STATE OF ARIZONA

Joint Legislative Budget Committee

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JOINT LEGISLATIVE BUDGET COMMITTEE
Monday, November 25, 2002
8:00 a.m.*
Senate Appropriations Room 109

AGENDA

- Call to Order

- Approval of Minutes of October 24, 2002.

- DIRECTOR'S REPORT (if necessary).

- EXECUTIVE SESSION
  - A. Arizona Department of Administration, Risk Management Services - Consideration of Proposed Settlements under Rule 14.
  - B. Department of Revenue - Consider Approval of Remaining Ladewig Expenditure Plan under A.R.S. § 38-431.03.

1. ARIZONA DEPARTMENT OF ADMINISTRATION
   - A. Consider Approval of Mileage Reimbursement for State Travel by Motor Vehicle.
   - B. Consider Approval of Lodging Reimbursement Rates.
   - C. Bimonthly Report on the Implementation of Self-Insurance for State Employee Health Insurance.

2. SCHOOL FACILITIES BOARD - Consider Approval of Inflation Index.

3. STATE COMPENSATION FUND - Consider Approval of Calendar Year 2003 and 2004 Budgets.

4. DEPARTMENT OF ECONOMIC SECURITY - Determine Adjustments to General Assistance Program.

5. COMMISSION FOR POSTSECONDARY EDUCATION - Consider Approval of Requested Transfer of Appropriations.

* If a Special Session is called for November 25, the meeting will last until the session convenes. If the Committee has not completed its business by that time, the meeting may be recessed until later in the day or until Tuesday, November 26, depending on the Special Session calendar.

6. OFFICE OF THE ATTORNEY GENERAL
   A. Review Allocation of Settlement Monies.
   B. Review of Expenditure Plan for Antitrust Enforcement Revolving Fund.

7. ARIZONA LEARNING SYSTEMS/COMMUNITY COLLEGES - Determine Disbursement of Arizona Learning Systems Equipment.

8. ARIZONA DEPARTMENT OF ADMINISTRATION/GOVERNMENT INFORMATION TECHNOLOGY AGENCY
   A. Report on HRMS Replacement Project.
   B. Review of Telecommunications Services Plan.

9. STATE DEPARTMENT OF CORRECTIONS - Review of Pay Stipend and Hiring Bonus Program.

10. AHCCCS - Report on Cost Sharing Measures.

11. REPORT ON RECENT AGENCY SUBMISSIONS
   A. Arizona Department of Administration - Report on the Use of Alternative Fuels and Clean Burning Fuels in the State Motor Vehicle Fleet.
   B. State Board of Directors for Community Colleges - Report on Tuition and Fees Charged by Community College Districts.
   C. Department of Economic Security - Report on Developmental Disabilities Title XIX Reimbursement Rates.
   D. Department of Economic Security - Report on Cost of Care Collections in Developmental Disabilities Program.
   E. Department of Economic Security - Report on Annual Child Care Expenditures.
   F. Arizona Department of Education/JLBC Staff - Report on the Technology Assisted Project-Based Instruction Program.
   G. Department of Health Services - Report on Assurance and Licensure Backlogs.
   H. Department of Health Services - Report on Behavioral Health Title XIX Reimbursement Rates.
   I. Arizona Historical Society - Report on Expenditures of Non-Appropriated Funds.
   J. Department of Racing - Report on Boxing Events and Revenue.

The Chairman reserves the right to set the order of the agenda.
11/20/02

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MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

October 24, 2002

The Chairman called the meeting to order at 9:37 a.m., Thursday, October 24, 2002, in Senate Appropriations Room 109. The following were present:

Members:	Senator Solomon, Chairman	Representative Burton Cahill
	Senator Bee	Representative Gray
	Senator Bennett	Representative Lopez
	Senator Brown	Representative Pearce
	Senator Cirillo	Representative Pickens
	Senator Rios	
Excused:	Senator Arzberger	Representative Knaperek, Vice-Chairman
	Senator Bundgaard	Representative Allen
		Representative May
Staff:	Richard Stavneak, Director	Cheryl Kestner, Secretary
	Gina Guarascio	Paul Shannon
	Brad Regens	Jill Young
Others:	Cynthia Odom	Attorney General's Office
	Scott Smith	Arizona Department of Corrections
	Chuck Ryan	Deputy Director, Prison Operations, ADC
	Catherine Eden	Director, Department of Health Services
	Mark Killian	Director, Department of Revenue

APPROVAL OF MINUTES

Senator Solomon moved that the minutes of September 19, 2002 be approved. The motion carried.

DIRECTOR'S REPORT

Mr. Stavneak, Director, JLBC Staff, stated that once a year the JLBC Staff reports on all the JLBC statutory duties and responsibilities. Duties for the Committee went from 131 last year to 147 this year, and Staff responsibilities went from 68 to 74. All this information is on-line, and is available for agencies to see what they have to report on and what their deadlines are. Most of the increase has to do with Community Colleges, because when they reduced the responsibilities with the State Board, some of those oversight functions were picked up by the JLBC.

EXECUTIVE SESSION

Senator Bee moved that the Committee go into Executive Session. The motion carried.

At 9:40 a.m. the Joint Legislative Budget Committee went into Executive Session.

Senator Bee moved that the Committee reconvene into open session. The motion carried.

At 11:55 a.m. the Committee reconvened into open session.

A. ARIZONA DEPARTMENT OF ADMINISTRATION RISK MANAGEMENT SERVICES - Consideration of Proposed Settlements under Rule 14.

Senator Bee moved that the Committee approve the recommended settlement proposals by the Attorney General's Office in the following cases:

1. *Jardine v. ASU, City of Tempe*
2. *Villanueva, et al. v. State of Arizona, et al.*
3. *Zabala v. State of Arizona, et al.*

The motion carried.

B. ARIZONA DEPARTMENT OF CORRECTIONS - Review of Negotiated Private Prison Rates.

Senator Bee moved that the Committee approve Executive Session item B, option 2 which has the effect of giving a favorable review to the department's proposal to contract for 645 private prison beds as described in scenario 2 of the department's handout. The motion carried.

C. DEPARTMENT OF REVENUE - Consider Approval of Ladewig Expenditure Plan under A.R.S. § 38-431.03.

Senator Bee moved that the Committee approve $6 million in FY 2003 in line with the department's general administrative plan. The Committee will approve the remainder of the cost of the plan at the November Committee meeting. The motion carried.

Senator Solomon stated that the Committee would only be hearing items 1 through 3 at this meeting and that items 4 through 8 would be held for the next JLBC meeting due to time constraints.

JLBC STAFF - Review of Calculation of Inflation for Transaction Privilege Tax County Withholding.

Ms. Jennifer Vermeer, JLBC Staff, stated that statute requires JLBC Staff to calculate an inflation adjustment on county contributions for Proposition 204 administration costs. The item does not technically require Committee review because statute requires the JLBC Staff to do the calculation. However, since it was the first time the JLBC Staff was doing the inflation adjustment they wanted the Committee to review the methodology they are using. They took the calendar year 2001Gross Domestic Product price deflator, which is required in statute and is consistent with the way the Economic Estimates Commission does the adjustment for the county expenditure limit. Applying this inflation adjustment, the county contribution for Proposition 204 administration costs is $5,118,200 and the JLBC Staff recommends a favorable review.

Representative Pickens asked what the breakdown is by each county. Ms. Vermeer said that she did not have that information with her but would provide it after the meeting.

Senator Bee moved that the Committee give a favorable review to the Calculation of Inflation for Transaction Privilege Tax County Withholding. The motion carried.

BOARD OF REGENTS (ABOR) - Review of Expenditure Plan for Additional FY 2003 Tuition Revenues.

Ms. Jill Young, JLBC Staff, said that pursuant to a footnote in the General Appropriation Act, ABOR is reporting on additional tuition collections beyond the appropriated amount and submitting an expenditure plan of those monies for Committee review. On page 2 of the JLBC memo is a breakdown of the $31.7 million of additional tuition by campus. The increases are attributable to an increase in tuition as approved by the ABOR in April 2002, enrollment growth, and the change in mix of resident versus non-resident students. At the bottom of page 2 it delineates how each campus proposes to utilize those funds. The JLBC Staff recommends a favorable review of this item.

Senator Bee moved the Committee give a favorable review of the Board of Regents expenditure plan for additional FY 2003 Tuition Revenues. The motion carried.

Representative Burton Cahill said at the August JLBC meeting there was an item on the agenda to approve the index for constructing new school facilities. It was going to be moved to the October meeting so the Committee would have the benefit of demographic data. She understands that it has to be reviewed yearly and noted that it was not on the October agenda.

Mr. Stavneak said the board had not submitted the information by October 1 when it was due. The JLBC Staff has just received the detail within the last week and it is a relatively extensive document in terms of their construction cost estimates.

Senator Solomon said the JLBC Staff has not had an opportunity to review the data, and she presumed the item will be on the November meeting agenda.

DEPARTMENT OF HEALTH SERVICES (DHS) - Review of Expenditure from the Vital Records Electronic Systems Fund.

Ms. Gina Guarascio, JLBC Staff, stated that DHS requests a review of the expenditure plan to spend $94,000 from the Vital Records Electronic Systems Fund that is required by statute. DHS would like to spend the $94,000 to hire a consultant to evaluate the needs of a new vital records system. The JLBC Staff recommends a favorable review for this item.

Representative Pickens asked who hires the consultant. Ms. Guarascio said she believes that DHS in conjunction with the Government Information Technology Agency (GITA) will hire the consultant.

Ms. Catherine Eden, Director of Department of Health Services, said that DHS will hire the consultant but would work with GITA to make sure they are compatible.

Mr. Stavneak said that this is 1 of a 2-part process. Part 2 is reviewing the whole plan after the consultant has designed it. Once it has been designed, they will then meet with GITA and GITA will have to approve it. It would then come back to the Committee for a review of the overall plan.

Representative Pearce said a lot of money is spent on outside consultants, and questioned why GITA is not being made the consultant.

Ms. Eden said she is in favor of in-house consultants, but in terms of this project DHS really needs someone who has vital records expertise to take them through the process.

Senator Bee moved the Committee give a favorable review of the Department of Health Services request to spend $94,000 from the Vital Records Electronic Systems Fund. The motion carried.

Senator Solomon asked Committee members to take a look at the report on implementation of self-insurance. There are concerns that have been raised by staff, Universities, and the Department of Administration and she would like everyone to look through the report.

Without objection, the meeting adjourned at 12:10 p.m.

Respectfully submitted:

_____
Cheryl Kestner, Secretary

_____
Richard Stavneak, Director

_____
Senator Ruth Solomon, Chairman

NOTE: A full tape recording of this meeting is available at the JLBC Staff Office, 1716 West Adams.

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CHRISTINE WEASON

DATE: October 17, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Jennifer Vermeer, Assistant Director

SUBJECT: JLBC STAFF - REVIEW OF CALCULATION OF INFLATION FOR TRANSACTION PRIVILEGE TAX COUNTY WITHHOLDING

Request

A.R.S. § 11-292P requires the JLBC Staff to calculate an inflation adjustment for the counties' contributions for Proposition 204 administration costs. This item does not technically require a review by the Committee as the statute requires the JLBC Staff to perform the calculation. However, since this is the first time this calculation is being made, the Staff requests the Committee review the methodology for the calculation.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of a $5,118,200 county contribution for Proposition 204 administration costs. Pursuant to A.R.S. § 11-292P, the calendar year 2001 Gross Domestic Product (GDP) price deflator was used in the calculation, consistent with the Economic Estimates Commission's calculation for county expenditure limits.

Analysis

The Proposition 204 program expanded coverage in the AHCCCS program up to 100% of the Federal Poverty Level. Prior to Proposition 204, counties retained responsibility for the health care costs for some individuals who did not qualify for AHCCCS. This responsibility was eliminated as part of the Proposition 204 legislation. In return, the counties were required to pay for some of the costs of the Proposition 204 program, including a contribution for administration costs. A.R.S. § 11-292P requires the State Treasurer to withhold $5,000,000 from the Transaction Privilege Tax (TPT) distribution to counties for these costs.

(Continued)

Beginning in FY 2003, A.R.S. § 11-292P also requires this amount to be adjusted for inflation as calculated by the JLBC Staff. The statute further specifies that the Gross Domestic Product (GDP) price deflator used in the calculation of county expenditure limits by the Economic Estimates Commission (EEC) be used as the inflation index for the calculation. In calculating the FY 2003 expenditure limits, the EEC used the calendar year 2001 GDP price deflator.

The Economic and Business Research Program at the University of Arizona estimate of the GDP price deflator for calendar year 2001 is 2.37%. Using this estimate, the inflation adjustment is $118,200. Thus, the total amount to be withheld for the county contribution for FY 2003 is $5,118,200.

The statute is not entirely clear about whether the inflation adjustment begins in FY 2003 or in the next fiscal year, FY 2004. We contacted Legislative Council for their interpretation and they opined that the adjustment begins in FY 2003. In FY 2004, a new adjustment for population begins. As a result, from FY 2004 onward the county contribution amount will be adjusted annually for both inflation and population growth.

RS/JV:lm

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CHRISTINE WEASON

DATE: October 16, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Jill Young, Fiscal Analyst
Lorenzo Martinez, Principal Fiscal Analyst

SUBJECT: ARIZONA BOARD OF REGENTS – REVIEW OF EXPENDITURE PLAN FOR ADDITIONAL FY 2003 TUITION REVENUES

Request

Pursuant to a footnote in the General Appropriation Act (Laws 2002, Chapter 327), the Arizona Board of Regents (ABOR) is submitting a report on FY 2003 tuition revenue amounts that are different from the amounts appropriated by the Legislature and expenditure plan for Committee review.

Recommendation

The JLBC Staff recommends a favorable review of the request.

Systemwide, FY 2003 tuition collections are estimated to be $31,665,100, or 13%, more than tuition amounts appropriated by the Legislature. The higher amount is due to increases in tuition approved by ABOR in April 2002, enrollment growth, and the mix of resident versus non-resident students.

Analysis

Footnotes in the General Appropriation Act (Laws 2002, Chapter 327) require ABOR to inform the Committee of any tuition revenue amounts that are different from the amounts appropriated by the Legislature to each university. The same footnotes also appropriate tuition collections above the appropriated amounts to each university for operating expenditures, capital outlay, and fixed charges.

An additional clause was added to the previous footnote (explained above) requiring ABOR to submit an expenditure plan for any tuition revenue amounts that are greater than the appropriated amounts to the JLBC for its review.

(Continued)

The following table shows the tuition amounts above (or below) the appropriated levels for each university.

Tuition Revenue Above/(Below) Appropriated Amounts	
ASU-Main	$18,818,200
ASU-East	523,400
ASU-West	2,305,500
NAU	(511,400) 1/
UofA-Main	9,653,300
UofA-Health Sciences Center	876,100
TOTAL	**$31,665,100**

1/ Technically NAU has a $4,511,400 decrease in collections, however, NAU received a $4 million General Fund increase to offset debt service payments paid by tuition revenue in FY 2003.

ABOR reports the increased amounts are due to increases in tuition approved by ABOR at its April 2002 meeting, enrollment growth, and the mix of resident versus non-resident students. The following table shows the changes in resident and non-resident tuition and fees from FY 2002 to FY 2003.

