STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

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HOUSE OF REPRESENTATIVES

JOINT LEGISLATIVE BUDGET COMMITTEE
Tuesday, March 28, 2006
8:00 a.m.
Senate Appropriations Room 109

MEETING NOTICE

- Call to Order
- Approval of Minutes of February 28, 2006.
- DIRECTOR'S REPORT (if necessary).

1. STATE DEPARTMENT OF CORRECTIONS
   A. Consider Approval and/or Review of Transfer of Appropriations.
   B. Report on Public - Private Bed Cost Comparison.

The Chairman reserves the right to set the order of the agenda.
03/21/06

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MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

February 28, 2006

The Chairman called the meeting to order at 8:15 a.m., Tuesday, February 28, 2006, in Senate Appropriations Room 109. The following were present:

Members:	Representative Boone, Vice-Chairman	Senator Burns, Chairman
	Representative Biggs	Senator Cannell
	Representative Burton Cahill	Senator Garcia
	Representative Gorman	Senator Harper
	Representative Lopez	Senator Martin
	Representative Pearce	
	Representative Tully	
Absent:	Representative Huffman	Senator Arzberger
		Senator Bee
		Senator Waring

APPROVAL OF MINUTES

Senator Burns moved *that the Committee approve the minutes of December 20, 2005.* The motion carried.

ARIZONA DEPARTMENT OF CORRECTIONS - Consider Approval of Requested Transfer of Appropriations.

Mr. Lorenzo Martinez, JLBC Staff, explained that this item was in consideration of 2 Department of Correction (ADC) transfers. The first transfer would move $12 million from Personal Services and Employee Related Expenditures (ERE) line items to the Overtime Special Line Item. The department currently has $5.6 million available from security position vacancies and $6.6 million from health care position vacancies. The department reported that the need for additional overtime was the result of, primarily, the security position vacancies. In addition, the department recently changed its policy to no longer allow compensatory time and, instead, is paying cash overtime. This transfer would provide a total of $30.2 million for overtime; however, the department reported that it projects the need by the end of the fiscal year to be $37 million. The split between Personal Services and ERE is different than what the department had reported. The department recently reported that it believes it has $9 million available in Personal Services and $3 million available from ERE. Given that the department believes that these monies are available, the JLBC Staff recommends the amounts of $9 million in Personal Services and $3 million in ERE transferring to Overtime/Compensatory time totaling $12,000,000.

Mr. Martinez said the second transfer relates to moving $15.4 million from the Private Prison Per Diem Special Line Item (SLI) to the department's Other Operating Expenditures budget. These monies are available because the department was supposed to open some private beds in FY 2006 that it hasn't been able to accomplish and therefore the Private Prison Beds SLI has excess money. As a result of not opening these beds, the department continued to operate some provisional beds that were supposed to be eliminated. Provisional beds are temporary private beds. The JLBC Staff estimates the total need to fund these 2,064 provisional beds would be $36.2 million and therefore recommends a transfer of $15.4 million because the FY 2006 budget included $20.8 million to fund provisional beds. The department, however, believes that it requires $3 million more and requests a transfer of $18.4 million, because the department does not agree with the $20.8 million in the base.

Mr. Martinez pointed out that the ADC recently sent in a request for a third transfer that would be considered at a separate JLBC meeting. That transfer would move monies from the Private Beds SLI to the Other Operating budget to fund health care costs. However, at this time it is not clear if the Private Beds SLI has the capacity to support that transfer any more than the existing Operating Budget would have. Mr. Martinez clarified the first transfer requires Committee approval, whereas the second transfer would only require Committee review.

Representative Pearce expressed his support for the $18.4 million transfer. His concern is if this transfer does not happen, we will not have enough money to pay for the private beds.

Mr. Martinez replied that the Private Prison SLI does currently have the capacity to move the $18.4 million that is being requested. However, a difference in what JLBC Staff has calculated and the request of $3 million is because in FY 2006 budget, the allocation for provisional beds was $20.8 million. The JLBC Staff believes the total need to fully fund the provisional beds in FY 2006 is $36.2 million ($20.8 million plus $15.4 million). The department does not agree with the FY 2006 budget having the original $20.8 million. They believe that it is $3 million lower. In the FY 2006 report, there is a table that identifies the original amount.

Representative Pearce recalled the discussion and believed there was $20.8 million available. He is still concerned that if the money is not moved, the demands on the cost for the beds will not be satisfied. He does not believe there are public beds available to those that are in provisional beds.

