 21, 2005

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

THRU: Richard Stavneak, Director

FROM: John Malloy, Fiscal Analyst

SUBJECT: Department of Health Services – Review of Children's Rehabilitative Services Capitation Rate Changes

Request

Pursuant to a footnote in the General Appropriation Act, the Department of Health Services (DHS) must present an expenditure plan to the Committee for its review prior to implementing any change in capitation rates for the Title XIX Children's Rehabilitative Services (CRS) program.

Recommendation and Summary

The JLBC Staff recommends that the Committee give a favorable review of the DHS CRS capitation adjustments. A footnote in the General Appropriation Act prohibits the use of any potential savings in the CRS program for other DHS programs without prior review by the Committee.

The proposed rates are based upon an actuarial study, which is required by the federal government. The proposed changes would cost $(1.3) million General Fund less than the FY 2006 budgeted amount. The weighted average rate change is (2)% below FY 2005. In comparison, the FY 2005 budget assumed a 6% capitation rate increase.

The actual FY 2006 cost of the Title XIX CRS program will depend upon the number of people that enroll for CRS services. If enrollment is higher than projected, the actual costs of the CRS program could be greater than budgeted, even with lower capitation rates.

(Continued)

Analysis

The CRS program provides services for children with chronic and disabling or potentially disabling conditions. Contractors are reimbursed using a per-member, per-month capitation rate, which varies by providers in 4 different sites: Phoenix, Tucson, Flagstaff, and Yuma. The rate structure also includes a high, medium and low tier, which represent varying degrees of medical acuity. The average change across these various rates was (2)%, although some rates increased and some rates decreased. In comparison, the FY 2006 budget assumed a 6% capitation rate increase. The table below displays the FY 2006 budgeted and proposed rates by city and medical acuity and details the changes from FY 2005.

Proposed CRS Capitation Rate Changes, FY 2005 to FY 2006 [1/]

	FY 2005 Rate	FY 2006 Budgeted Rate	FY 2006 Actual Rate	FY 2006 Change Above FY 2005	Anticipated State Match Cost/(Savings) [2/]
Phoenix					
High	444.25	470.91	509.72	14.74%	371,200
Medium	229.02	242.76	299.00	30.56%	665,900
Low	211.50	224.19	143.79	(32.01)%	(1,537,600)
Tucson					
High	384.47	407.54	431.14	12.14%	95,400
Medium	345.20	365.91	311.65	(9.72)%	(226,900)
Low	207.67	220.13	156.55	(24.62)%	(366,200)
Flagstaff					
High	245.27	259.99	238.28	(2.85)%	(35,300)
Medium	167.19	177.22	139.12	(16.79)%	(89,700)
Low	120.91	128.16	93.70	(22.50)%	(79,500)
Yuma					
High	234.11	248.16	288.17	23.09%	38,700
Medium	159.53	169.10	126.50	(20.70)%	(15,900)
Low	140.06	148.46	70.26	(49.84)%	(104,200)
Total				**(2)%** [2/]	**(1,284,100)**

1/ Represents rates for services only. The administrative components of the rates are not shown here
2/ Rate change for services only.

The rate adjustments are developed using the following assumptions:

- Mercer and CRS utilized encounter data from FY 2002 through FY 2004 to reestablish risk level assignments for each CRS contractor. Each member who qualifies for the CRS program is grouped into 3 risk levels: high, medium and low. As a result of this regrouping, 13% of those individuals that had been categorized as "low risk" were re-characterized as "medium risk." This would explain a portion of the capitation rates decreases for the medium and low populations in the table above.
- Weighted Annual Trend Adjustment: The actuaries estimated an average weighted trend adjustment of 5.5%. This includes 1.4% for utilization and 4.1% for medical inflation. The FY 2006 appropriation assumed an increase of 8%. The trend adjustment in FY 2005 was 8.2%. Actual figures varied by contractor.