	Resident Tuition & Fees				Non-Resident Tuition & Fees			
	FY 2002	FY 2003	$ Change	% Change	FY 2002	FY 2003	$ Change	% Change
ASU	$2,486	$2,583	$97	3.9%	$10,352	$11,103	$751	7.3%
NAU	2,486	2,583	97	3.9%	9,328	10,079	751	8.1%
UofA	2,486	2,583	97	3.9%	10,352	11,103	751	7.3%

The additional amounts will be used to provide support for ongoing services and program enhancements. The following table shows the expenditure plan submitted by ABOR for the additional $31.7 million of tuition revenue in FY 2003.

Uses of Increased Tuition Revenues	
ASU-Main	Provides additional class sections and computing support for about 43,000 FTE students (an 1,800 increase over last year); supports an unfunded health insurance rate increase and a contingency for an estimated state collections shortfall; and enhancements in Law and Business programs supported from Special Program Fee Revenue.
ASU-East	Supports additional academic and student services staff to serve a growing student enrollment.
ASU-West	Supports a record high 5,053 FTE student enrollment by adding class sections; provides additional chairs/tables to maximize seating capacity in every classroom; and adds library resources and student services to address workload demands.
NAU	Reduction of $4 million is related to a General Fund offset for an increase in debt service payments with no negative impact on the overall operating budget.
UofA-Main	Supports increased electric & natural gas costs, operations and maintenance of facilities, library acquisitions, diversity and outreach improvements in response to NCA review.
UofA-Health Sciences Center	Supports instructional and academic support services.

RS:JY:ss

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CHRISTINE WEASON

DATE: October 17, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Gina Guarascio, Senior Fiscal Analyst

SUBJECT: DEPARTMENT OF HEALTH SERVICES – REVIEW OF EXPENDITURE FROM THE VITAL RECORDS ELECTRONIC SYSTEMS FUND

Request

Pursuant to Laws 2002, Chapter 160, the Department of Health Services requests review of a plan to spend $94,000 from the Vital Records Electronic Systems Fund for a consultant to evaluate the needs of a new system. Statute requires that prior to expenditure of monies from this fund for the purchase of new information technology, a detailed expenditure plan be submitted to JLBC for its review. DHS does not yet have a detailed expenditure plan, and will rely on the work of the consultant to develop a plan.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the plan to spend $94,000 from the Vital Records Electronic Systems Fund for a consultant to develop basic system requirements for a new information system for Vital Records. The department would then return to the Committee for a review of its detailed plan, once it is developed.

Analysis

Laws 2002, Chapter 160 authorized the creation of a Vital Records Electronic Systems Fund for the purpose of funding a new vital records information system. The fund receives revenues from a fee increase of $4 on requests for birth and death records. The chapter specifies that DHS must submit a detailed expenditure plan to JLBC for its review, after it receives approval from the Government Information Technology Agency (GITA). DHS does not yet have a detailed expenditure plan available. In order to develop this plan, DHS will rely on the work of a consultant. The consultant will determine the necessary business requirements for the new system. These requirements will help guide the purchase of both hardware and software for the project. DHS is requesting a favorable review of the plan to spend $94,000 for a consultant in order to develop a detailed plan. JLBC Staff recommends a favorable review of this expenditure.

RS/GG:ck

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CHRISTINE WEASON

DATE: October 17, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Stefan Shepherd, Senior Fiscal Analyst

SUBJECT: DEPARTMENT OF ECONOMIC SECURITY — ADJUSTMENTS TO GENERAL ASSISTANCE PROGRAM

Request

Pursuant to A.R.S. § 46-207, the Department of Economic Security (DES) requests that the Committee determine adjustments to the General Assistance (GA) program due to a projected insufficiency of funds in the program for FY 2003.

Recommendation

This item is for information only at the October meeting. It is the Chairman's intent that the Committee vote on the DES plan at the Committee's November meeting.

Analysis

The General Assistance program provides financial assistance to persons who are unemployable because of a physical or mental disability. Eligibility is limited to 12 months out of every 36-month period. Pursuant to changes in Laws 2002, Chapter 329 (the Health Omnibus Reconciliation Bill, or "ORB"), the department is required to provide GA benefits only to clients they believe will qualify for federal Supplemental Security Income (SSI) benefits. SSI provides cash benefits to low-income elderly, blind, or disabled persons.

The department received a FY 2003 appropriation of $2,130,400 General Fund (GF) for GA benefits. DES currently projects, however, a FY 2003 deficit of approximately $1.9 million GF. This deficit is expected to occur even after the department required each GA recipient to come into eligibility offices in mid-August to have their eligibility verified under the new requirements of the Health ORB. The deficit is the result of two issues: increasing caseloads and understimates of the percentage of clients continuing to be eligible under the new requirements. At the time the FY 2003 budget was finalized, it was assumed

(Continued)

that the GA caseload (without the new requirements) would be 2,600 clients. DES estimated that at least half of the clients would become ineligible for GA under the new requirements, reducing the caseload to 1,300 clients. However, by July 2002, the GA caseload had climbed to 3,719, or 43% higher than the 2,600-client level originally assumed. In addition, the new eligibility requirements have only reduced the caseloads by about 27%, not 50% or more as originally estimated.

DES is projecting that it will have a deficit of $(1,946,000) by the end of FY 2003 and that it will run out of money for the program by December.

A.R.S. § 46-207B states the following:

> "If the total monies available for payment of assistance grants are not sufficient to meet the maximum amount for which each applicant or recipient is eligible by law, the department shall notify the joint legislative budget committee of the insufficiency of monies and shall make recommendations on how to overcome the insufficiency. The department shall not recommend reductions of an equal amount from every grant in each category of assistance, but shall take into consideration the needs of the applicants or recipients, and shall recommend the reductions necessary by specifying the percentage of budgeted needs which may be met within the maximums established in accordance with subsection A of this section. The department shall make the adjustments determined by the joint legislative budget committee."

Pursuant to this requirement, the department has notified the Committee of its projected insufficiency of funds. There are several potential options available to the Committee:

1. Running the program until it has exhausted all funding: DES recommends this option.
2. Implementing a waiting list: This is the only other option mentioned by DES. DES does not favor this option because implementing a waiting list would require additional departmental resources.
3. Reduce benefits to some clients more than others: DES did not suggest this option. One problem with this option is that the GA population is relatively homogeneous, which would make it administratively difficult to develop a system for providing different levels of benefits based on non-financial criteria. We would note that persons for whom drug and alcohol abuse caused their disability are now no longer eligible for GA since they are ineligible to receive SSI.
4. Keep full benefits for first few months but then phase out benefits: DES also did not suggest this option. DES says most GA clients are more in crisis in the first few months of GA receipt.

We need to solicit additional legal advice as to whether all 4 options are permitted under statute. A.R.S. § 46-207B, however, does appear to give the Committee broad latitude in making changes to the General Assistance program.

The Chairman has placed this item on the Committee's October agenda for information only. It is the Chairman's intent to vote on the DES plan at the Committee's November meeting. In the interim, we would have another month of caseload data to confirm the current caseload trends and get additional input on any relevant legal issues. We would also have additional time to get information on SSI recoupments. This is important because the federal government pays back the state for all GA payments made to clients approved for SSI. Now that the GA population is theoretically composed only of clients expected to qualify for SSI, we would expect to see higher levels of SSI recoupments, thereby decreasing the program's General Fund costs. JLBC Staff also would like additional information on SSI approval and denial statistics for GA clients.

RS/SSh:jb

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CHRISTINE WEASON

DATE: October 17, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

SUBJECT: ARIZONA DEPARTMENT OF ADMINISTRATION/GOVERNMENT INFORMATION TECHNOLOGY AGENCY – REPORT ON HRMS REPLACEMENT PROJECT

Request

As part of the favorable review of the expenditure plan for the Human Resources/Payroll System, formally known as the Human Resources Information Solution (HRIS), the Arizona Department of Administration (ADOA) and the Government Information Technology Agency (GITA) are required to report back quarterly to provide information on the project.

Recommendation

This item is for information only and no Committee action is required. ADOA and GITA have submitted separate reports on the progress of the project. ADOA reports the project is "on time and on budget." GITA concurs with this assessment and will continue to closely monitor the project.

Analysis

The HRIS project is monitored by the project staff and GITA for progress in several different functional areas, which are assigned to the following:

- Project Administration group provides oversight of the implementation of the system and communication with the client agencies within the system. Functionality issues with the Department of Public Safety are reported to have been resolved. Similar issues with the Legislature and its component agencies are being resolved during October. This group is also researching the use of the current payroll and benefits data into the new system.

(Continued)

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CHRISTINE WEASON

DATE: October 17 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

SUBJECT: ARIZONA DEPARTMENT OF ADMINISTRATION — BIMONTHLY REPORT ON THE IMPLEMENTATION OF SELF-INSURANCE FOR STATE EMPLOYEE HEALTH INSURANCE

Request

As required by Laws 2002, 2nd Regular Session, Chapter 328, the Arizona Department of Administration (ADOA) has submitted the first bimonthly report on the implementation of self-insurance for the state employee health and dental insurance plans.

Recommendation

This report is for information only and no Committee action is required. ADOA reports that the project is proceeding as planned and that, barring any new legislative mandates on employee health insurance, they can comply with the provisions of A.R.S. § 38-651 requiring the department to self-insure health and dental coverage by October 1, 2003. ADOA notes that they would prefer to have an additional 3 months to ensure that the project is implemented thoroughly and efficiently. ADOA also believes delaying the implementation for 1 year should be considered to ensure the state is fiscally strong enough to handle the financial requirements of self-insurance.

While ADOA finds that self-insurance is consistent with the state's goals in providing quality, cost effective health care to employees/retirees while maintaining financial efficiency, ADOA does not believe self-insurance will reap any significant reduction in health/dental expenditures.

Analysis

Laws 2002, Chapter 328 amended A.R.S. § 38-651 to require ADOA to self-insure the medical and dental plans offered to state employees, and to implement those self-insured plans, with Committee approval, by October 1, 2003. This date coincides with the expiration of the current health and dental plan contracts.

(Continued)

ADOA began the process of implementing self-insurance in the last quarter of FY 2002. ADOA received an appropriation of $1.5 million from the Special Employee Health Insurance Trust Fund (HITF) in addition to their regular operating budget for health insurance administrative costs. Using those funds, ADOA contracted with Mercer Human Resources Consulting ("Mercer") to assist in the program implementation and organizational transition. ADOA reports that as of September 30, 2002, $151,100 of the $1.5 million has been expended, both for the project manager salary and Mercer costs.

ADOA formed the Self-Insurance Advisory Council (SIAC) consisting of representatives from 9 large agencies, the Supreme Court, the Arizona Board of Regents, the 3 universities, the Arizona State Retirement System/Public Safety Retirement System, the Governor's Office of Strategic Planning and Budgeting, JLBC Staff, House and Senate Staff, and a retiree representative. The first meeting of the SIAC occurred on August 6th and there have been 3 meetings since that time.

ADOA has identified 6 contracts necessary to implement self-insurance. These contracts are for medical services, dental services, pharmacy benefits management, utilization review/disease management, stop-loss insurance, and a third party administrator. The primary manager of a self-insurance program would be the third party administrator, who would monitor and integrate the implementation of the other 5 contracts. The medical services and dental services contracts would not be made directly with medical and dental services providers. Instead, the contracts would be made with existing medical and dental plans that have their own networks of providers. Similarly, the pharmacy benefits manager contract engages a network of affiliated pharmacies statewide, and will also provide a mail-order pharmacy service. The utilization review/disease management contract will assist in the medical management of severe or identified medical conditions and is staffed with medical personnel. Finally, the stop-loss insurance contract consists of insurance against extremely high cost medical conditions.

It is possible that all of the 6 contracts could be awarded to 1 service provider. ADOA indicates that the use of 6 separate contracts will allow the department to chose "best of class" providers that specialize in each of the 6 components of health care service. The department will have a better idea about the structure of the contracts when they receive responses to the Request for Proposals that will be offered by mid-November of this year. Those responses are expected to be received and analyzed by February 2003.

Under self-insurance, the role of ADOA is to manage all vendor activities and to pay all the actual claims that are incurred by state employees as they relate to their personal health and dental care. ADOA will continue in its current responsibilities: eligibility determination, payroll deduction, retirement deductions and/or direct payments, open enrollment, and the financial management of the HITF fund, as well as other benefit management activities such as provisions of life insurance, short- and long-term disability insurance, flexible spending accounts, vision coverage, and state employee day care center oversight.

ADOA has identified several issues that will affect their FY 2004 budget. Self-insurance will require an increased level of financial management, especially in the area of reconciliation of benefit claims and the analysis of those claims. While some of these responsibilities could be overseen by the third party administrator contract, the department feels that contract management is properly their responsibility. ADOA will also be responsible for increased vendor oversight, including significantly more reporting and performance standards associated with the 6 contracts. As part of its FY 2004 budget request, ADOA has requested an additional 8.5 FTE Positions and associated expenditures of $490,200 from the HITF fund.

A further issue associated with self-insurance is the appeals process, where state employees can appeal decisions about the provision of health care. In the current CIGNA contract, 1st and 2nd level appeals are handled internally by CIGNA; the 3rd appeal is heard by the Office of Administrative Hearings (OAH). Since the statutes that apply to CIGNA are not valid in a self-insured environment, ADOA has suggested 2 alternatives:

(Continued)

- Creating an arrangement with the OAH, with appeals past that point handled by the ADOA Director, or litigated in the Superior Court.
- Contracting with an Independent Review Organization that is staffed with medical professionals. This suggested review is medically based, but does not include the presence of the medically affected individual.

The department does not feel that this review function can be made part of the medical or dental services contract due to implicit conflict of a provider reviewing its own medical decisions. ADOA will continue to research these options and will report on their results in their next bimonthly report.

ADOA also is preparing contingency plans for health and dental insurance should the Legislature and the Executive agree that the implementation schedule is inappropriate. These options include renewing the existing CIGNA contract and delaying the implementation of self-insurance.

Finally, ADOA reports a "major concern" regarding the financial reserves necessary to fund contingencies associated with self-insurance. ADOA estimates, on the advice of actuaries, that reserves of 18%-26% of annual incurred claims are necessary for the financial stability of the program. This would imply reserves of approximately $72 million to $104 million, based on estimated annual claims of $400 million. ADOA estimates that the reserve build-up can occur in the course of the first fiscal year by utilizing the delay between the receipt of premiums and the expenditure of claims. While using this method will generate a significant cash balance in the HITF fund, this balance will be to some degree encumbered for the payment of future claims. This is a weakness in ADOA's proposal, since there is not a truly unencumbered reserve amount available for unanticipated contingencies.