Representative Pearce asked the agency where the difference came from for provisional beds and what it believed to be available.

Ms. Dora Schriro, Director, Arizona Department of Corrections, said there is a table that reports $20.8 million allocation, but there was $4.4 million that was transferred from All Other Operating Expenditures into ERE, which left that account short. It is that discrepancy that results in the difference in the request between the $15.4 million and the $18.4 million transfer.

Representative Pearce said he understands that there are no empty beds that can be filled at this time. He said moving the $18.4 million provisional bed money it is safer to make sure the money is available to pay for the out-of-state provisional beds.

Senator Burns asked when funds will run out for health care.

Ms. Schriro said health care monies will run out this week. In terms of what is happening in line items, technically there is money to operate the department until early May at which time funds will run out. That is the reason for the supplemental request.

Senator Burns asked if health care vacancies are being held to free up money or if the positions are going to be filled.

Ms. Schriro replied that they are making the best of a bad situation. The positions are not being held open purposely, but because they are vacant, they are being used to offset other personnel costs.

Mr. Richard Stavneak, Director, JLBC Staff, asked for clarification on the second transfer request where the department is proposing to move money out of the Private Prisons SLI, which has no extra money after today's transfer, and into health care.

Ms. Schriro replied that the preference is to do it at the earliest possible opportunity. The department relies on AHCCCS to review and process payments on health care bills that are delivered outside the agency. The department is out of the funds and at a point where AHCCCS and the providers need to be advised there is no money.

Representative Pearce asked how the $5 million move for overtime will impact filling vacancies.

Ms. Schriro reiterated that they are having difficulties filling positions, so they anticipate continuing to redirect the vacancy savings to partially offset other personnel costs. Included in the letter of Friday, February 24, is the request for an additional transfer from the Private Prison SLI to cover the health care, pending the belief that the supplemental will be received favorably and will arrive in sufficient time to replenish the Private Prison SLI so the end of year bills can be honored. This is the one area that still has sufficient funds to cover other immediate costs in health care.

Mr. Stavneak stated that he disagrees that if $15 million is needed immediately, the Private Prison SLI is not the only source of money. It could be taken out of the Private Prison SLI or the Personal Services for June.

Representative Pearce said that the opening of private beds has been slower than anticipated, and in some cases, ignoring the statute of not opening private beds. This is an area that we keeping looking at, there are a lot of other places to go, not just private beds. He would not support moving private money out of the Private Prison SLI.

Ms. Schriro replied that she disagrees that the department is disregarding direction from the Committee. There was a request for proposal (RFP) issued for the building of private beds. They made an evaluation of the RFP's and determined that none of the proposals were cost effective. Per statute, the Committee and the bidders were advised that the department would not proceed for that reason.

Ms. Schriro also stated that it is clear the department is short on money and it was known since the beginning of this fiscal year. Since the passage of this year's budget, in the department's view, this is the one place where money can be taken and not be delinquent on bills. There is a terrific need for an infusion in the form of a supplemental. She agreed with Senator Cannell that were the matter to be resolved, some of these conversations might not be necessary. Whichever source it comes from, there must be some adjustments from the remaining money to enable the department to continue to pay bills on time.

Representative Lopez asked where the other places are to take money and how would it impact the operation.

Mr. Stavneak said he was responding to the point that the only source of money is private prisons. He agrees the department has a problem. The department is spending at a rate that would exceed the appropriation by the end of the year. If you have to suddenly infuse money into the health care system, 1 option is to take it from private prisons, another is to take it from June's Personal Services money, in that, it would probably require some supplemental funding if they are going to continue to spend at the same rate. To suggest that private prisons are the only source because there are no contractual obligations, there are people in those beds right now. There are contractual obligations; there are Correctional Officers that have been hired and expect to be paid for June. There are a number of obligations, but there is not just a single option in terms of the money.

Representative Lopez stated that if it is taken from June Personal Services, it still needs to be made up at some point.

Mr. Stavneak agreed with Representative Lopez. He added that there is surplus Private Prison SLI money right now for today's transfer and beyond this point there is no additional surplus money. Anything will be backfilled at this point.

Representative Lopez said the supplemental would go into replacing the fund pulled out of the private prisons. The agency has an issue and they are looking for ways to deal with it.

Senator Burns stated this discussion is something we would need to worry about at the next meeting rather that dealing with it at this meeting.