(Continued)

- Profit/Risk Margin: The actuaries kept the profit/risk/contingency margin at 2.5%.
- Medicare Part D: Under the Medicare Modernization Act, a prescription drug benefit will be provided by Medicare for the Medicare/Medicaid dual eligible population, resulting in expenditures for dual eligibles to be significantly reduced. CRS has very few dual eligible children in its population, resulting in a $(0.12) reduction to the FY 2006 claim costs.

The proposed FY 2006 rates continue to limit a contractor's revenue from member month growth. In FY 2005 this limit was 2.5% and in FY 2006 it increases to 10.0%. This limit was established in prior years and is designed to prevent overpayment of capitation rates to providers. Over the past 3 fiscal years, Title XIX member month growth has risen at the compounded annual rate of 10.1%.

Enrollment in the Title XIX CRS program in Phoenix has been lower than was expected when the FY 2006 budget was developed. This lower enrollment could lead to further savings in addition to the capitation rate changes. The JLBC Staff will continue to monitor enrollment in the program to determine the potential impact on the FY 2006 budget.

RS/JM:ck

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DATE: June 20, 2005

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 Ladewig Expenditure Plan

Request

In compliance with a Ladewig Settlement Payments Budget Reconciliation Bill (Laws 2005, Chapter 333) footnote, the Department of Revenue (DOR) requests that the Committee review its FY 2006 Ladewig administrative expenditure plan for the remainder of the project.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of DOR's estimated administrative expenditure plan of $1,424,700 for the FY 2006 Ladewig project. DOR's administrative expenses are estimated to be $2.6 million in FY 2007. We will be in a better position, however, to review the FY 2007 figures next year, since that number is not yet final.

The JLBC Staff further recommends that DOR report back to the Committee after the taxpayer refund overpayment issue has been resolved. The report should include DOR's updated estimate of the total cost of the Ladewig Settlement. A September 2005 court hearing is scheduled on this issue.

The total Ladewig costs are projected to be $58.3 million in FY 2006, and $99.2 million in FY 2007.

Analysis

The case of Ladewig v. State of Arizona involved the different state income tax treatment of dividends from Arizona and non-Arizona companies. The court settlement was for the amount of taxpayer claims with a cap of $350 million. DOR currently estimates the total cost of the Ladewig Settlement at $308.5 million. The numbers are not yet final. This amount is to be paid out over 5 fiscal years from FY 2003 through FY 2007, and includes taxpayer refunds, DOR administration costs and plaintiff attorney fees. Refunds to taxpayers began in FY 2005. Half of the taxpayer refunds were paid in FY 2005, with 25% of the refunds to be paid in each of FY 2006 and FY 2007. The amounts of taxpayer payments and plaintiff attorneys' fees are governed by the court settlement.

The estimated cost is $134.7 million in FY 2005, $58.3 million in FY 2006, and $99.2 million in FY 2007. Final taxpayer payments in FY 2007 are higher than in FY 2006, since they include unused set asides for DOR's administrative costs and plaintiff attorney fees. Any unused set asides will be distributed to taxpayers in FY 2007. The following table summarizes this information.

Summary of Ladewig FY 2003 & FY 2004 Expenditures and FY 2005 - FY 2007 Estimates

	Expenditures 1/		Estimates		
	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
DOR Administration	$ 8,587,100	$3,741,600	$3,000,000 2/	$ 1,758,900 3/	$ 2,566,300
Plaintiff Attorneys	2,000,000	2,000,000 4/	6,000,000	4,900,000	4,900,000
Taxpayer Payments	0	0	125,700,000	51,600,000	91,700,000
Total Expenditures	$10,587,100	$5,741,600	$134,700,000 5/	$58,258,900	$99,166,300
Ending Balance	$ 4,412,900	$671,300 6/			

1/ In addition, DOR reports operating budget expenditures of $134,600 in FY 2002 for Ladewig administration.
2/ JLBC favorably reviewed $3,000,000 to fully fund DOR's estimated administrative costs in FY 2005 at the June 29, 2004 JLBC meeting.
3/ $334,200 is unallocated in the department's most recent plan.
4/ Reimbursed to DOR by Department of Administration Risk Management.
5/ DOR estimate reported at the August 17, 2004 JLBC meeting. DOR has paid $132.6 million through May 2005. DOR pays Ladewig expenses which exceed the allocation from the tax refund account in the General Fund.
6/ The $671,300 remaining balance reverted to the General Fund.