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- The Business Functionality group implements the business process foundation for the operation of the system. This unit is preparing for integration testing and has successfully simulated the hiring and compensation of a hypothetical employee.
- The Technology group provides the technical foundation for the project. This group incorporates the various components of the system into a functional business product. Currently, this group is conducting increasingly comprehensive integration testing as well as preparing technical documentation.
- The Training Management group develops and implements the training curriculum for the project. Every state agency using the system has a designated Agency Training Facilitator (ATF), who will train their agency personnel in the use of the system. The process of training these individuals was begun over the summer. Agencies are monitored for their completion of these tasks and are notified when they are not on schedule.
- The Change Management group investigates and implements the steps necessary to implement changes from the current system into the new system. This group has delivered a document that outlines the prospective organization of payroll and benefits roles, both within ADOA and at the agencies, for review by the project management; this document is further reviewed by payroll and benefits consultants hired by the project. When approved, this document will be used to determine the training needs of the agencies. This group also notes those areas where solutions have not been agreed upon ("gaps"), which are monitored until resolution is achieved. This gap analysis will be further reviewed over the fall, with completion set for this December. A newsletter distributed by this group provides project information to agency personnel and, in a summarized form, to agency heads.

The project received a letter grade from the project contractor (IBM) of "B." The project is not encountering unforeseen problems. ADOA has not changed any of the implementation dates. The first phase of the project, generating paychecks with the new system, is scheduled to "go live" on April 14, 2003. Additional components of the system will be implemented in the first quarter of FY 2004.

GITA provided a separate update on the projects progress that notes the achievements cited by ADOA. GITA also believes that the project is on time and on budget. GITA indicates that the next phase of the project, integration testing, will take the most time and is the most complex series of tasks undertaken by the project to date. These tasks are shorter term in nature, but are more tedious and time sensitive.

According to GITA, the next phase of the project will involve the development of features and functions that are not currently available. To realize the efficiency gains of these new features, the HRIS project will need a marketing/educational plan that informs agencies about the capabilities of the new system.

In summary, GITA states that the project is "getting back on target" and that considerable progress has been made. GITA will continue to closely monitor the progress of the project.

RS:PS:ss

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CHRISTINE WEASON

DATE: October 16, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Jennifer Vermeer, Assistant Director

SUBJECT: AHCCCS - REPORT ON COST SHARING MEASURES

Request

Pursuant to a footnote in the General Appropriation Act, AHCCCS has submitted a report on cost sharing measures that could be added to the AHCCCS program.

Recommendation

This item is for information only and no Committee action is required. AHCCCS estimates a total maximum state savings of $14 million to $17.3 million if all of the cost sharing strategies are implemented. Federal approval of waivers is required in several instances, however, so any savings would not likely be realized until FY 2004.

While no Committee action is required, AHCCCS is requesting guidance on how to proceed with the cost sharing measures.

Analysis

A footnote in the General Appropriation Act requires AHCCCS to report by October 1, 2002 on savings that could be achieved if applications fees and other cost sharing measures were implemented. The report shall detail the saving associated with each option by program and any administrative costs associated with each option. AHCCCS's report includes increasing the amounts and types of copayments, implementing monthly premiums, and enrollment fees.

AHCCCS notes several important caveats on implementing any of the cost sharing arrangements.

- Federal Medicaid law and regulations limit the types of cost sharing options that can be implemented, the populations that can be charged, and the amounts that can be charged.

- Any revenue collected must be shared with the federal government at the Federal Matching Assistance Percentage (FMAP).
- Waivers are required to implement some of the cost sharing strategies discussed in the report. AHCCCS reports that waiver approval through the federal Centers for Medicare and Medicaid Services (CMS) would likely take 4-6 months. As a result, they project it may take until October 1, 2003 to implement these strategies.
- Under AHCCCS's current structure, any revenues collected through these strategies are retained by the providers. These payments are then deducted from the amount they receive in reimbursement or capitation rates. As a result, increasing cost sharing would not directly benefit the state. The savings would come through future decreases to capitation rates due to the increased revenue at the providers.
- Therefore, in order to generate immediate savings to the state, the capitation rates would need to be decreased prospectively. Otherwise, any savings would not be generated until some point in the future.

The following table summarizes the revenue estimates and important caveats for each of the cost sharing options.

Cost Sharing Arrangement	Maximum Potential Revenue	Comments
Copayments	$7 - $10.3 million (State Share)	• Federal law requires copays on the traditional Medicaid population to be nominal and must be waived if the enrollee cannot pay. • AHCCCS currently requires copays on some services. The experience in AZ and other states is a collection rate of 2%. • Copays cannot be imposed on certain services. • There is more flexibility for expansion populations (such as Proposition 204). • Federal law limits the amount that can be charged for copays. • A waiver would be required to deny services if copays are not paid. To date, CMS has not approved this type of waiver. (See page 4 of the report for detail on each proposed copay).
Monthly Premiums	$3.9 million (State Share)	*AHCCCS:* • No premium can be charged on traditional Medicaid populations. • Monthly premiums are currently charged in the KidsCare program and are allowed for adults in the KidsCare program (also known as HIFA parents) up to certain limits. • There is some flexibility to charge premiums on expansion populations (see page 5 of the report for more detail).
	$1.8 million (State Share)	*DD-ALTCS:* • Parental income is not counted toward eligibility in the Developmentally Disabled Long-Term Care program. Monthly premiums could be charged to this population. • A waiver is required (see page 7 of the report for more detail).
Enrollment Fees	$1.3 million (State Share)	• An enrollment fee would be charged to applicants when they are initially enrolled in the program. • The fee can apply to the Proposition 204 and KidsCare programs (children and adults). • This could result in people not applying when they are healthy and only enrolling when they become sick. This could have unknown consequences for providers and the AHCCCS program. (see page 7 of the report for more detail)
Total Collections	$14 – 17.3 million (State Share)	(See page 8 of the report for more detail)

RS/JV:lm

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CHRISTINE WEASON

DATE: October 17, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

FROM: Richard Stavneak, Director

SUBJECT: REPORT ON RECENT AGENCY SUBMISSIONS

Request

The JLBC has received a number of statutorily required reports during the past month. Each report is briefly described below.

Recommendation

The reports are for information only and no Committee action is required. We do not intend to discuss the reports at the JLBC meeting unless a member has a question. If any member knows in advance that they will have questions, we would appreciate knowing that before the meeting so as to ensure the relevant agency is available.

Reports

A. Board of Accountancy -Report on Plan to Reconcile Budget

Pursuant to a General Appropriation Act footnote, the Board of Accountancy is to report by June 30, 2002 to the JLBC on progress made in evaluating the equity of the board's fee structure in relation to asset management and a plan to bring agency expenditures in line with revenues. The Board submitted its report on October 4, 2002. The Board plans to maintain the current uniform fee structure so that the public is treated in a fair and equitable manner. Also, the Board is currently at its statutory limit for fees. The Board has established a task force to review the current fee structure.

The report does not outline any specific plan to bring expenditures into line with revenue beyond "good fiscal management." In FY 2002, expenditures exceeded on-going, non-cost recovery revenues by $90,000. The Board, however, used a prior year fund balance of $1,623,000 to keep their overall budget in balance. The imbalance of revenues and expenditures would have been worse, but the Board spent only 77% of its appropriation. The Board points out that it has a large fund balance due to cost recovery. The Board received cost recovery of $583,634 in FY 2001, $671,700 in FY 2002, and projects about $100,000 in FY 2003.

B. AHCCCS - Report on Medicaid in Public School Initiative Services Reimbursement

Pursuant to a General Appropriation Act footnote, the Arizona Health Care Cost Containment System (AHCCCS) is providing the annual report on the Medicaid in the Public Schools (MIPS) program. This program is designed to provide Title XIX covered services to special needs children in special education programs in public schools. As the Legislature requested, the report by AHCCCS gives an overview of the MIPS program, and also provides information on the services provided, the number of children being served, and the cost of these services.

As of June 30, 2002, over 9,000 children throughout Arizona are receiving services through the MIPS program. These services must be determined "medically necessary" by a health care professional. These children are eligible for nursing services, health aide services (attendant care), occupational therapy, speech therapy, physical therapy, and transportation services. In FY 2002 participating schools received a total of $19,052,200 in Medicaid Federal Financial Participation Funds. This total represents approximately 65% of the total cost of the services, while the remaining matching monies were provided by the participating schools. In addition, over $4 million was spent for the administration of the program, with half in the form of Federal monies, and half from participating schools.

C. Department of Economic Security - Bimonthly Report on Children Services

Pursuant to a General Appropriation Act footnote, the Department of Economic Security (DES) has submitted the bimonthly Children Services report for October 1. The report includes actual expenditure and caseload data through August 2002. Year-to-date expenditures total $8,143,900, which essentially reflect just one complete month of expenditures, since payments are generally made the month after services are provided. Although it is early in FY 2003, DES currently projects a General Fund deficit of $(9,597,200). August 2002 client counts are 4.1% (621 children) higher than August 2001 client counts.

Also, pursuant to a Committee request from the August meeting, DES has incorporated data on residential placement clients and expenditures in its report. The Committee asked DES to include this information as part of the Committee's review of the Department of Health Services' (DHS's) behavioral health capitation rate increase. DES expenditures for residential placement clients were $872,800 in July and $756,900 in August, though DES notes that not all provider payments may be included in these figures. These amounts show a continued decline from June, in which DES expenditures for residential placement clients totaled $1,022,900. These figures seem to indicate that DHS and the Regional Behavioral Health Authorities (RBHAs) continue to absorb more DES clients into its system as assumed in the capitation rate increase. DES expenditures, however, are still above the $450,000 to $500,000 per month level JLBC Staff assumed would remain after DHS and the RBHAs assumed more responsibility for these clients.

D Department of Emergency and Military Affairs - Report on Declared Emergencies

Pursuant to A.R.S. § 26-303, on August 22, 2002, the Governor amended the earlier proclamation of July 3, 2002 (PCA 23001) relating to a potable water shortage in Coconino and Gila Counties. The August amendment extended the proclamation to include support for Navajo County. Pursuant to A.R.S. § 35-192, the Governor directed that an additional sum of $30,000 from the General Fund be made available for expenditure by the Director of the State Division of Emergency Management. The proclamation in July had authorized the expenditure of $50,000. The total authorized expenditure for the emergency is $80,000.

Under A.R.S. § 35-192, the Governor is authorized to approve the expenditure of $200,000 or less for any single disaster or emergency. Authorization of larger expenditures cannot be made without consent of a majority of the members of the State Emergency Council. The total amount of all expenditures for States of Emergency cannot exceed $4,000,000 for any fiscal year. There have been four emergency

declarations, amendments or other actions in FY 2003 with total authorized expenditures of $3,492,500 from the General Fund.

E. Game and Fish Department - Report on Game and Fish Publications Revolving Fund

Pursuant to A.R.S. § 17-269(B), the Arizona Game and Fish Department (AGFD) is required to submit an annual report detailing all revenues and expenditures made from the department's Publications Revolving Fund.

The AGFD Publications Revolving Fund is established from monies received from the sale of publications relating to wildlife and the activities of the AGFD. Monies in the fund are appropriated to the AGFD to produce and distribute department publications and information. Any balance in excess of $80,000 immediately reverts to the Game and Fish Fund. Monies in the AGFD Publications Revolving Fund, up to an amount of $80,000 are exempt from the provisions relating to lapsing appropriations.

We received the report for the 4th quarter of FY 2002 on October 8, 2002. A summary of the AGFD Publications Revolving Fund cash balance for FY 2002 by quarter is shown below.

	1st Quarter	**2nd Quarter**	**3rd Quarter**	**4th Quarter**
Ending Balance (with Encumbrances)	**$37,500**	**$73,900**	**$12,200**	**$66,000**

F. Department of Health Services - Report on Transfer Allocation

At its August meeting, JLBC approved a transfer of $3,562,300 from the Seriously Emotionally Handicapped (SEH) Special Line Item in the Behavioral Health cost center of the Department of Health Services (DHS) budget to the Behavioral Health Operating Lump Sum. The General Appropriation Act for FY 2003 distributed the DHS lump sum reduction in each of the DHS cost centers operating budgets, excluding the Arizona State Hospital. DHS determined that they could best absorb the bulk of their lump sum reduction by transferring payment for services previously paid for through the SEH Line Item to the Title XIX program.

JLBC approved this transfer understanding additional transfers would be made through Department of Administration to cover the reductions that were taken in the operating lump sum appropriations in the other DHS cost centers in the General Appropriation Act. The Committee requested that DHS report on the amount of those additional transfers by September 25.

The following table summarizes the original lump sum reduction taken in each of the DHS cost centers, the amount transferred to each operating budget, and the net reduction absorbed by each operating lump sum budget.

Cost Center	Original Lump Sum Reduction	Transfers	Net Reduction
Administration	$(1,884,500)	$1,390,500	$(494,000)
Public Health	(947,500)	676,600	(270,900)
Family Health	(533,300)	381,000	(152,300)
Behavioral Health	(1,198,700)	1,114,200	(84,500)
	$(4,564,000)	$3,562,300	$(1,001,700)

G. JLBC Staff - Report on Analysis of Fee Equity

Pursuant to Laws 2002 Chapter 214, the Joint Legislative Budget Committee Staff is required to analyze the fees, assessments and taxes imposed by the Department of Insurance (DOI) and report to the Joint Legislative Budget Committee by October 1, 2002. The report must include an analysis of the actual costs of the services for which the fees are charged and a discussion of whether the fees are equitable. In its October 1 report, JLBC Staff analyzed insurance fees and assessments for FY 2002 using information provided by the Department of Insurance. The equity of insurance fees was determined by comparing the actual cost of providing DOI services with the fee revenue generated from different types of insurers and insurance professionals.

The results of the analysis indicate that a significant imbalance exists between costs and revenues in two areas. Fees collected for medical or hospital service corporations, health care services organizations (HMOs), or prepaid dental plan organizations were $8,250 while DOI's cost to administer these 22 organizations was $726,040. On the other hand, fees collected in FY 2002 for domestic life/disability reinsurers, and unaffiliated credit life/disability reinsurers were $1,190,725 compared to expenditures of $111,413.

Fee ranges applying to each type of insurer are set legislatively, rather than by DOI. A.R.S. ' 20-167 requires the Department of Insurance to revise its fees upward if the revenue collected from all fees during the prior fiscal year is less than 95% of the appropriated budget, or adjust its fees downward if it collects more than 110% of the appropriated budget for the current fiscal year. When making adjustments, DOI is required under A.R.S. ' 20-167 to adjust fees on a "uniform percentage basis among all fee categories." Thus, the department cannot adjust one fee without adjusting all other fees by the same percent. As a result, it is difficult to eliminate fee inequities without statutory changes.

In addition to the fees charged by the Department of Insurance, there is also a tax imposed on net insurance premiums received by insurance companies in the state. Except for a portion of the insurance premium tax on fire insurance premiums and an additional premium tax paid on vehicle insurance premiums, the proceeds from this tax are deposited into the state's General Fund. Over and above the $6.5 million in fee revenues collected for FY 2002, the Insurance Premium Tax generated $195.3 million in General Fund revenue for the fiscal year. Chapter 214 did not specify the type of analysis required for the Insurance Premium Tax. A recent study of insurance tax rates prepared by the PJB/Wakonda Group for the insurance industry is available upon request.

H. Department of Juvenile Corrections - Report on Overtime, Turnover, and Travel Stipend

Pursuant to a General Appropriation Act footnote, the Arizona Department of Juvenile Corrections (ADJC) is required to submit a report on its findings on the relationship between a travel stipend, turnover, and overtime pay.