<u>Representative Boone moved</u> *that the Committee approve the General Fund transfer of $9 million from Personal Services and $3 million from Employee Related Expenditures to the Overtime/Compensatory Time SLI. The Committee also favorably review the General Fund transfer of $18.4 million from Private Prison Per Diem SLI to All Other Operating Expenditures to fund 2,064 provisional beds.* The motion carried.

ARIZONA DEPARTMENT OF ADMINISTRATION – Review of Initial Telecommunications Contractor and Carrier Cost Rate Structure.

Ms. Shelli Carol, JLBC Staff, said this item is a request from the Arizona Department of Administration (ADOA) for Committee review of the initial telecommunications contractor and carrier cost rate structure. The state privatized telecommunications in FY 2005. Statute requires a review of these rates. The contract is currently more expensive than original estimates showed, so this structure would cost $10 million more from the General Fund and $4.3 million from other appropriated funds spread among the agencies.

Representative Boone asked if the $10 million General Fund over 2005 was an ongoing expense to the General Fund.

Ms. Carol replied that not all of the $10 million is an ongoing expense, $3.6 million is a one-time expense to pay off the 5-year lease and $0.9 million is the reserve proposed to reconcile any discrepancies in ADOA estimates, part of which might become an ongoing expense.

Mr. Bill Bell, Director, Arizona Department of Administration, said that ADOA is on schedule with implementing the project. The transition is almost complete and expects to have it completed in April. The rates presented are reasonable and are part of the contract.

Senator Burns asked what decision process was used in the decision to use a 5-year lease-purchase since there was no legislative input into the decision.

Mr. Mike Totherow, Telecommunications Program Office Director, said the decision to use the financing was a contract option from the beginning. The contracts were showing expenses that were above what the agencies could afford in FY 2006. The Telecommunications Programs Office worked with the Executive Branch's financial offices and realized that the best option was to use financing to survive FY 2006. The agreement was to reduce the cost in the first year by $2.6 million through a restricted seat which is basically a zero cost seat to multiple agencies. There was also $3.6 million that financed the equipment portion and project costs. This is a 5-year lease effectively deferring costs from FY 2006 for the agencies. There were contract amendments made to make sure the new technology was at a price advantage to moving forward to the new platform. This looks like the best feasible mechanism to engage and stay within the forecasted costs of the contract.

Representative Tully asked if anyone was informed in the Legislature about the contract option.

Mr. Totherow stated that the Executive Governance Committee has representation from the Legislature, JLBC sits on that committee so they can see the activities that were taken on at the time. This was a contractual option from the beginning. As it was entered, it was made sure that the cost of the contract was below the overall cost of the rate structure approved.

Representative Gorman asked what would be proposed if the $10 million was not extended.

Mr. Totherow said if there were no monies available to move the contract forward, there would need to be restructuring or renegotiation with the contract in order to make the contract affordable for the agencies. That would mean reducing either security, service levels, or the new technologies such that there would not be a fulfillment of legislative intent to provide for the converged voice video and data network statewide.

Representative Boone asked if this was a 5- or 7-year term.

Mr. Totherow replied that during the renegotiation of the contract in FY 2006, the first 2-year option on the contract was extended. When the contract was solicited for statewide telecommunication outsourcing, the lowest cost to the state was chosen. The original contract was for 5 years with two 2-year extension possibilities. In the renegotiation, the first option was engaged.

Representative Boone asked what the total contract amount is at this time.

Mr. Totherow said the total contract amount for 5 years is $179 million. The last 2 years is $15 million each.

Representative Boone asked if there are any carrying charges or if the only part of the lease is the $3.6 million or if was all a lease-purchase arrangement or a portion of the $179 million.

Mr. Totherow said the carrying charges are under the contract as is a leasing option. Those technologies that are purchased with lease-options would have 5-year terms associated with it. Currently as it stands, this program will generate $30 million to $35 million in savings over the lifecycle. The dollars are planned to be used and are embedded in the current seat rate structure as an investment pool to replace the technology out in the agencies. The available cash will be used as much as possible and not engaging commitments to the state that carries beyond the 7 years. Representative Boone asked if there was an opportunity for the state to save any of the interest that might be in the contracts now if they were paid differently.

Mr. Totherow said the $3.6 million is the only leasing finance vehicle that was taken in FY 2006. To explain the lease-option that was in FY 2006, the contractor provided a cost structure that the rate structure was set around $55 per seat, it was restructured by taking out capital and project costs. That represented $3.578 million to be paid July 1.

Senator Martin said the savings on this program pays off once the full state system is implemented. The worst thing to do is have agencies pull out because that is where the costs come in. We need to make sure agencies stay on the 5-year plan for the real savings.