The Ladewig Settlement Payments Budget Reconciliation Bill (Laws 2005, Chapter 333) allocates $58.3 million in FY 2006 to the department for payments and costs associated with the case of Ladewig v. State of Arizona, with any unused amount to be held in reserve for future payments. The $58.3 million includes up to $1,758,900 for department administration costs and review of payments. The department is required to present an expenditure plan for review by the JLBC that includes an estimate and scope of the entire administrative requirement associated with disbursing payments and costs for this case, before expending any of the $58.3 million.

The following table provides further detail on DOR's estimated administration cost in FY 2006. The estimated cost for postage, printing and mailing has been reduced by $334,200 by consolidating form 1099 mailings to taxpayers, and DOR pre-paying postage from the FY 2004 budget for the second payment to taxpayers which is due by July 20, 2005. This has reduced the overall projected administrative cost from $1,758,900 to $1,424,700.

DOR's Estimated Administration Cost in FY 2006

Personal Services	$321,000
Employee Related Expenditures	73,800
Professional & Outside Services 1/	395,000
Travel	200
Other Operating Expenditures 2/	634,700
Total	$1,424,700

1/ Includes $85,000 for computer consultant, $165,000 for temporary personnel, $80,000 for mail data entry and imaging, and $65,000 for court appointed special master.
2/ Includes $352,500 for postage, $253,300 for printing and mailing, and $28,900 for other items.

DOR's administration cost estimate for FY 2006 seems reasonable. The bulk of the cost will be for Other Operating Expenditures for printing, postage and mailing warrants and form 1099's for taxpayer payments. DOR's permanent staff assigned to the Ladewig project and temporary personnel will continue to respond to the public and handle internal issues. The computer consultant will continue to maintain and enhance the computer system as necessary.

Current Status

DOR's monthly status report shows expenditures of $25,700 for Ladewig in May 2005 for administrative costs. Expenditures totaled $132.6 million for the first 11 months of FY 2005, out of DOR's estimated total of $134.7 million for FY 2005. The following table summarizes these items.

DOR's Ladewig Expenditures in FY 2005

	DOR's Estimate [1/]	Through May 2005
DOR Administration	$ 3,000,000 [2/]	$ 1,639,800
Plaintiff Attorneys	6,000,000	6,188,800
Taxpayer Payments	125,700,000	124,775,500
Total Expenditures	$134,700,000	$132,604,100

1/ Reported by DOR at the August 17, 2004 JLBC meeting.
2/ JLBC favorably reviewed $3,000,000 to fully fund DOR's estimated administrative costs in FY 2005 at the June 29, 2004 JLBC meeting.

DOR estimates that the FY 2005 refunds included overpayments of $6.3 million to 3,000 of the 306,000 claimants due to clerical and computer matching errors. DOR reports that they have corrected the errors they have found, and are working to avoid future problems. Overpayments ranged from a few dollars to $750,000. DOR reports that there were a variety of manual data input and technical computation errors, including the following main categories:

- Certain optical character recognition data recovered from microfiche tax returns for 1986 through 1989 were manually entered into the wrong field;
- Various data input errors were made by temporary staff;
- Various technical calculation errors were made involving taxpayers who used the optional tax tables, and previously audited and adjusted returns.
- The mainframe computer truncated 2 high dollar amounts, which produced the largest overpayment.

DOR has also identified underpayments of refunds due to taxpayers. However, the department does not know how many underpayments occurred, since they corrected their records and issued supplemental refunds as the underpayments were found. DOR reports that they have issued a total of 72,000 additional warrants for reasons such as estate changes (adding or changing heirs) and reissuing stale dated warrants, as well as for issuing supplemental refunds.