In an effort to reduce turnover, improve recruitment, and maintain its recruitment competitiveness with the Arizona Department of Corrections (ADC) neighboring Lewis Complex, the ADJC implemented a $2,500 per year travel stipend for all Southwest Regional Complex (SWR) Staff in April 2000. In a subsequent review on the impacts of the travel stipend on turnover and overtime spending between FY 2000 and FY 2002, the department discovered the following:

- The turnover rate at SWR decreased 20% between FY 2000 and FY 2001.

- The percentage of employees citing job competitiveness as the reason for leaving the SWR fell from 52% to 28% in the two years following the stipend's implementation.

- The percentage of employee responses citing the institution's location as their reason for leaving SWR fell from 15% to 5% in the two years following the stipend's implementation.

However, total overtime expenditures per FTE Position at SWR increased by 15% between FY 2000 and FY 2001. ADJC reports this increase comes as a result of opening the Department's Parole Violator Center (PVC) at SWR. In February 2001, ADJC opened the Sunrise Mountain PVC to focus on youth who fail to comply with the conditions of their parole. During its first four months of operation, the PVC used SWR Staff, on an overtime basis, to provide support to the center. At this time SWR's overtime expenditures more than doubled, pushing annual expenditures per FTE Position past the prior year. However, ADJC reports that for the first 8 months of FY 2001 prior to the opening of the PVC, SWR's overtime usage was 24% below the FY 2000 level. The ADJC in some circumstances does not report the effect of the stipend in FY 2002.

I. State Parks Board - Report on Park Operating Expenditures

Pursuant to Laws 2002, 5th Special Session, Chapter 3 the Arizona State Parks Board is providing the park operating expenditure report for the quarter ending September 30, 2002.

This report is for information only and no Committee action is required. As part of legislation granting the Parks Board a $450,000 FY 2003 supplemental, the Legislature directed the Parks Board to submit to JLBC a report on the operating expenditures of each state park, on a quarterly basis. This submission meets this requirement.

Operating expenditures for the 28 state parks totaled $1,845,900 for the first quarter of FY 2003. Of this total, $1,561,400 (approximately 85%) was spent on Personal Services and ERE. Kartchner Caverns State Park represented approximately 20% of the total operating expenditures, and General Fund monies accounted for approximately 56% ($1,041,100) of the total quarterly spending. All State Parks are currently open.

RS:lm

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MARION L. PICKENS

DATE: November 20, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

SUBJECT: ARIZONA DEPARTMENT OF ADMINISTRATION – CONSIDER APPROVAL OF MILEAGE REIMBURSEMENT FOR STATE TRAVEL BY MOTOR VEHICLE

Request

In accordance with A.R.S. § 38-623D, the Arizona Department of Administration (ADOA) requests that the Committee approve the maximum mileage reimbursement rates. The change would be effective immediately after Committee approval. The rate is used to reimburse state employees who use their own vehicle while on official travel status.

Recommendation

The Committee has at least 2 options regarding this item:

- The Committee may choose to approve the rates as submitted, which would increase the cost of travel to the agencies, who will have to absorb the additional costs. ADOA estimates that the annual fiscal impact of these changes is $52,000 from the General Fund and $226,000 from all other funds in FY 2003, excluding the Universities.
- The Committee may choose to not approve the new rates, which has the effect of transferring some of the implied higher travel costs to employees.

Analysis

The federal government conducts an annual study based on market conditions across the nation including the cost of gasoline, repairs, maintenance, insurance, and depreciation It uses the data to update its travel reimbursement rates by November of each year. These rates are used by the Internal Revenue Service for tax purposes. ADOA compares Arizona's current rates to the federal rates and requests adjustments from the Joint Legislative Budget Committee. The federal government adjusted its mileage reimbursement rates to 36.5 cents per mile on January 1, 2002. At that time, ADOA did not believe an additional adjustment was necessary because of substantial decreases in the price of gasoline. Recent increases in gasoline prices have now provided justification for the proposed increase.

(Continued)

ADOA has requested that the increased reimbursement rate be effective immediately upon Committee approval. ADOA estimates impact of the new rates as an increase to the General Fund of $52,500 and an increase to all other appropriated and non-appropriated funds of $226,300 in FY 2003. ADOA utilized actual reimbursement amounts to estimate the impact. Those estimates did not include any cost data from the Universities, who do not utilize the ADOA accounting system.

RS:PS:ss

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DATE: November 20, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

SUBJECT: ARIZONA DEPARTMENT OF ADMINISTRATION – CONSIDER APPROVAL OF LODGING REIMBURSEMENT RATES

Request

In accordance with A.R.S. § 38-624C, the Arizona Department of Administration (ADOA) requests that the Committee approve changes to maximum lodging rates for state employees on official travel. The new rates would become effective immediately after Committee approval.

Recommendation

The Committee has at least 2 options regarding this item:

- The Committee may choose to approve the rates as submitted, which would increase the costs of travel to the agencies, who will have to absorb the additional costs. ADOA estimates that a partial estimate of the net General Fund impact of these changes is $4,700 in FY 2003. This estimate is based only on travel purchased through the state's contracted travel agency and we cannot extrapolate this amount to a statewide total. We do not have a reliable estimate of the percentage of travel purchased by the contracted travel agency, other travel agencies, or directly by the agency.
- The Committee may choose to not approve the new rates, which has the effect of transferring some of the implied higher travel costs to the employee.

Analysis

Lodging rates were last approved by the Committee on November 28, 2000. ADOA is requesting an increase of between $7.00 and $34.00 per night for out-of-state lodging in 7 selected cities so that the state's reimbursement rates match federal reimbursement rates. Those cities include Washington, D.C., with an increase of $31.00 per night (for a total rate of $150.00 per night); Seattle, WA, with an increase of $34.00 per night; and Denver, CO, Chicago IL, San Antonio TX, and Orlando, FL, with increases at or below $26.00 per night. ADOA is also requesting a decrease of between $(1.00) and $(33.00) per night in 35 out-of-state cities or seasonal rates to match federal reimbursement rates.

(Continued)

ADOA additionally requests an increase in the in-state lodging rates of $5.00 for the off-season rates in Casa Grande and a $10.00 increase for the City of Yuma, and requests decreases to the off-season rates for Chinle and the Grand Canyon.

ADOA estimates that the General Fund impact of the lodging changes will be an increase of approximately $4,700 in FY 2003. ADOA utilized actual lodging expenditures from FY 2002 and inferred a percentage increase from the proportion of trips to the affected cities. The cost data was derived from the travel agency on contract with the state, but the impact is probably understated because some travel arrangements are made without the use of the agency. Similarly, ADOA cannot provide an estimate of the costs to the Universities because the campuses manage accounting information independently.

RS:PS:ss

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DATE: November 20, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

SUBJECT: ARIZONA DEPARTMENT OF ADMINISTRATION – BIMONTHLY REPORT ON THE IMPLEMENTATION OF SELF-INSURANCE FOR STATE EMPLOYEE HEALTH INSURANCE

Request

As required by Laws 2002, 2nd Regular Session, Chapter 328, the Arizona Department of Administration (ADOA) has submitted the first bimonthly report on the implementation of self-insurance for the state employee health and dental insurance plans.

Recommendation

This report is for information only and no Committee action is required. ADOA reports that the project is proceeding as planned and that, barring any new legislative mandates on employee health insurance, they can comply with the provisions of A.R.S. § 38-651 requiring the department to self-insure health and dental coverage by October 1, 2003. ADOA notes that they would prefer to have an additional 3 months to ensure that the project is implemented thoroughly and efficiently. ADOA also believes delaying the implementation for 1 year should be considered to ensure the state is fiscally strong enough to handle the financial requirements of self-insurance.

Legislation drafted for a November Special Session includes language that would delay the implementation of self-insurance by 1 year, to October 1, 2004.

ADOA finds that self-insurance is consistent with the state's goals in providing quality, cost effective health care to employees/retirees while maintaining financial efficiency. Self-insurance should reduce health/dental expenditures by shifting the risk of larger than expected claims. In a fully insured plan, the insurer factors in a charge for that uncertainty; in a self-insured contract, the state assumes the risk for that uncertainty. ADOA has not estimated the cost savings for the elimination of the risk of uncertainty. Any savings resulting from the elimination of risk will only reduce the expected cost increase associated with medical inflation.

(Continued)

Analysis

Laws 2002, Chapter 328 amended A.R.S. § 38-651 to require ADOA to self-insure the medical and dental plans offered to state employees, and to implement those self-insured plans, with Committee approval, by October 1, 2003. This date coincides with the expiration of the current health and dental plan contracts.

ADOA began the process of implementing self-insurance in the last quarter of FY 2002. ADOA received an appropriation of $1.5 million from the Special Employee Health Insurance Trust Fund (HITF) in addition to their regular operating budget for health insurance administrative costs. Using those funds, ADOA contracted with Mercer Human Resources Consulting ("Mercer") to assist in the program implementation and organizational transition. ADOA reports that as of September 30, 2002, $151,100 of the $1.5 million has been expended, both for the project manager salary and Mercer costs.

ADOA formed the Self-Insurance Advisory Council (SIAC) consisting of representatives from 9 large agencies, the Supreme Court, the Arizona Board of Regents, the 3 universities, the Arizona State Retirement System/Public Safety Retirement System, the Governor's Office of Strategic Planning and Budgeting, JLBC Staff, House and Senate Staff, and a retiree representative. The first meeting of the SIAC occurred on August 6 and there have been 3 meetings since that time.

ADOA has identified 6 contracts necessary to implement self-insurance. These contracts are for medical services, dental services, pharmacy benefits management, utilization review/disease management, stop-loss insurance, and a third party administrator. The primary manager of a self-insurance program would be the third party administrator, who would monitor and integrate the implementation of the other 5 contracts. The medical services and dental services contracts would not be made directly with medical and dental services providers. Instead, contracts would be made with existing medical and dental plans that have their own networks of providers. Similarly, the pharmacy benefits manager contract engages a network of affiliated pharmacies statewide and will also provide a mail-order pharmacy service. The utilization review/disease management contract will assist in the medical management of severe or identified medical conditions and is staffed with medical personnel. Finally, the stop-loss insurance contract would consist of insurance against extremely high cost medical conditions.

It is possible that all of the 6 contracts could be awarded to 1 service provider. ADOA indicates that the use of 6 separate contracts will allow the department to choose "best of class" providers that specialize in each of the 6 components of health care service. The department will have a better idea about the structure of the contracts when they receive responses to the Request for Proposals that will be offered by mid-November of this year. Those responses are expected to be received and analyzed by February 2003.

Under self-insurance, the role of ADOA is to manage all vendor activities and to pay all the actual claims that are incurred by state employees as they relate to their personal health and dental care. ADOA will continue in its current responsibilities: eligibility determination, payroll deduction, retirement deductions and/or direct payments, open enrollment, and the financial management of the HITF fund, as well as other benefit management activities such as provisions of life insurance, short- and long-term disability insurance, flexible spending accounts, vision coverage, and state employee day care center oversight.

ADOA has identified several issues that will affect their FY 2004 budget. Self-insurance will require an increased level of financial management, especially in the area of reconciliation of benefit claims and the analysis of those claims. While some of these responsibilities could be overseen by the third party administrator contract, the department feels that contract management is properly their responsibility.

(Continued)

ADOA will also be responsible for increased vendor oversight, including significantly more reporting and performance standards associated with the 6 contracts. As part of its FY 2004 budget request, ADOA has requested an additional 8.5 FTE Positions and associated expenditures of $490,200 from the HITF fund.

A further issue associated with self-insurance is the appeals process, where state employees can appeal decisions about the provision of health care. In the current CIGNA contract, first and second level appeals are handled internally by CIGNA; the third appeal is heard by the Office of Administrative Hearings (OAH). Since the statutes that apply to CIGNA are not valid in a self-insured environment, ADOA has suggested 2 alternatives:

- Creating an arrangement with the OAH, with appeals past that point handled by the ADOA Director, or litigated in the Superior Court.
- Contracting with an Independent Review Organization that is staffed with medical professionals. This suggested review is medically based, but does not include the presence of the medically affected individual.

The department does not feel that this review function can be made part of the medical or dental services contract due to implicit conflict of a provider reviewing its own medical decisions. ADOA will continue to research these options and will report on their results in their next bimonthly report.

ADOA also is preparing contingency plans for health and dental insurance should the Legislature and the Executive agree that the implementation schedule is inappropriate. These options include renewing the existing CIGNA contract and delaying the implementation of self-insurance.

Finally, ADOA reports a “major concern” regarding the financial reserves necessary to fund contingencies associated with self-insurance. ADOA estimates, on the advice of actuaries, that reserves of 18%-26% of annual incurred claims are necessary for the financial stability of the program. This would imply reserves of approximately $72 million to $104 million, based on estimated annual claims of $400 million. ADOA estimates that the reserve build-up can occur in the course of the first fiscal year by utilizing the delay between the receipt of premiums and the expenditure of claims. While using this method will generate a significant cash balance in the HITF fund, this balance will be to some degree encumbered for the payment of future claims. There is not a truly unencumbered reserve amount available for unanticipated contingencies. We have requested information on the level of unencumbered reserves in other states.

RS:PS:ss

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DATE: November 18, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Jake Corey, Fiscal Analyst

SUBJECT: SCHOOL FACILITIES BOARD – CONSIDER APPROVAL OF INFLATION INDEX

Request

The School Facilities Board (SFB) requests that the Committee approve an increase of 4.8% in the cost-per-square foot factors used in its building renewal and new school construction financing formulas, based on the Marshall Valuation Service (MVS) construction cost index for July 2002. The 4.8% adjustment would take effect for new school construction in FY 2003. The adjustment for building renewal would be scheduled to take place in FY 2004. Laws 2002, Chapter 330, however, suspended the building renewal formula in that year. In February 2000, the Committee selected the MVS index as a benchmark for adjusting the cost-per-square-foot figures each year.

At the August 2002 meeting, the Committee considered approval of an inflation index. The Committee considered many options at the meeting, including 1) a 4.8% increase based on the MVS construction cost index for July 2002; 2) a 1.0% increase, which is equal to the Gross Domestic Product (GDP) price deflator for FY 2002; 3) a 0.6% increase, which is equal to the inflation increase that was adopted in FY 2002; and 4) no inflation increase. The Committee did not take action at the August meeting, opting instead to defer any decision until SFB had submitted to JLBC Staff its new school construction report for FY 2004.

Recommendation

The Committee has at least four options:

1) Approve a 4.8% increase in the cost-per-square-foot factors used in the building renewal and new school construction financing formulas based on the MVS index. The index, which the Committee has used in the past, would cost $9.4 million in FY 2004. A.R.S. § 15-2041D.3c requires the cost-per-square-foot to be adjusted "for construction market considerations."

(Continued)

2) Approve a 1% increase in the cost-per-square-foot factors used in the building renewal and new school construction financing formulas. This increase is equal to the Gross Domestic Product (GDP) price deflator for FY 2002. This option would cost $2 million in FY 2004, but is not based on a construction-specific inflation index.