Representative Boone moved that the Committee defer its review until the Legislature finalizes its budget decisions and amend statute to require an annual rate structure report from ADOA to facilitate the budgeting process. The motion carried.

EXECUTIVE SESSION

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

At 9:00 a.m. the Joint Legislative Budget Committee went into Executive Session.

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

At 9:30 a.m. the Committee reconvened into open session.

Representative Boone moved that the Committee approve the recommended settlement proposal by the Attorney General's Office in the case of Sharpe/Burman/Turnage v. State of Arizona, et al. The motion carried.

Chairman Burns recessed the meeting until 3:30 p.m. THE MEETING RECESSED AT 9:30 a.m.

THE MEETING RECONVENED AT 4:03 P.M. All members were present except for Representative Huffman, Representative Lopez, and Senator Bee

DEPARTMENT OF ECONOMIC SECURITY – Review of Options for Case Management Privatization in Child Protective Services.

Mr. Eric Jorgensen, JLBC Staff, said this item is a review of a report by the Department of Economic Security (DES) related to options for privatization portions of the case management duties in Child Protective Services (CPS). This report was submitted pursuant to a footnote in the General Appropriation Act last year.

Representative Biggs asked what would happen if the Committee gives a favorable to the second option with its provisions.

Mr. Jorgensen replied that DES would be asked formally by the Committee to pursue the options identified in the report taking the next step for privatization.

Representative Biggs asked what would happen if DES did not provide the report.

Mr. Jorgensen replied that there is no punitive measure associated with not providing the report.

Representative Biggs asked the agency how likely it would be for the Committee to receive the report within 4 months.

Mr. David Berns, Director, Department of Economic Security, said that the agency would do its best to get the report done in that time. The workgroup will be established by the end of March and the workgroup will answer the questions.

Representative Pearce said a letter was sent to the agency asking for results on the differences between DES and the Attorney General on reporting the number of children that are awaiting home placement. A response to the letter was due on December 31, 2005. He has not seen the response and asked when the response will be received.

Mr. Berns replied that he did not recall the specific request, but he will check into the response.

Representative Biggs said according to the McCullough report, there seems to be an intrinsic opposition within DES to privatization. He asked what will likely been seen as a product of this public/private work group, a report that is more inclined to place hurdles or an honest good-faith report.

Mr. Berns said they would look at the areas where there is the most agreement and try to work forward with those. There was a lot of agreement on privatization of areas in the adoption and in-home services. They may try to look at those first, but the other areas are up for additional review and consideration as well.

<u>Representative Pearce moved</u> that the Committee give a favorable review of the report with the following provisions:

- *DES establish a Public/Private Partnership Workgroup as recommended by the report to continue to explore options for privatization, including the identification of parameters for a pilot program, and report by the end of each calendar quarter to the Committee on the actions and discussions of the workgroup, beginning June 30, 2006.*
- *DES report back to the Committee on how it is addressing the issues identified in the report regarding current internal procurement and contract monitoring by June 30, 2006.*
- *DES identify the potential legal, financial and risk impacts of privatization, as recommended in the report, and report these to the Committee by June 30, 2006.*

The motion carried.

ARIZONA DEPARTMENT OF EDUCATION – Review of Full Day Kindergarten Research.

Mr. Steve Schimpp, JLBC Staff, said this is a review of the Full Day Kindergarten (FDK) study from Arizona Department of Education (ADE). Last year's FDK bill required the ADE to conduct a review of existing FDK studies focusing on ones that address the academic outcomes of those programs. Secondarily, the FDK bill requires the Legislature to review the ADE study before appropriating additional money for FDK. The ADE study basically concluded that they believe there is not enough research to definitively conclude that academic benefits of FDK last beyond 2nd Grade.

Representative Biggs asked if there have been longitudinal studies begun in connection with FDK as part of the legislation that went forward.

Mr. Schimpp replied that there was nothing required in last year's FDK bill requiring a long-term study of Arizona's FDK program.

Representative Pearce said we do not have to just track our program, there have been FDK in other states. He asked if there was any connection between FDK and graduation scores.

Mr. Schimpp said ADE could not find studies even beyond the early elementary grades much less all the way to high school.

Representative Boone asked for clarification in terms of the cost that currently 80% is implemented for free and reduced schools to get FDK. The total amount in the budget is $38 million for M&O. In terms of the request, the Governor has a budget to expand FDK to 100%, which would require an additional $105 million in the operating budget.