The Ladewig Settlement requires DOR to make the second taxpayer refund payment by July 20, 2005. At a May 26, 2005 hearing, the judge agreed to allow the State to hold off mailing refunds to the 3,000 overpaid claimants, until the overpayment issue is resolved. DOR will mail refunds to the remaining 303,000 claimants prior to July 20, 2005. DOR's position is that the overpayments should be collected back from the taxpayers. A September 2005 hearing is scheduled on DOR's motion. The judge ordered DOR to mail a notice to the 3,000 overpaid claimants by June 30, 2005 to allow them due process to protest the return of the overpayments.

DOR currently estimates the total cost of the Ladewig Settlement at $308.5 million. However, the numbers are not yet final. The final total cost may be affected by each of the following items:

- DOR is unsure how much of the overpayments may be included in the $308.5 million estimate of total cost. DOR speculates that some of the errors that produced the overpayments may also have been incorporated in the $308.5 million figure, while others may not. DOR is investigating and expects to have a revised estimate of total cost, perhaps by mid-July 2005.
- The court is expected to rule in September 2005 how to address the overpayment issue. The court is expected to decide whether to: 1) let DOR collect the FY 2005 overpayments from taxpayers, and make no more overpayments in FY 2006 & FY 2007, or; 2) let the FY 2005 overpayments

stand, but make no more in FY 2006 & FY 2007, or; 3) let the FY 2005 overpayments stand, and continue the overpayments in FY 2006 & FY 2007.

- The court has ordered DOR to keep separate track of their administration cost for overpayments. The court is expected to rule in September 2005 how to handle DOR's administration cost for the overpayments.
- DOR reports that the total cost may be reduced by a couple of million dollars as taxpayer disputes are settled, but does not yet have these figures.

RS/BH:ym

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1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 542-5491

FAX (602) 542-1616

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DATE: June 20, 2005

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

THRU: Richard Stavneak, Director

FROM: Eric Jorgensen, Fiscal Analyst

SUBJECT: Arizona State Retirement System – Review of FY 2006 Information Technology Expenditure Plan

Request

The Arizona State Retirement System (ASRS) requests Committee review of their FY 2006 Information Technology (IT) Expenditure Plan. ASRS was appropriated $6,378,700 in FY 2006 to upgrade their current information technology system. A General Appropriation Act footnote requires ASRS to seek JLBC review of each year's expenditure plan prior to any expenditures.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the FY 2006 expenditure plan submitted for the agency's IT plan. The agency's proposed expenditure plan submitted for Committee review are in line with the expenditures outlined in the Project and Investment Justification (PIJ) document approved by the Information Technology Authorization Committee (ITAC).

While the department's PIJ document was approved by ITAC, the Government Information Technology Agency (GITA) has changed the project status from "green," indicating the project is expected to be completed as planned, to "red," indicating a serious risk to project completion by the planned date. Therefore, JLBC Staff also recommends that the Committee request that ASRS provide an update by the end of each calendar quarter as to progress made towards bringing the IT plan back to a green status until that status is achieved.

Analysis

The footnote requiring JLBC review of the expenditure plan was added to the General Appropriation Act because of the magnitude and importance of the IT Plan for the agency. The ASRS Plan is meant to address IT inefficiencies and to position the agency for the increases in the longevity of retirees and actual number of retirees as the "baby boomer" generation reaches retirement.

An additional component of the IT Plan is designed to improve the ASRS Web site. Instead of being only an information resource, the agency is creating a Web site that provides services to members. For example, the enhanced ASRS Web site will enable members to complete tasks such as viewing their pension payment history, scheduling appointments with retirement advisors, and using an online benefit estimate calculator.

The document imaging component converts hundreds of thousands of paper files to electronic files, allowing member files to be accessible to benefit counselors in both the Phoenix and Tucson offices as well as the call centers. This also provides a key component of the ASRS disaster recovery capabilities.

Finally, the IT Plan includes upgrades for the agency's telecommunications system, which is the primary point of contact for ASRS members.

This integrated functionality has been split into three separate task components: the Public Employees Retirement Information System (PERIS), a document imaging system, and a financial management system.