3) Approve a 0.6% increase in the cost-per-square-foot factors used in the building renewal and new school construction financing formulas based on the MVS index for the period July 1, 2000 to June 30, 2001. The Committee selected this as the adjustment for FY 2002 at the August 2001 meeting. This option would cost $1.2 million in FY 2004.

4) Do not approve an increase in the cost-per-square-foot factors used in the building renewal and new school construction financing formulas. This option, which would require the Legislature to notwithstand the statutory indexing requirement in session law, would have no cost in FY 2004.

The Committee wanted to receive more information from the SFB new school construction report on demographic assumptions, proposed construction schedule and new school construction costs before approving an index. According to the report, SFB plans to spend about $391 million on new construction projects in FY 2003 and about $229 million in FY 2004.

Analysis

This section includes 1) background information regarding the SFB inflation index, 2) an explanation of the options available for the current index, 3) a summary of the estimated impact of each option on the state, and 4) a discussion of the new school construction report.

Background Information

The original Students FIRST legislation (Laws 1998, Chapter 1, 5th Special Session) established funding amounts per square foot of space for new construction and building renewal (e.g., $90 per square foot for Grades K-6). It required, however, that those amounts be adjusted periodically for inflation (A.R.S. § 15-2041D.3c). The latter provision states that the funding amount per square foot "shall be adjusted annually for construction market considerations based on an index identified or developed by the Joint Legislative Budget Committee as necessary but not less than once each year."

At its February 2000 meeting, the Committee approved the MVS construction cost index for Class C structures (masonry bearing walls) for Phoenix for the period from July 1 through June 30 of each year. At that time, the relevant MVS index was 3.5%, so the Committee approved that index for the subsequent budgetary period. Later that year (during September 2000), the Committee approved an additional 4.6% "catch up" increase based on revised data from MVS.

At its August 2001 meeting, the Committee again used the MVS index for Class C structures. At that time, the relevant MVS index was 0.6%.

Options for the Current Index

The MVS index for "Class C – Masonry Bearing Walls" structures for Phoenix for the period from July 1, 2001 through June 30, 2002 is 4.8%. Approving this option would be consistent with past decisions of the Committee. It would require, however, a greater increase in expenditures of the 2 options. In addition, the MVS only provides information on buildings in the city of Phoenix. We do not have information on the index for areas in Arizona outside of Phoenix. Therefore, we do not know how accurate the index is statewide.

(Continued)

A 1% increase would equal the GDP deflator for FY 2002. Though this option is not specifically tied to a construction index, it is a standard inflationary index and it is used to adjust K-12 maintenance and operations funding.

It should be noted that both of the above options are based on inflation that has occurred in the past. Neither of the measures is prospective.

The current cost-per-square-foot factors, and what those factors would become according to each of the above two options, are presented in the table below.

SFB Cost Per Square Foot Factors
Current and Proposed

	Urban Cost/Sq. Ft.			Rural Cost/Sq. Ft. (Urban * 1.05)		
Grade Level	Current	Proposed		Current	Proposed	
		4.8%	1.0%		4.8%	1.0%
Preschool w/Disabilities & K-6	$98.01	$102.71	$98.99	$102.91	$107.85	$103.94
Grades 7-8	$103.47	$108.44	$104.50	$108.64	$113.85	$109.73
Grades 9-12	$119.80	$125.55	$121.00	$125.79	$131.83	$127.05

In addition to the above 2 options, the Committee also considered a 0.6% increase at the August meeting, which is equal to the previous year adjustment.

Affect on State Budget for K-12 Building Renewal

There would be no affect on the Building Renewal Fund in FY 2003 or FY 2004 no matter what index is approved. Laws 2002, Chapter 330 suspended the building renewal formula in those years and determined a building renewal distribution amount of $38,274,100 in FY 2003.

Affect on State Budget for New School Construction

The SFB assumes that an increase in the cost-per-square-foot factors *would* affect costs for new school construction during FY 2003. If a 4.8% increase were approved, the estimated fiscal impact for this change for FY 2003 would be $495,600. SFB indicates that the new factors would increase the cost of new school construction by approximately $9,912,800 to be spread over FY 2003 and FY 2004. Based on the typical funding flow for new school facilities, only about 5% of that sum**C**$495,600**C**would be expended in FY 2003. The remainder (estimated at $9,417,200) would be expended in FY 2004, with some expenditure possibly slipping into FY 2005.

Assuming a 10% increase, the estimated fiscal impact for FY 2003 would be $103,300. The impact in FY 2004 (with again the possibility of some expenditures in FY 2005) would be $1,961,900 in this scenario. The total impact, therefore, would be $2,065,200.

Laws 2002, Chapter 330 give SFB authority to conduct lease-to-own transactions in an amount not to exceed $400 million. Because the costs arising from the new construction cost factor are small compared with the total funding required for new construction in FY 2003, costs may be able to be absorbed within the existing amounts set aside in the budget for this year. Either inflation adjustment, however, would affect SFB's FY 2004 estimated funding.

(Continued)

New School Construction Report

A.R.S. § 15-2002A.13 requires SFB to submit its demographic assumptions, proposed construction schedule, and new school construction cost estimates for the following fiscal year to the Joint Committee on Capital Review. *Attachment 1* is the JLBC Staff preliminary analysis associated with that report. As the analysis indicates, SFB analyzes district enrollment figures on a case by case basis. The board, therefore, did not include any statewide student enrollment projections in the report. Based on historical data, JLBC Staff estimates statewide district enrollment to grow by 2.3% in FY 2003 and 2.4% in FY 2004. This is about equal to the FY 2002 growth rate of 2.4%. The growth rate for FY 2002 is slightly inflated, however, due to the inclusion, for the first time, of Joint Technology Education District (JTED) students in the data. Excluding those students, student enrollment grew by 1.8% in FY 2002.

Also included in the report is the board's projected funding of new school construction projects by year. The board expects to spend approximately $391 million on new projects in FY 2003 and about $229 million in FY 2004. As noted in the analysis, however, SFB may be projecting some FY 2003 expenditures that will actually occur in FY 2004.

RS:JC:ss

STATE COMPENSATION FUND - Consider Approval of Calendar Year 2003 and 2004 Budgets.

This will be distributed under separate cover or may be deferred to the December meeting.

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DATE: November 20, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Stefan Shepherd, Senior Fiscal Analyst

SUBJECT: DEPARTMENT OF ECONOMIC SECURITY -– DETERMINE ADJUSTMENTS TO GENERAL ASSISTANCE PROGRAM

Request

Pursuant to A.R.S. § 46-207, the Department of Economic Security (DES) requests that the Committee determine adjustments to the General Assistance (GA) program due to a projected insufficiency of funds in the program for FY 2003.

Recommendation

A.R.S. § 46-207 states that DES shall make adjustments to the GA program as determined by the Committee. There are several potential options available to the Committee:

1. Running the program until it has exhausted all funding.
2. Implementing a waiting list.
3. Reducing benefits to some clients more than others.
4. Keeping full benefits for first few months but then phasing out benefits.

Legislative Council has indicated that the Committee has broad latitude in making changes to the program and that the Committee's changes can supersede other statutory language.

Analysis

The General Assistance program provides financial assistance to persons who are unemployable because of a physical or mental disability. Eligibility is limited to 12 months out of every 36-month period. Pursuant to changes in Laws 2002, Chapter 329 (the Health Omnibus Reconciliation Bill, or "ORB"), the department is required to provide GA benefits only to clients they believe will qualify for federal Supplemental Security Income (SSI) benefits. SSI provides cash benefits to low-income elderly, blind, or disabled persons.

The department received a FY 2003 appropriation of $2,130,400 General Fund (GF) for GA benefits. DES currently projects, however, a FY 2003 deficit of approximately $3.0 million GF. This deficit is expected to

(Continued)

occur even after the department required each GA recipient to come into eligibility offices in mid-August to have their eligibility verified under the new requirements of the Health ORB. The deficit is the result of two issues: increasing caseloads and understimates of the percentage of clients continuing to be eligible under the new requirements. At the time the FY 2003 budget was finalized, it was assumed that the GA caseload (without the new requirements) would be 2,600 clients. DES estimated that at least half of the clients would become ineligible for GA under the new requirements, reducing the caseload to 1,300 clients. However, by July 2002, the GA caseload had climbed to 3,719, or 43% higher than the 2,600-client level originally assumed. In addition, the new eligibility requirements have only reduced the caseloads by about 18%, not 50% or more as originally estimated. In October 2002 there were 3,040 GA cases.

DES is projecting that it will have a deficit of $(2,967,900) by the end of FY 2003 and that it will run out of money for the program by December.

A.R.S. § 46-207B states the following:

> "If the total monies available for payment of assistance grants are not sufficient to meet the maximum amount for which each applicant or recipient is eligible by law, the department shall notify the joint legislative budget committee of the insufficiency of monies and shall make recommendations on how to overcome the insufficiency. The department shall not recommend reductions of an equal amount from every grant in each category of assistance, but shall take into consideration the needs of the applicants or recipients, and shall recommend the reductions necessary by specifying the percentage of budgeted needs which may be met within the maximums established in accordance with subsection A of this section. The department shall make the adjustments determined by the joint legislative budget committee."

Pursuant to this requirement, the department has notified the Committee of its projected insufficiency of funds. There are several potential options available to the Committee:

1. Running the program until it has exhausted all funding: DES recommends this option.
2. Implementing a waiting list: This is the only other option mentioned by DES. DES does not favor this option because implementing a waiting list would require additional departmental resources.
3. Reducing benefits to some clients more than others: DES did not suggest this option. One problem with this option is that the GA population is relatively homogeneous, which would make it administratively difficult to develop a system for providing different levels of benefits based on non-financial criteria. We would note that persons for whom drug and alcohol abuse caused their disability are now no longer eligible for GA since they are ineligible to receive SSI.
4. Keeping full benefits for first few months but then phasing out benefits: DES also did not suggest this option. DES says most GA clients are more in crisis in the first few months of GA receipt.

Legislative Council has indicated that even if DES' recommended option of running the program until funding is exhausted did not meet the statutory requirement that DES "not recommend reductions of an equal amount from every grant in each category of assistance, but shall take into consideration the needs of the applicants or recipients," the Committee is not bound by this requirement. The Committee, in other words, has the authority to require that DES make reductions of an equal amount from every grant. Legislative Council has also indicated that A.R.S. § 46-207B gives the Committee broad latitude in making changes to the General Assistance program and that the changes can supersede other statutory language regarding General Assistance.

We have asked DES for additional information on SSI recoupments, approvals, and denials. This is important because the federal government pays back the state for all GA payments made to clients approved for SSI. Now that the GA population is theoretically composed only of clients expected to qualify for SSI, we would expect to see higher levels of SSI recoupments, thereby decreasing the program's General Fund costs. DES did not have this information in time for this memorandum, but will have it by the Committee meeting.

RS/SSh:jb

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DATE: November 18, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Jill Young, Fiscal Analyst

SUBJECT: COMMISSION FOR POSTSECONDARY EDUCATION – CONSIDER APPROVAL OF REQUESTED TRANSFER OF APPROPRIATIONS

Request

The Commission for Postsecondary Education requests Committee approval to transfer appropriations in FY 2003. Specifically, the Commission requests to transfer $52,500 as shown below:

TRANSFER FROM:		TRANSFER TO:	
Family College Savings Program SLI	$48,700	Personal Services	$42,600
College and Career Guide SLI	3,800	Employee Related Expenditures	9,900
TOTAL	$52,500	TOTAL	$52,500

Recommendation

The JLBC Staff recommends that the Committee approve the agency request.

Analysis

The Commission's budget format for FY 2003 is Modified Lump Sum by Agency with Special Line Items. Pursuant to A.R.S. § 35-173E, this budget format requires the Committee to approve any transfer to or from Personal Services and Employee Related Expenditures (ERE) from or to any other budget program or expenditure class.

This transfer is necessary to offset a $(100,000) General Fund reduction in general administration enacted in the last regular session and is consistent with the intent at the time of enactment. The monies being transferred from the Family College Savings Program SLI are administration dollars that will be used on that program as well as other programs.

RS:JY:ss

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MARION L. PICKENS

DATE: November 19, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Kim Hohman, Fiscal Analyst

SUBJECT: ATTORNEY GENERAL – REVIEW ALLOCATION OF SETTLEMENT MONIES

Request

Pursuant to a footnote in the General Appropriation Act, the Office of the Attorney General (AG) has notified the Committee of the allocation of monies to be received from 4 settlement agreements.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the allocation plan for the following 2 settlements: Sears, Roebuck Company and Household Finance Corporation.

In addition to the 2 above mentioned settlements, the AG has notified the Committee of settlement agreements with Salton, Inc and with music distributors involved in antitrust litigation, but distribution plans for these settlement monies have not yet been determined. As the intent of the General Appropriation Act footnote is for the Committee to advise the AG on the distribution of settlement monies, the JLBC Staff recommends that the Committee defer review of these 2 settlements until we have more information on the specific distribution plans.

Analysis

The FY 2002 and 2003 General Appropriation Act contains a footnote that requires JLBC review of the allocation or expenditure plan for settlement monies over $100,000 received by the Attorney General or any other person on behalf of the State of Arizona, and specifies that the Attorney General shall not allocate or expend these monies until the JLBC reviews the allocations or expenditures. Settlements that are deposited in the General Fund pursuant to statute do not require JLBC review.

Consumer Fraud
The Office of the Attorney General recently settled 2 consumer fraud cases that will result in the receipt of settlement monies over $100,000. The first case involved violations of the Arizona Consumer Fraud

(Continued)

Act by Sears, Roebuck and Co. related to a 1993 court order directing the company to clearly post maintenance agreement signs in both English and Spanish. The original court order required the company to specify that Sears' maintenance agreements cannot be obtained in Mexico, and can only be performed in an authorized service center in the United States. In the settlement agreement, Sears agreed to pay a total of $200,000 for investigative costs, attorneys' fees, and civil penalties. Pursuant to A.R.S. § 44-1531.01, these monies will be deposited in the Consumer Fraud Revolving Fund. Monies in this fund are used for consumer fraud education, investigations and enforcement operations.

The second settlement involved violations by Household Finance Corporation related to the company's alleged unfair and deceptive lending practices. The complaining states alleged that Household violated state laws by misrepresenting loan terms and failing to disclose material information to borrowers. In the settlement agreement, Household agreed to pay up to $484 million in restitution, of which approximately $5.4 million represents restitution to Arizona consumers. These monies will be distributed directly to consumers by a national administrator, utilizing a formula not yet determined. In addition to restitution, Household Finance agreed to pay the participating states up to $10.2 million for attorney costs and fees. The amount paid to Arizona has not been determined, but the AG's Office estimates that it will be no less than $200,000 and will be deposited in the Consumer Fraud Revolving Fund.

Antitrust

A third settlement involved violations by numerous music distributors and retailers related to illegal practices intended to raise the price of prerecorded music. Pursuant to the settlement agreement, the companies agreed to pay a total of $67.4 million for the payment of attorneys fees and direct distribution to consumers in each settling jurisdiction, and to provide approximately 5.5 million music CDs for distribution by the state Attorneys General for the benefit of consumers in each state.