Mr. Schimpp replied that yes, the Governor has $143 million total, which is an increase of $105 million.

Representative Boone asked if the $105 million was agreed with since there was concern that it was only $4,200 per student.

Mr. Schimpp stated that the $4,300 was a policy choice from the Governor. If we were to fund to kindergarteners at the same level as 1st graders, which would occur through Basic State Aid, kids would get $700 more than under the Governor's plan.

Representative Boone asked how much more it would be if implemented.

Mr. Schimpp replied that it would be about another $60 million, which is $700 per kid multiplied by 85,000 kids.

Representative Boone asked for clarification that on the capital side, would the School Facilities Board (SFB) require $180 million to complete the capital in their budget.

Mr. Schimpp replied that is correct.

Representative Boone said that from the Appropriations (B) Committee meeting, SFB was to follow up on a calculation on the number of kids now and the square footage for new construction. He asked if SFB has followed up with that calculation.

Mr. Schimpp said he has not seen the numbers.

Representative Boone said he was asking so that he could put it into perspective in terms of the cost to implement the balance of the program. The least expensive is to go with what the Governor has proposed which is the $285 million, but it may be $60 million more on the operating side and more than $180 million on the capital side. He would like to see the numbers from SFB.

Representative Biggs asked for clarification on M&O for the first year at $38 million and capital at $10 million total. He asked if the $38 million is for both years or a single year.

Mr. Schimpp replied that it is the M&O for FY 2006.

Representative Biggs asked if the Governor's $143 million for M&O is for next year going forward.

Mr. Schimpp replied that is correct.

Representative Biggs asked if SFB is estimating an additional $180 million for completing the capital program.

Mr. Schimpp replied correct, but it has been pointed out by Representative Boone that SFB is working on an alternative number.

Representative Boone said the reason SFB is revising the number is because $180 million was calculated on the low end because they counted some of the cost from the new FDK classrooms in some of the growing districts as a normal growth, which is not looking at the actual cost. SFB was going to do a separate calculation on the basis of the number of students and give a true cost, which will be more than the $180 million to complete.

Senator John Huppenthal said his interest in the FDK issue is that we proceed with the best possible research. There are a number of studies that are cited but the Longitudinal Study that is being financed by the federal Department of Education is the best of all these studies. They pulled a random sample of 22,000 kids nationwide, employed some of the best research companies to design the test, they had 3 different tests and a steering test. The lack of research companies introducing bias extends into the way the measurements are done. The trainers go into the classroom, do their measure results, and leave. They do not interact with the classroom, which is important because if you are trying to measure or prove a certain outcome, there should be no interaction. They also measure frequently at the start of the experiment, which is important. They measured at the beginning of school, the end of school, beginning of 1st grade, 3rd grade, end of 5th grade, and followed the children all the way through.

They ended up with a sample size of 10,000 kids and what they found was that at the end of kindergarten, there was a temporary bump up for FDK. They also did affective measures from the standpoint of the teacher, child, and parent, on the level of motivation, perceived anti-social behavior frequency, and pro-social behavior frequency. The FDK had a bump up, but they had a bump down on the affective measures. They were not huge effects, but they were there. At the end of 1st grade they measured the test again, the bump up disappeared at the end of 1st grade. At the end of 3rd grade, the bump up disappeared and FDK were in the negative – not at a tremendous amount, but more than at the end of FDK. The 5th grade data has not been released yet, but it is not looking good because it appears the students had attitudinal changes while in FDK. There are a lot of complex things that go on. Children who came from where they spoke a foreign language in the home, had enduring benefits from FDK that sticks all the way to the end. Children that come from high socioeconomic homes also had enduring benefits. Because they have enduring benefits, there was an overall loss. That means all other kids lost more.

The debate over FDK has been in promises made that if it was invested in, there would be higher test scores etc. If there is a definitive study on this, it would be this study. It says that investing in FDK overall will not yield those types of gains. If you have FDK, it says the educational institutions should be looking at this and there are very complex things going on that appear to be affecting kids long-term and they should be redesigning FDK as a response. This data does not suggest that we need a more rigorous curriculum in FDK. Yet people respond by wanting a more rigorous curriculum. This is the best research study and should be the basis upon which we proceed.

Representative Biggs asked if the study can be found online.

Senator Huppenthal said the way the study is being conducted, National Center for Educational Statistics (NCES), a subsidiary of USDOE, is doing the massive collection. They are releasing the data to a broad array of groups, which are then analyzing the data. ADE is publishing studies. If you search on Jerry West and All Day Kindergarten, he presented the data through the 3rd grade for the National Educational Research Association. That is when they show the FDK gains had disappeared. The information is available if you search through the NCES Web site.