For FY 2006, two new components of the plan were added. First, two additional FTE Positions were added to assist in the document imaging portion of the project. These FTE Positions are for the operation of the IT Plan and not development. Second, a two-year software and hardware development component has been added, at a cost of $326,500 in FY 2006, with an anticipated cost of $295,600 in FY 2007. This includes new software tools and upgraded network hardware to assist in the development of the plan as well as future upgrades to the project. Of the appropriated amount, $31,900 will be for on-going operational expenses beyond FY 2007.

Implementation of the IT Plan began in FY 2002. Until recently, the project was proceeding largely on schedule and budget, and there were no significant changes to the original Project and Investment Justification (PIJ) documents. A PIJ is the required project plan submitted to GITA for technical approval of the scope, costs, benefits and risk of the project. The total development cost in the PIJ documents over the lifetime of the projects is $40.6 million.

FY 2006 is the last year for which the department plans on requesting major development funding. While the project will continue its development until FY 2008, the funding that has been received thus far should be sufficient to cover those costs. As a result, in FY 2007, the bulk of the request will be for operational monies. FY 2006 operating expenses are shown in *Table 1*, and on-going expenses will be comparable.

ASRS has submitted an expenditure plan for the $6,378,700 allocated in FY 2006 for the IT Plan, which includes 20 FTE Positions. These expenditures are in line with the cost estimates

included in the PIJ, which were determined reasonable by GITA and ITAC as part of their approval process. *Table 1* details the components of the $6,378,700 allocated in FY 2006.

Table 1

FY 2006 Appropriation Expenditure Plan[1/]

	Development Expenses		Operating Expenses			Total
	Document Imaging	Software/ Hardware	Original Plan	Document Imaging	Software/ Hardware	
FTEs	--	--	18	2	--	**20**
Personal Services	--	--	$1,150,200	$64,200	--	**$1,214,400**
Employee Related Expenses	--	--	274,100	20,700	--	**294,800**
Professional Services	$3,452,900	--	--		26,000	**3,478,900**
License/Maintenance and OOE	--	--	765,100	3,600	--	**768,700**
Equipment	--	300,500	250,000	13,400	--	**563,900**
Total	**$3,452,900**	**$300,500**	**$2,439,400**	**$101,900**	**$26,000**	**$6,320,700**

1/ Amounts do not include appropriations for statewide salary and other technical adjustments

Recently, there have been some concerns raised as to the progress of the IT plan. An Independent Advisory Consultant (IAC) raised concerns on two of the projects, PERIS and the Financial Management System (FMS). These concerns caused GITA to change the project status from "green," indicating the project is expected to be completed as planned, to "red," indicating a serious risk to project phase completion by the planned date.

The concern with PERIS revolved around the difficulty implementing the Service Purchase application and ASRS was asked to consider the elimination of in-house development in favor of buying the products. ASRS has indicated that they have since fully implemented the application and intend to continue with in-house development. The issue with the FMS was a misunderstanding with a vendor that has been resolved. The Information Technology Authorization Committee (ITAC) is working with an internal ASRS review team to monitor the project status and a new IAC is evaluating the project. On April 27, 2005, ITAC decided to reconsider the project status after a 4-week review by the new IAC. The new IAC is scheduled to report back to the ITAC at the July 27th meeting. GITA has requested that at that time ASRS submit a amendment to the PIJs updating the project schedule to reflect the IAC's report. JLBC Staff recommends that ASRS report back to the Committee on the status of their projects by the end of each calendar quarter.

RS/EJ:ck

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FAX (602) 542-1616

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DATE: June 20, 2005

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

THRU: Richard Stavneak, Director

FROM: Kevin Bates, Fiscal Analyst

SUBJECT: Arizona Department of Corrections – Report on Employee Overtime Pay and the On-Call Pay Settlements

Request

Laws 2005, Chapter 6 requires the Arizona Department of Corrections (ADC) to report by May 1, 2005 to the Committee on the payment of overtime and on-call settlement claims. ADC was appropriated $7.5 million for employee compensatory time payments and $12.5 million for settlement of a lawsuit related to on-call pay.