The court has not yet determined the amount each state will receive in recovered attorney expenses, but the Arizona AG's Office estimates that the state will receive approximately 99,500 CDs for distribution to nonprofit and government entities selected by the Arizona Attorney General. In addition, injured consumers will be allowed to file claims for direct cash distribution. The amount of cash available to Arizona consumers depends on the number of claims filed. If the number of claims exceeds the amount of funds available, Arizona will receive $896,348 to be distributed in a manner to benefit consumers throughout the state. In this scenario, the participating states will submit distribution plans for the court's approval. Any recovered attorney expenses will be deposited in the Arizona Attorney General's Anti-Trust Revolving Fund.

The JLBC Staff recommends that the Committee review this settlement when the AG can provide a specific distribution plan for the 99,500 CDs. In addition, the JLBC Staff requests that the AG provide the Committee with a cash distribution plan if the number of claims exceeds the funds available.

A fourth settlement involved violations of federal and state antitrust laws by Salton, Inc., which is the manufacturer of the "George Foreman" indoor grill. The settling jurisdictions complained that Salton Inc. arranged an illegal resale price maintenance scheme that prevented retailers from discounting prices, and excluded rivals from the marketplace. Salton agreed to pay approximately $8.2 million over 3 years, of which approximately $145,800 will be paid to the State of Arizona and distributed in a manner to benefit consumers throughout the state. The participating states are required to submit a distribution plan for approval by the courts, but a deadline for these plans has not yet been determined. Since the AG's Office has not finalized a distribution plan for the settlement monies, the JLBC Staff recommends that the committee review the plan as soon as it is available.

RS/KH:ck

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DATE: November 19, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Kim Hohman, Fiscal Analyst

SUBJECT: ATTORNEY GENERAL – REVIEW OF EXPENDITURE PLAN FOR ANTITRUST ENFORCEMENT REVOLVING FUND

Request

Pursuant to a footnote in the General Appropriation Act (GAA), the Office of the Attorney General (AG) has notified the Committee of the allocation of monies to be received from a recent antitrust settlement agreement. Pursuant to a second GAA footnote, the AG requests Committee review of its expenditure plan to spend an additional $266,200 from the Antitrust Enforcement Revolving Fund in FY 2003.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the allocation plan for the recent settlement with Stericycle, Inc., as well as the request to spend additional revenue from the Antitrust Enforcement Revolving Fund in FY 2003. The expenditure plan follows the use of monies outlined in statute and will enable the agency to fulfill its payroll and operating obligations through FY 2003.

Analysis

The FY 2002 and 2003 General Appropriation Act contains a footnote that requires JLBC review of the allocation or expenditure plan for settlement monies over $100,000 received by the Attorney General or any other person on behalf of the State of Arizona, and specifies that the Attorney General shall not allocate or expend these monies until the JLBC reviews the allocations or expenditures. Settlements that are deposited in the General Fund pursuant to statute do not require JLBC review.

The Office of the Attorney General recently settled a case that will result in the receipt of settlement monies over $100,000. The case involved violations of state antitrust laws by Stericycle, Inc., related to the company's anti-competitive practices in the transportation of chemotherapy waste. In the settlement agreement, Stericycle Inc. agreed to pay the State of Arizona $320,000 in civil penalties and attorneys' fees over 3 years. Of this amount, the AG estimates that approximately $120,000 will be deposited in the Antitrust Enforcement Revolving Fund and $200,000 will be deposited in the General Fund.

Pursuant to A.R.S. § 41-191.01, any monies received as cost reimbursement of antitrust litigation are deposited in the Anti-Trust Enforcement Revolving Fund. The first installment of $75,000 was deposited in the fund on September 27, 2002. The AG estimates an additional $45,000 will be deposited before the end of FY 2003. Statute also requires any monies received in addition to the reimbursement of legal expenses to be deposited in the General Fund, unless the settlement agreement specifies otherwise. The AG's Office estimates that the remaining $200,000 of the settlement amount will be deposited in the General Fund over 3 years.

Pursuant to a footnote in the FY 2003 General Appropriation Act, before the expenditure of any Antitrust Enforcement Revolving Fund receipts in excess of $138,800 in FY 2003, the AG must submit an expenditure plan for review by the Committee. The footnote specifies that any monies in excess of $138,800 are appropriated, but the expenditure plan for the additional revenue must be reviewed prior to any expenditures. In FY 2003, the agency estimates that the Antitrust Enforcement Revolving Fund will receive approximately $157,800 in revenue (the Stericycle, Inc. agreement is included in this estimate). In addition to new revenue, the agency has requested to spend an additional $108,400 from the existing fund balance, for an increase of $266,200 over the fund's original FY 2003 appropriation of $138,800. The agency is now estimating total Antitrust Enforcement Revolving Fund expenditures of $405,000 for FY 2003. (*See table below for comparison of FY 2002 and FY 2003 expenditures from the fund.*)

Pursuant to A.R.S. § 41-191.02, monies in the Antitrust Enforcement Revolving Fund are used for court costs and investigative expenses related to the enforcement of antitrust laws, except monies in the fund cannot be used for attorney compensation. The AG plans to expend $405,000 for personnel costs, operating expenses, investigative and court costs, and a statutorily required report on fuel prices in the Phoenix and Tucson areas. The AG is required to compile and save data on average rack fuel prices for the Phoenix and Tucson petroleum pipeline terminals as well as the average dealer tank wagon prices for Phoenix and Tucson on a weekly basis.

The following is a breakout of the agency's FY 2002 expenditures from the fund as well as the intended expenditures for FY 2003:

Antitrust Enforcement Revolving Fund Expenditures

	FY 2002	FY 2003
FTE Positions [1/]	5.0	6.0
Personnel Costs	$214,400	$265,200
Investigative/Court Costs for Multi-State Cases	45,000	45,000
Automotive Report [2/]	34,000	34,200
Operating Expenses	68,200	60,600
	$361,600	$405,000

1/ Includes the following positions in FY 2003: Economist, Financial Investigator, Legal Assistant III, Legal Assistant II, and 2 Legal Secretaries.
2/ Required by Statute.

The additional monies will provide the AG with the resources to pay investigative and court costs associated with future antitrust cases, as well as fulfill its payroll and operating obligations through FY 2003. This expenditure plan follows the intent of monies appropriated to the Antitrust Enforcement Revolving Fund and the JLBC Staff recommends a favorable review.

RS/KH:ck

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DATE: November 18, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Jill Young, Fiscal Analyst

SUBJECT: ARIZONA LEARNING SYSTEMS/COMMUNITY COLLEGES – DISBURSEMENT OF ARIZONA LEARNING SYSTEMS EQUIPMENT

Request

Pursuant to a footnote in the General Appropriation Act (Laws 2002, Chapter 327), Arizona Learning Systems (ALS) terminated at the end of August 2002 and the JLBC is responsible to direct the disbursement of ALS state-funded assets. State-funded assets include video and telecommunications equipment at one site in each of the 10 community college districts and hub equipment housed at Rio Salado Community College in the Maricopa County Community College District (MCCCD).

At its meeting held on August 22, 2002, the Joint Legislative Budget Committee (JLBC) deferred action on the disbursement of ALS state-funded assets until it received additional information. The JLBC has received reports from the 10 community college districts, the Arizona University System, and the Government Information Technology Agency (GITA).

Recommendation

The Committee is required to direct the disbursement of ALS state-funded assets, which include 10 sets of video and telecommunications equipment and hub equipment. In this, the Committee has at least 3 options:

1. Allow the community college districts to retain all or part of the equipment as proposed by each community college district.

2. Transfer possession of all or part of the ALS equipment to the University of Arizona Health Sciences Center for collaborative use by the Arizona University System per their proposal.

(Continued)

3. Sell all or part of the equipment. We do not have a precise estimate of the current value of these assets, but the sale could possibly generate $300,000. This is generally considered a last resort as articulated in the GITA letter.

In any of the options before the Committee, there may be equipment that cannot be utilized. JLBC Staff, therefore, recommends that any equipment that cannot be utilized be sold and the funds returned to the General Fund.

JLBC Staff further recommends that the ALS Executive Director be retained for 90 days to carry out the disbursement decision of the Committee and any related activities necessary to dismantle the network and that the director submit a follow-up report within 75 days on the transition process, expenditures, and remaining funds from ALS appropriations to be reverted to the General Fund.

Analysis

The Committee heard this item at its August meeting and deferred action on the disbursement of the state-funded assets of ALS until they received additional information. JLBC Staff sent a letter to the community colleges, the University of Arizona Health Sciences Center (AHSC), the Arizona Board of Regents (ABOR), the Arizona Telemedicine Program, and GITA requesting use plans by the community colleges, proposals on uses for the ALS equipment, and any other input or interest by October 21, 2002. We received use plans from the 10 community college districts, a collaborative proposal by the Arizona University System through AHSC, an informational letter from GITA, and an additional request from the Maricopa County Community College District.

Below you will find summaries of the information received. Copies of the complete proposals and letters submitted to JLBC and a full equipment list are available upon request. We have attached the August JLBC memo on ALS for additional background information.

Community College District Use Plans
The 10 community college districts submitted use plans for the ALS equipment physically in their possession. This equipment includes one set of identical video and telecommunications equipment at a site within each district. In general, the community college districts intend to redirect the ALS video equipment for a different use within their intra-district networks. The additional equipment would either allow them to extend distance learning to a new location or add a second classroom at a central location to increase course offerings. Approximately half of the districts will move the equipment to another location as part of their proposal and some of the plans require the purchase of additional equipment to utilize the ALS state-funded equipment. The individual district use plans did not address the use of the centrally located hub equipment. A brief synopsis of each proposal is outlined below.

District	Use Plan for ALS Equipment
Cochise County Community College District (Cochise College)	Add a second classroom to their current ITV network at their Sierra Vista campus and purchase additional hardware for the Douglas campus and eventually the Willcox Center so the systems could communicate with each other.
Coconino County Community College District (Coconino Community College)	Move it to the Page campus as a second ITV classroom at that location to meet the high demands of students in the area.
Graham County Community College District (Eastern Arizona College)	Add a second classroom at the Thatcher campus to their existing distance education delivery system to increase course offerings.
Maricopa County Community College District (Maricopa Community Colleges)	Utilize equipment in its current capacity as part of it multimedia room at its Rio Salado campus primarily for classes, videotaping, and workforce development.

(Continued)

District	Use Plan for ALS Equipment
Mohave County Community College District (Mohave Community College)	Utilize at one site in their intra-district ITV network (which is scheduled to be operational January 2003) for classes, meetings, and community use.
Navajo County Community College District (Northland Pioneer College)	Add another site to their current district-wide ITV network in either Ganado or Sanders (both communities have requested access to ITV courses).
Pima County Community College District (Pima Community College)	Keep the ALS equipment at their Community Campus to communicate with and offer courses in the rural districts with which they have contracts for service.
Pinal County Community College District (Central Arizona College)	Integrate the ALS equipment into their recently purchased intra-district network. It is unclear with which systems this equipment would communicate.
Yavapai County Community College District (Yavapai College)	Discussed 3 different initiatives to utilize the ALS equipment in their proposal. In general, they plan to integrate the ALS equipment into their existing intra-district ITV network.
Yuma/La Paz Counties Community College District (Arizona Western College)	Integrate the ALS equipment into their internal network to increase their distance learning capacity.

Maricopa County Community College District Office Proposal

Under separate cover, MCCCD requested 2 specific pieces of the hub equipment, a Cisco Lightstream switch and a Cisco 7200 series router (the purchase price of these items in 2000 was $123,800). This equipment would allow for videoconferencing capabilities between the Maricopa colleges and replace an obsolete component of their existing system.

The hub equipment ran the ALS network and is currently located at Rio Salado Community College in the MCCCD system. The Arizona University System proposal also includes the use of the hub equipment; however, the community college district use plans outlined above did not address the disbursement of the hub equipment.

Arizona University System Proposal

The University of Arizona Health Sciences Center (AHSC) submitted a proposal to make use of all or part of the ALS equipment collaboratively with Arizona State University (ASU), Northern Arizona University (NAU), and the newly established Translational Genomics Research Consortium. They propose to utilize the equipment to expand educational programs to address critical shortages in nursing, pharmacy, medicine, and public health, as well as improve statewide communication for health and sciences faculty. The ABOR submitted a letter in support of this proposal. Their joint goals are outlined below.

Installation Location for Equipment	Goal
UA and ASU Colleges of Nursing	Increased presence of nursing educational opportunities on the network to facilitate video-based courses and meetings.
UA College of Pharmacy	College of Pharmacy participation in statewide healthcare education/emergency response activities.
AHSC Phoenix Programs Office	Addition of a second videoconference capability from AHSC Phoenix office to increase classes offered and statewide meeting participation.
Arizona Cancer Center (Phoenix)	Establishing a video-based networking capability for the Arizona Cancer Center to allow more active involvement in statewide educational and clinical matters (they currently do not have videoconferencing capabilities on-site).

(Continued)

Installation Location for Equipment	Goal
Translational Genomics Research Institute	Videoconference capability for the institute at the temporary headquarters and later their permanent facility to facilitate the statewide planning process and on-going research efforts.
Arizona Department of Health Services (ADHS)	Videoconference capability for ADHS to serve cooperative programs among the universities in the educational, research, and public health arenas.
NAU College of Health Professions, AHSC Phoenix office, Arizona Telemedicine Network Operations Center	Replace video equipment at the AHSC Phoenix office and NAU College of Health and replace "Hub equipment" at AHSC in Tucson. Any remaining equipment would be utilized to upgrade network components of the Arizona Telemedicine Network. The aforementioned upgrades would enhance network reliability.

Government Information Technology Agency Letter
GITA made attempts to see if other agencies could utilize the ALS equipment and network. Due to concerns about having the necessary staff and funds to install, support, and maintain the equipment and network, there was no definite interest in the system.

GITA further expressed that the state should attempt to maximize the use of the highly underutilized equipment since the resale value of the technology will be minimal in the current economy. As a last resort, they recommend the equipment be sold.

Logistical Issues
The ALS network has been maintained and is still connected in accordance with the Committee's previous decision at its August meeting. The network needs to be shut down as none of the proposals before the Committee would utilize the existing network. If the community college districts retained the equipment, they would run it through their own intra-district networks and if the Arizona University System obtained the equipment, they would utilize their existing statewide network. According to the ALS Executive Director, the contractor is being cooperative in allowing ALS to end its contract before the original terms expire. They estimate that it will take approximately 60 days to shut down the network and resolve any contract issues.

If the Committee decides to transfer ALS state-funded assets from one entity to another, arrangements must be made. One option is to utilize professional de-installers to move equipment as this program has done in the past. In addition, there may be equipment that cannot be utilized by either the community colleges or the universities. In this situation, selling any equipment that cannot be utilized remains an option to recoup funds.

In order to carry out the Committee's decision and shut down the network, we recommend that the Executive Director of ALS be retained for 90 days. We also recommend that the Executive Director submit a follow-up report to the JLBC within 75 days on the transition process, expenditures, and remaining funds from ALS appropriations to be reverted to the General Fund.

RS/JY:ss
Attachment

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DATE: November 18, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

SUBJECT: ARIZONA DEPARTMENT OF ADMINISTRATION/GOVERNMENT INFORMATION TECHNOLOGY AGENCY – REPORT ON HRMS REPLACEMENT PROJECT

Request

As part of the favorable review of the expenditure plan for the Human Resources/Payroll System, formally known as the Human Resources Information Solution (HRIS), the Arizona Department of Administration (ADOA) and the Government Information Technology Agency (GITA) are required to report back quarterly to provide information on the project.

Recommendation

This item is for information only and no Committee action is required. ADOA and GITA have submitted separate reports on the progress of the project. ADOA reports the project is "on time and on budget." GITA concurs with this assessment and will continue to closely monitor the project.

Analysis

The HRIS project is monitored by the project staff and GITA for progress in several different functional areas, which are assigned to the following:

- Project Administration group provides oversight of the implementation of the system and communication with the client agencies within the system. Functionality issues with the Department of Public Safety are reported to have been resolved. Similar issues with the Legislature and its component agencies are being resolved during November. This group is also researching the use of the current payroll and benefits data into the new system.

(Continued)

- The Business Functionality group implements the business process foundation for the operation of the system. This unit is preparing for integration testing and has successfully simulated the hiring and compensation of a hypothetical employee.
- The Technology group provides the technical foundation for the project. This group incorporates the various components of the system into a functional business product. Currently, this group is conducting increasingly comprehensive integration testing as well as preparing technical documentation.
- The Training Management group develops and implements the training curriculum for the project. Every state agency using the system has a designated Agency Training Facilitator (ATF), who will train their agency personnel in the use of the system. The process of training these individuals was begun over the summer. Agencies are monitored for their completion of these tasks and are notified when they are not on schedule.
- The Change Management group investigates and implements the steps necessary to implement changes from the current system into the new system. This group has delivered a document that outlines the prospective organization of payroll and benefits roles, both within ADOA and at the agencies, for review by the project management; this document is further reviewed by payroll and benefits consultants hired by the project. When approved, this document will be used to determine the training needs of the agencies. This group also notes those areas where solutions have not been agreed upon ("gaps"), which are monitored until resolution is achieved. This gap analysis will be further reviewed over the fall, with completion set for this December. A newsletter distributed by this group provides project information to agency personnel and, in a summarized form, to agency heads.

The project received a letter grade from the project contractor (IBM) of "B." The project is not encountering unforeseen problems. ADOA has not changed any of the implementation dates. The first phase of the project, generating paychecks with the new system, is scheduled to "go live" on April 14, 2003. Additional components of the system will be implemented in the first quarter of FY 2004.

GITA provided a separate update on the project's progress. GITA also believes that the project is on time and on budget. GITA indicates that the next phase of the project, integration testing, will take the most time and is the most complex series of tasks undertaken by the project to date. These tasks are shorter term in nature, but are more tedious and time sensitive.

According to GITA, the next phase of the project will involve the development of features and functions that are not currently available. To realize the efficiency gains of these new features, the HRIS project will need a marketing/educational plan that informs agencies about the capabilities of the new system.

In summary, GITA states that the project is "getting back on target" and that considerable progress has been made. GITA will continue to closely monitor the progress of the project.

RS:PS:ss

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MARION L. PICKENS

DATE: November 20, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

SUBJECT: ARIZONA DEPARTMENT OF ADMINISTRATION/GOVERNMENT INFORMATION TECHNOLOGY AGENCY – REVIEW OF TELECOMMUNICATIONS SERVICES PLAN

Request

Laws 2002, Chapter 327 requires the Arizona Department of Administration (ADOA) and the Government Information Technology Agency (GITA) to submit a report for review by the Committee on any options, including privatization and allowing agencies to procure their own telecommunications services, that would increase the fiscal efficiency of Arizona telecommunication services.

Recommendation:

The JLBC recommends a favorable review of ADOA/GITA's recommendation to privatize state government's telecommunication system, pending private sector input into possible methods of conversion.

The JLBC has also identified 3 policy issues within the report: ADOA has recommended a centralized governance and funding model, and state ownership of the telecommunications assets. GITA concurs with the centralized governance and funding model, but recommends private ownership of telecommunication assets. The policy issues are: whether or not to centralize governance of the system, whether or not to centralize funding for the system, and whether or not the state should own the telecommunication assets.

The Appropriations Committee Chairs have proposed legislation for the November Special Session that requires GITA to prepare a Request for Proposal that would privatize state government's telecommunication system.

(Continued)

Background

Arizona Telecommunications Services (ATS) was established in 1951 to negotiate long distance rates for the state. In 1988, the state began installing state-owned centralized telephone systems in Phoenix and Tucson. In 1997, ATS's authority was expanded to allow the transmission of data, video, and graphic images.

ATS currently is a division of ADOA's Information Technology Division (ISD), with 57.5 FTE Positions. There are 3 subdivisions within ATS: the Projects Group, which is responsible for the development of services, architecture and oversight of project management and vendor led projects; the Operations Group, which provides network engineering, wide area network (WAN) support, and voice engineering; and the Service Center, which provides direct customer service. Additionally, ATS has a Finance & Planning group that provides accounting and budgeting support, and also a switchboard for the Phoenix Capitol Mall and Tucson state offices. ATS provides approximately 14,000 subscriber lines on the Capitol Mall and in Tucson. Capitol Mall telephone services are provided by a switching mechanism that is capable of handling Voice Over Internet Protocol Telephone (VOIP) services over data networks.

ATS also provides a fiber optic data network (MAGNET) that connects 31 buildings in Phoenix and Tucson. This network provides high-speed data and Internet connectivity. ATS also provides toll bypass long-distance services to the Department of Corrections and the Game and Fish Department.

Toll bypass refers to the avoidance of toll charges assessed by telephone companies for long-distance telephone calls. Currently, toll bypass is achieved by some state agencies through the leasing of dedicated network lines that link 2 geographically removed locations. Toll bypass can also be achieved by digitizing voice communications and transmitting those digital signals over dedicated data network lines that are similar to, but separate from, Internet lines. The most common method of sending digital voice signals uses a technology known as VOIP. For a VOIP telephone call to achieve toll bypass savings, there must be a state owned VOIP connection in the remote location.

Analysis

The ADOA/GITA report identified 2 areas for cost savings. The most significant of these was through VOIP toll-bypass. Some toll bypass savings are already being realized by purchasing dedicated circuits between locations where long distance calls are common (e.g. in the Department of Corrections.) Utilizing VOIP technology can significantly increase those savings by creating what is essentially a private, digital telephone network. This network would provide toll bypass savings for calls within the state where the private network is established. VOIP technology also makes traditional voice communications systems unnecessary, generating additional savings by eliminating redundant traditional voice systems.

The ADOA/GITA report team utilized a total cost of ownership (TCO) methodology to analyze the state's telecommunication systems. The 14 largest state agencies, not including the universities or the courts, representing 80% of the total state telecommunication costs, provided detailed financial information on their telecommunications costs. From that data, the report estimated the other 20% of the state's costs (excluding the universities and the courts). The report team also created a detailed inventory of data and voice equipment and conducted interviews and meetings with agency personnel.

There were 4 models described in the report: As Is, Decentralized, Shared Services, and Privatized. The report provides 2 options in each model. All 4 models assume that the state will move to VOIP technology in some form over a 5 year span. The first option, Data Network Upgrade, is a basic move

(Continued)

towards VOIP services where toll-bypass opportunities are available. This option creates a state-owned telephone network that digitizes voice communications between cities, but still uses existing traditional telephone equipment. The second option, Full VOIP Implementation, assumes that VOIP is implemented in every agency, with every desktop enabled with a VOIP telephone handset that creates fully digitized signal from user to user. Because this option involves a much more extensive purchase of equipment for every state agency building around the state, many of which are not prepared for this technology, Full VOIP Implementation requires a significant capital investment that would need to be financed over a 9 year period. The differences between the models lie in how that transition is implemented:

- The As Is model maintains the status quo. In this model, the VOIP transition is implemented by ATS for ATS customers and by the agencies themselves in those cases where agencies currently provide their own telecommunications systems.
- The Decentralized model removes ATS from the management of the telephone and data systems, with agencies contracting, managing, and delivering their own telecommunication systems.
- The Shared Services model provides all telecommunication services centrally through a public/private partnership, with the exception of agency-specific Local Area Networks (LANs), which will continue to be managed by the agencies.
- The Privatized model assumes that the private sector will provide a wide spectrum of options for the delivery of voice and data communications services. This model would result in reductions in FTE Positions in ADOA and at agencies with their own telecommunications systems. This could be accomplished with either state or private ownership of the telecommunications assets.

ADOA/GITA Telecommunication Models
Costs/(Savings) Compared to Current Expenditures
Over a 5-Year Period (in millions of dollars)

	Data Network Upgrade Only (no financing required)	Full VOIP Implementation (requires financing)
As Is Model	$(35,662.8)	$44,330.1
Decentralized Model	3,700.7	49,550.6
Shared Services Model	(39,263.8)	40,728.9
Privatized Model	(41,218.6)	38,774.1

Currently, the total annual cost of ownership (TCO) for the state's telecommunications system is $66,368,700 (excluding the universities and the courts). Of this amount, approximately $11 million is assumed to be base equipment funding. The report bases its savings as a comparison to that TCO amount, which is assumed stable for a five-year period. This also assumes that agencies would continue to receive equipment funding at the same level of FY 2002. With those assumptions, the chart above demonstrates that the greatest savings are available with a privatized data network upgrade, which will result in savings of $(41,218,600) over 5 years. Significantly, full VOIP implementation increases the cost of telecommunication services due to the high capital investment and resulting financing costs. The report estimates the capital investment associated with the implementation of Full VOIP at over $90 million. VOIP is a relatively new technology that could present unanticipated problems, especially as rival standards are developed. There is a risk that the technologies implemented could become obsolete more quickly than anticipated.

For reference, the first year savings of the various models are listed below:

(Continued)

ADOA/GITA Telecommunication Models
Costs/(Savings) Compared to Current Expenditures
First Year Only (in millions of dollars)

	Data Network Upgrade Only (no financing required)	Full VOIP Implementation (requires financing)
As Is Model	$(1,053.2)	$(6,214.7)
Decentralized Model	36,186.7	2,209.2
Shared Services Model	(1,053.2)	(6,214.7)
Privatized Model	(1,670.5)	(6,832.0)

The savings in the first year of the project in the Full VOIP Implementation can be misleading as the costs of financing escalate in the remaining 4 years. ADOA/GITA have prepared an amortization schedule that details the costs of financing:

Full VOIP Implementation Financing
Proposed Amortization Schedule

Year	Principal Payment	Interest Payment	Total Financing Cost
Year 1	$5,108,700	$851,500	$5,960,200
Year 2	8,440,500	1,200,900	9,641,300
Year 3	11,837,800	1,538,100	13,264,900
Year 4	15,207,700	1,511,800	16,719,500
Year 5*	18,547,600	1,455,700	20,003,300

*The principal and interest due Year 6 through Year 9 totals $34,427,200

As mentioned in the Recommendation Section of this memo, the Committee is presented with two unresolved policy issues. Both ADOA and GITA recommend centralizing both the management of the privatization contracts and centralization of the telecommunications budget. Centralized management of the privatization contracts is a significant departure from current practice, where many larger agencies maintain control over their voice and data networks. Similarly, every agency is currently provided with a telecommunications budget that is used to purchase equipment, services from ADOA and/or private vendors and to hire technical telecommunications staff. Under the centralized budget model, the telecommunications budget for the state would be allocated to one centralized telecommunications agency that would provide telecommunications services for all State agencies. To implement a centralized telecommunications budget, all telecommunications budgets and related personnel would be removed from the various agencies and appropriated to the centralized agency. This would require a detailed understanding of the agencies' telecommunications budgets to achieve the savings outlined above. Since the agencies would no longer be accountable for their telecommunications budgets, there could also be conflict between agencies perceived telecommunications needs and the services provided by the centralized agency.

Finally, the report identified short-term operational savings totaling $1,523,600 that are being implemented in FY 2003.

RS:PS:ss

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DATE: November 19, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Brad Regens, Senior Fiscal Analyst
Tony Vidale, Fiscal Analyst

SUBJECT: STATE DEPARTMENT OF CORRECTIONS – REVIEW OF PAY STIPEND AND HIRING BONUS PROGRAM

Request

The State Department of Corrections (ADC) requests Committee review of a pay stipend for the Arizona State Prison Complex (ASPC) – Lewis Rast Unit and a hiring bonus program for the ASPC – Lewis, Eyman, and Florence prisons. The Committee is not required to review this item, however, ADC is requesting Committee review of the pay stipend and hiring bonus programs. While they have sufficient funding in FY 2003 to implement both programs, the department will only proceed if they have assurances that the Legislature will annualize the funding in the FY 2004 budget. ADC believes that a favorable review will establish a legislative commitment to annualize the cost. In the past, ADC has implemented pay stipends and hiring bonuses to address vacancies without legislative review or additional funding.

Recommendation

The Committee has at least three options:

1. The Committee may choose to favorably review the pay stipend for 125 correctional officers at ASPC – Lewis (10% of base salary) at an annual cost of $353,000. The department has indicated the pay stipend costs could be absorbed in FY 2003, however, funding would need to be provided for FY 2004 and beyond. The Committee may also choose to defer discussion on the pay stipend until the FY 2004 appropriations process.
2. The Committee may choose to favorably review the hiring bonus program for approximately 3,000 correctional officers ($5,160 per position) for ASPC – Lewis, Eyman, and Florence at an annual cost of approximately $7.7 million. The Committee may also choose to defer discussion on the hiring bonus program until the FY 2004 appropriations process.

(Continued)

3. The Committee has a third option to consider instead of option 1 and/or option 2 for the pay stipend and hiring bonus program. The Committee may choose to recommend that the department privatize the 350 beds at ASPC – Lewis Rast Unit. The department's FY 2003 appropriation includes $7,749,100 in Corrections Fund monies to operate the final 350 beds at the ASPC – Lewis. Based on the most recent private prison contract entered into by the department, this option would have a total cost of $4,886,400 ($38.25 per diem per bed) and create an annual savings of $2,862,700.

Analysis

Pay Stipends

The ADC has utilized pay stipends and hiring bonuses to attract and retain correctional officers at prisons located in geographical areas that have proven difficult to staff. Since the mid 1980's, the Arizona Department of Administration has approved pay stipends and hiring bonuses for certain correctional officer positions. The most recent pay stipends and hiring bonuses offered were in FY 2000 and FY 2001, respectively. No funding was provided for the stipends or bonuses in the appropriations process.

ADC was appropriated $7.7 million in FY 2003 from the Corrections Fund to open 350 state-operated beds at Lewis, however, to date the department has been unable to open these beds due to unsuccessful recruitment efforts for correctional officers. Under the department's proposal, 10% pay stipends would be offered to approximately 125 correctional officers at the ASPC – Lewis Rast Unit. Providing a 10% pay stipend to the officers would have an annual cost of $353,000, which the department can absorb in FY 2003 utilizing savings from the delayed opening of the Rast Unit (funded for operation since July 2002). The department believes it cannot continue to absorb this cost in FY 2004 and would require additional funding to cover the costs in future years. The department currently provides stipends to correctional officers at Eyman, Florence, Lewis, and Winslow at an annual cost of $14.0 million. To date, the department has not received an appropriation for the stipends.