Recommendation

This item is for information only and no Committee action is required. ADC submitted a report on June 9, 2005 stating that all FY 2004 compensatory time was paid and that all but 3 on-call claims were paid as of May 2005. ADC reports that the sum of $7.8 million was expended for FY 2004 employee compensatory time payments and $12.3 million was expended for on-call claims.

While the report does not discuss payment of FY 2005 compensatory time, the department has indicated to JLBC Staff that employees will earn up to $13 million in new time payments during FY 2005. The Legislature has at least 2 options in this situation: 1) to increase ADC's base appropriation to cover these costs permanently, or 2) not to adjust ADC's appropriation, requiring the department to absorb the costs within its existing appropriation. The department's ability to absorb these costs is difficult to determine because its salary expenditures depend on staffing levels. Staffing shortages result in employees working overtime and earning compensatory time. Savings realized through staff vacancies, however, are used to pay for overtime and compensatory time earned. These vacancy savings are also used by the department for other compensation issues, such as prison complex pay differentials. As a result, it is difficult to determine how much of ADC's base budget is available to address compensatory time payments.

(Continued)

Analysis

On-Call Payments

Schofield v. State of Arizona was a 1997 lawsuit brought by current and former state employees alleging that they and other state employees had been assigned to on-call duty but had not been compensated as personnel rules required. Because of staff shortages, ADC employees in the 1990s were required to be "on-call," or available to work on short notice. Employees alleged that they were not compensated at the $1-per-hour rate required by personnel rules. Following the lawsuit, ADC received claims from employees totaling approximately $23 million. Two payments of approximately $4.2 million each were issued to claimants in settlement agreements, the first occurring in FY 2003 and the second in FY 2004. Of each payment, $2 million came from the state's Risk Management Fund and the rest was from ADC's general appropriation.

Laws 2005, Chapter 6 appropriated $10 million from the Risk Management Fund and $2.5 million from the General Fund for FY 2005 to the Arizona Department of Administration (ADOA) to pay the remaining on-call settlement agreements (approximately $12.5 million with interest). Chapter 6 directed ADC to forward all claims information to ADOA by April 27, 2005. The bill also directed ADOA to pay the claims within 15 days after receiving the claims. The ADC report does not indicate when the claims were forwarded to ADOA or specifically when ADOA paid them. ADC, however, does report that all but 3 of the claimants in the lawsuit have been paid. The department indicates that most of the $12.5 million was paid in April and May 2005 to 1,143 claimants, with the last checks issued on May 13. Six checks were returned because of incorrect addresses, and current addresses have been obtained for three of those. With help from claimant counsel, ADC is attempting to obtain correct addresses for the remaining individuals.

According to ADOA, a total of $12.3 million in settlement monies has been distributed as of June 6, 2005. This figure includes $1.4 million in interest.

Overtime

Because of staff shortages, correctional officers may be required to work overtime. Those officers can choose to be paid for the overtime or receive compensatory time. Officers choosing compensatory time may use their overtime hours as annual leave. However, because of the same staff shortages the department does not allow the officers to use their leave time. As a result, officers accrue compensatory time balances. The department attempts to "buy down" the balances at the end of each fiscal year.

At the end of FY 2004, ADC had paid approximately $2.4 million towards compensatory time balances; however, approximately $7.8 million remained unpaid. ADC paid the remaining $7.8 million using monies from the department's FY 2005 operating budget. Chapter 6 provided ADC $7.5 million to restore a portion of its FY 2005 operating budget that it used to pay the FY 2004 overtime payments.

The appropriation and payment does not reflect compensatory time accrued in FY 2005, estimated to be approximately $12 million to $13 million. It is our understanding that the department will pay off $4 million to $5 million in FY 2005. The remaining $8 million to $9 million would be paid in FY 2006; however, it is unclear whether ADC will request a supplemental appropriation for the payment.

RS:KB:ss

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