Hiring Bonus Program

The department is also proposing a hiring bonus program for ASPC – Lewis, Eyman, and Florence. The hiring bonus program consists of $5,160 per new hire for a two-year commitment to one of these prisons or $100 per pay period for two years for incumbent personnel, which provides hiring bonus parity. The program would have a total annual cost of approximately $7.7 million in FY 2003 and provide bonus pay for 2,966 authorized positions. The costs of the hiring bonus program could be absorbed in FY 2003 using vacancy savings; however, there is the potential that these costs would need to be funded in FY 2004. These costs would be in addition to the pay stipend offered at the Lewis Rast Unit.

Privatization

Instead of addressing pay stipends and hiring bonuses, the Committee could recommend the 350 state-operated beds at the ASPC – Lewis Rast Unit be privatized using a portion of the funds appropriated to open the state-operated beds in FY 2003. A.R.S. § 41-1609 authorizes ADC to contract with private institutions located inside or outside the state dedicated to the confinement of persons who are committed to the department. On publication, any request for proposals for private prison contracts must be provided to the Committee for review. Using the most recent contract rate of $38.25 per bed for 350 beds, an annual savings of $2,862,700 could be achieved on the department's current appropriation of $7,749,100 for the Lewis Rast Unit.

RS:TV:ss

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CHRISTINE WEASON

DATE: October 16, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Jennifer Vermeer, Assistant Director

SUBJECT: AHCCCS - REPORT ON COST SHARING MEASURES

Request

Pursuant to a footnote in the General Appropriation Act, AHCCCS has submitted a report on cost sharing measures that could be added to the AHCCCS program.

Recommendation

This item is for information only and no Committee action is required. AHCCCS estimates a total maximum state savings of $14 million to $17.3 million if all of the cost sharing strategies are implemented. Federal approval of waivers is required in several instances, however, so any savings would not likely be realized until FY 2004.

While no Committee action is required, AHCCCS is requesting guidance on how to proceed with the cost sharing measures.

Analysis

A footnote in the General Appropriation Act requires AHCCCS to report by October 1, 2002 on savings that could be achieved if applications fees and other cost sharing measures were implemented. The report shall detail the saving associated with each option by program and any administrative costs associated with each option. AHCCCS's report includes increasing the amounts and types of copayments, implementing monthly premiums, and enrollment fees.

AHCCCS notes several important caveats on implementing any of the cost sharing arrangements.

- Federal Medicaid law and regulations limit the types of cost sharing options that can be implemented, the populations that can be charged, and the amounts that can be charged.

- Any revenue collected must be shared with the federal government at the Federal Matching Assistance Percentage (FMAP).
- Waivers are required to implement some of the cost sharing strategies discussed in the report. AHCCCS reports that waiver approval through the federal Centers for Medicare and Medicaid Services (CMS) would likely take 4-6 months. As a result, they project it may take until October 1, 2003 to implement these strategies.
- Under AHCCCS's current structure, any revenues collected through these strategies are retained by the providers. These payments are then deducted from the amount they receive in reimbursement or capitation rates. As a result, increasing cost sharing would not directly benefit the state. The savings would come through future decreases to capitation rates due to the increased revenue at the providers.
- Therefore, in order to generate immediate savings to the state, the capitation rates would need to be decreased prospectively. Otherwise, any savings would not be generated until some point in the future.

The following table summarizes the revenue estimates and important caveats for each of the cost sharing options.

Cost Sharing Arrangement	Maximum Potential Revenue	Comments
Copayments	$7 - $10.3 million (State Share)	• Federal law requires copays on the traditional Medicaid population to be nominal and must be waived if the enrollee cannot pay. • AHCCCS currently requires copays on some services. The experience in AZ and other states is a collection rate of 2%. • Copays cannot be imposed on certain services. • There is more flexibility for expansion populations (such as Proposition 204). • Federal law limits the amount that can be charged for copays. • A waiver would be required to deny services if copays are not paid. To date, CMS has not approved this type of waiver. (See page 4 of the report for detail on each proposed copay).
Monthly Premiums	$3.9 million (State Share)	*AHCCCS:* • No premium can be charged on traditional Medicaid populations. • Monthly premiums are currently charged in the KidsCare program and are allowed for adults in the KidsCare program (also known as HIFA parents) up to certain limits. • There is some flexibility to charge premiums on expansion populations (see page 5 of the report for more detail).
	$1.8 million (State Share)	*DD-ALTCS:* • Parental income is not counted toward eligibility in the Developmentally Disabled Long-Term Care program. Monthly premiums could be charged to this population. • A waiver is required (see page 7 of the report for more detail).
Enrollment Fees	$1.3 million (State Share)	• An enrollment fee would be charged to applicants when they are initially enrolled in the program. • The fee can apply to the Proposition 204 and KidsCare programs (children and adults). • This could result in people not applying when they are healthy and only enrolling when they become sick. This could have unknown consequences for providers and the AHCCCS program. (see page 7 of the report for more detail)
Total Collections	$14 – 17.3 million (State Share)	(See page 8 of the report for more detail)

RS/JV:lm

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DATE: November 20, 2002

TO: Senator Ruth Solomon, Chairman
Members, Joint Legislative Budget Committee

FROM: Richard Stavneak, Director

SUBJECT: REPORT ON RECENT AGENCY SUBMISSIONS

Request

The JLBC has received a number of statutorily required reports during the past month. Each report is briefly described below.

Recommendation

The reports are for information only and no Committee action is required. We do not intend to discuss the reports at the JLBC meeting unless a member has a question. If any member knows in advance that they will have questions, we would appreciate knowing that before the meeting so as to ensure the relevant agency is available.

Reports

A. Arizona Department of Administration - Report on the Use of Alternative Fuels and Clean Burning Fuels in the State Motor Vehicle Fleet.

Pursuant to A.R.S. § 41-803 (R), the Arizona Department of Administration (ADOA) is required to report on the inventory of state vehicles, state vehicles in Maricopa County, state vehicles utilizing alternative fuels, the state's level of compliance with federal and state alternative fuel mandates and other information presented to the ADOA concerning alternative fuel vehicles. As of June 30, 2002, 39.3% of the state's total light duty vehicle fleet was capable of utilizing alternative fuels, which represents an increase of 1 percentage point above last year. Federal mandates require that 40% of the light duty vehicles in the state be capable of utilizing alternative fuels.

B. State Board of Directors for Community Colleges - Report on Tuition and Fees Charged by Community College Districts.

Pursuant to A.R.S. § 15-1424, the State Board of Directors for Community Colleges is providing a report listing the tuition and fees charged by the community college districts in Arizona. According to the statewide summary, the average resident tuition and fees for 30 credit hours is $962, ranging from $672 for Navajo County Community College District to $1,290 for Maricopa County Community College

District. The average non-resident tuition and fees for 30 credit hours is $4,220, ranging from $1,230 for Yavapai County Community College District to $5,494 for Pima County Community College District. The measure of 30 hours is used to represent a full-time student enrolled in 15 credit hours in both the fall and spring semesters in one academic year.

District	Resident Tuition & Fees (30 credit hours)	Non-Resident Tuition & Fees (30 credit hours)
Cochise County Community College District (Cochise College)	$930	$5,310
Coconino County Community College District (Coconino Community College)	$1,110	$2,700
Graham County Community College District (Eastern Arizona College)	$788	$4,908
Maricopa County Community College District (Maricopa Community Colleges)	$1,290	$5,400
Mohave County Community College District (Mohave Community College)	$848	$4,840
Navajo County Community College District (Northland Pioneer College)	$672	$4,740
Pima County Community College District (Pima Community College)	$949	$5,494
Pinal County Community College District (Central Arizona College)	$1,110	$2,220
Yavapai County Community College District (Yavapai College)	$930	$1,230
Yuma/La Paz Counties Community College District (Arizona Western College)	$990	$5,358
Average	**$962**	**$4,220**

C. Department of Economic Security - Report on Developmental Disabilities Title XIX Reimbursement Rates.

Laws 2001, Chapter 385 requires the department to contract with an independent consulting firm for an annual study of the adequacy and appropriateness of Title XIX reimbursement rates to service providers for the developmentally disabled program of both the Arizona Long Term Care System and the state only program. The department is to provide this report to the Committee by October 1 yearly. Besides contracting for a study in spring 2001, the department reported that it reviewed existing rate schedules from other state agencies using the same or very similar services. It also completed a cost survey of current providers in spring 2002. The department plans to publish model rates for public review and comment by December 2002. The department did not address the cost impact of implementing the rates; the impact would depend in part on how fast providers whose current reimbursement rates are above the model rates would be transitioned to those new model rates.

D. Department of Economic Security - Report on Cost of Care Collections in Developmental Disabilities Program.

Pursuant to a General Appropriation Act (Laws 2002, Chapter 327) footnote, the department has submitted its report on procedures the department plans to implement in order to improve the cost of care collections in the Division of Developmental Disabilities. The department bills individuals for residential services in the Title XIX and state-only program and non-residential services in the state-only program. The department listed several short-term and long-term enhancement activities. The short-term activities include identifying all individuals subject to billing for non-residential services and billing individuals 100% of the cost of non-residential services if they do not send in financial information forms. Long-

term enhancement activities require statutory or rule changes. These changes include, but are not limited to, increasing the amounts billed for non-residential services, billing for Arizona Early Intervention Services, and increasing the amount of Supplemental Security Income benefits billed for residential services.

E. Department of Economic Security - Report on Annual Child Care Expenditures

A.R.S. § 46-810 requires the Department of Economic Security (DES) to report child care data to the Committee by October 1 yearly. DES submitted its FY 2002 report on October 18. The report shows that the average number of children served increased to 40,700, or 1.5% above FY 2001; the families served increased by 1.2%. This growth was uneven across categories, however, as the number of children served in the Low Income Working category increased by 4.8% above FY 2001 while the number of TANF-related children declined by (4.5)% and the number of children receiving transitional child care declined by (6.6)%. Since April 1997, there has been no waiting list for child care subsidies.

The amount spent on child care subsidies increased to $133,105,200, or 12.2% above FY 2001. The average monthly subsidy paid per child increased 10.5% to $272.53. This increase is primarily due to the provider rate adjustment effective October 1, 2001. Co-payment levels for child care were unchanged except for adjusting income limits slightly upwards for new federal poverty level figures. The total amount of co-payments was virtually unchanged from FY 2001 at $14,138,600.

F. Department of Education/JLBC Staff - Report on the Technology and Assisted Project-Based Instruction Program.

The Technology Assisted Project-Based Instruction program (TAPBI) was established on a pilot basis by Laws 1998, Chapter 224 in order to "improve pupil achievement and extend academic options beyond the four walls of the traditional classroom." A.R.S. § 15-808(C) requires each school district that participates in TAPBI to submit an annual report to the State Board of Education and to the Joint Legislative Budget Committee regarding its program. A.R.S. §15-808(D) requires the State Board of Education (SBE) and JLBC to collaboratively compile and evaluate the information from site reports and present joint SBE/JLBC findings regarding TAPBI to the Governor, Speaker of the House and President of the Senate by November 15 of each year.

For FY 2002, the SBE and JLBC conclude that the program appears to be achieving its goal of extending academic options beyond the four walls of the traditional classroom, at least on a limited basis. The SBE and JLBC, however, also conclude that it is unclear whether TAPBI is meeting its goal of improving student achievement because most sites do not report standardized test scores for program participants, which are needed in order to measure their academic gain while in the program.

Approximately 400 Average Daily Membership (ADM) pupils, including about 216 home school pupils, participated in TAPBI during FY 2002. The program has no additional Basic State Aid cost for pupils who would attend public school even without the program, since they would be included in the statewide ADM count anyway. Home school pupils who participate in TAPBI, however, represent a "new" Basic State Aid cost, since they otherwise would not receive Basic State Aid funding. Basic State Aid funding equaled about $4,300 per pupil on average for FY 2002. TAPBI participation by home school pupils therefore increased Basic State Aid costs by an estimated $928,800 in FY 2002 (216 ADM home school pupils X $4,300 per pupil = $928,800).

The SBE and JLBC note that TAPBI currently is in its fifth year of "pilot" status and that the Legislature therefore may want to either make the program permanent or eliminate it during the upcoming Legislative session. In addition, the SBE recommends that the current annual reporting requirement for the program be replaced with a sunset-type review every 10 years. Finally, the SBE and JLBC note that the

Legislature may wish to change criteria for evaluating program effectiveness, since the current criteria are based partly on standardized test scores and those scores are not available for most TAPBI pupils.

A copy of the FY 2002 TAPBI report from JLBC/SBE may be obtained from the JLBC Staff (Steve Schimpp, 542-5491).

G. Department of Health Services - Report on Assurance and Licensure Backlogs

Pursuant to a footnote in the FY 2003 General Appropriation Act, the Department of Health Services is required to submit a report on the status of licensure backlogs in the Assurance and Licensure Division. The following table summarizes renewal backlog by office:

	Nov. 2001	Feb. 2002	June 2002	Aug. 2002
Child Care Licensure	135	136	193	254
Assisted Living	484	395	347	375
Behavioral Health	90	91	144	168
Medical Facilities	290	237	108	45
Long Term Care	16	6	0	1

The data indicates that while the backlogs for child care licensure and behavioral health licensure have increased since November 2001, backlogs for assisted living, medical facilities and long term care licensure have decreased substantially.

H. Department of Health Services - Report on Behavioral Health Title XIX Reimbursement Rates.

Laws 2001, Chapter 385 requires the department to contract with an independent consulting firm for an annual study of the adequacy and appropriateness of Title XIX reimbursement rates to community behavioral health providers. The department is to provide this report to the Committee by October 1 yearly.

The Department of Health Services (DHS) is reporting that the department contracted with EP&P Consulting to conduct a service matrix rate review of rates paid to community behavioral health providers. This review resulted in significant changes to rates paid to providers. These rate changes were integrated in the behavioral health capitation rates over a two-year period, beginning in FY 2002. The FY 2003 portion of the increases were incorporated in the rates approved by the Committee on July 17 and August 22, 2002.

I. Arizona Historical Society - Report on Expenditures of Non-Appropriated Funds

Pursuant to A.R.S. ' 41-821, the Arizona Historical Society is required to submit a written report detailing all expenditures of non-appropriated funds for the society at the beginning of each quarter. Non-appropriated fund expenditures for the first quarter of FY 2003 were $284,300. These expenditures are shown by fund source in the table below.

Arizona Historical Society
Expenditures by Source for 1st Quarter FY 2003

Trust Fund Earnings	15,700
Enterprise Fund	2,600
Grants	144,800
Special Revenue	46,800
Private Funds	74,400
Total Non-appropriated Expenditures	284,300
General Fund Expenditures	2,022,000
Total Arizona Historical Society Expenditures	2,306,300

J. Department of Racing - Report on Boxing Events and Revenue

Pursuant to a General Appropriation Act footnote, the Department of Racing is required to report semiannually on the number of boxing events, gross receipts, state revenues, and license fee collections. The Commission submitted its latest report on October 16.

In FY 2002, a total of 29 events were held in Arizona with the total for gross receipts and license fees equaling $30,982.

RS:lm