Representative Tully asked if the studies have added any other educational strategy that is effective for increasing education outcome for students. He asked Senator Huppenthal if, during his research, he has come up with an idea of what might be a more effective strategy for increasing educational outcomes.

Senator Huppenthal said that there are best practices out there and people who implement those best practices have better outcome. Best practices can produce better outcomes, but they do not necessarily produce better outcomes. That is a paradoxical statement because certain people have the leadership skills to search out best practices but they also have the skills to implement them properly and make them work. The only strategy he has come up with is to be cognizant of the fact that there are enormous differences on educational outcomes from school to school and district to district. If you can pull children out of ineffective schools and have them go to schools at effective schools, you will produce extraordinary gains.

Representative Burton Cahill asked Senator Huppenthal if he has spoken with any of the resources from the universities and asked them if they have looked at research.

Senator Huppenthal said he had discussions with Dr. Glass, who has done national research. He has the opposite ideological spectrum. Success for All is a program that he recommended as a best practice for English Language Learner (ELL) students. Most of the studies for this program did show that it produced higher outcomes, but they also had implementations in which it reduced outcomes. The key was there were effective schools that were implementing an effective program that produced higher outcomes. The ineffective schools that implement an effective program are just as likely to reduce outcomes.

Representative Burton Cahill asked Senator Huppenthal if he has asked if any of the graduate students are studying this research. She said that there are some schools that have more challenges with the students that are attending. When there is a predominance of children whose parents are not there to help with homework, sometimes those schools have more of a challenge.

Senator Huppenthal said that Dr. Glass runs a research journal that publishes a large volume of research papers published by the students. The American Research Institute did a study of ELL students in California that looked at longitudinal outcomes in a variety of school districts. There are the disadvantaged students in some school districts and they were able to move 90% of the ELL students from being labeled below to above the standard. At other school districts with the same types of disadvantaged students, they only had 7% over a 10-year period that 90% of the students were below the standard label for all 10 years they were attending the school. There were massively different outcomes for the same disadvantaged students. In the successful school districts, there was teamwork and effective leadership. There was no one approach to the highly effective schools. The ineffective schools had teachers disparaging the students in the classroom. The key is not the disadvantaged home, but the effective versus ineffective schools.

Senator Garcia asked why this review did not include the study referenced by Senator Huppenthal.

Allison Landy, Arizona Department of Education, replied that Senator Huppenthal was referring to the Jill Austin and Jerry West study included in the review as study #5. It was a review of the Early Childhood Longitudinal Study (ECLS) data. The ECLS is a database of statistics, so several of the studies that were included in the report actually looked at the same numbers in a variety of ways. Several researchers used the same database in order to make their findings and determinations.

Mr. Art Harding, Arizona Department of Education, said this review is a compilation of other studies without ADE conclusions.

Representative Boone asked if the ECLS study was part of the reason why ADE drew their conclusion that there are an insufficient number of research studies beyond 2nd grade.

Senator Huppenthal said that it has been so difficult to draw conclusions despite the thousands of studies available. A large part of the studies has concluded the gold standard for study and education is random assignment. The ECLS study did not have random assignment, they had random selection. When they pulled their students randomly, they pulled nationwide random samples on schools, classrooms and within classrooms, so not every student was picked within the classroom. When the initial test scores were done, the 2 groups of students were landing almost perfectly on top of each other. That tells you that these 2 populations may be highly similar even though their parents selected 2 different types of educational outcomes. A big part of the controversy in this study is that it was not random assignment. However, there are no other random assignment studies available in this area. There are methodological problems associated with the random assignment elements. It is a random assignment issue versus measuring what happens in real life. All the other studies in the review are measurements in real outcomes and real educational settings.

Representative Boone asked if, based upon the ECLS research through 3rd, 4th, or 5th grade, there is no measurable difference of student achievement between the FDK kids and non-FDK kids.

Senator Huppenthal said that there is a slight statistical edge to the half-day, but that this finding is not clinically significant.

Representative Boone asked in the department's review of the research, if there is research that would show on a longitudinal basis that there is an academic achievement benefit to FDK over non-FDK and where the study that shows it is.

Senator Huppenthal said there are a plethora of studies showing advantages to FDK, but they do not show that FDK reduces academic gains that last over time.

Senator Waring moved that the Committee review the report but make no designation as to a favorable or unfavorable review. The final determination will move to the full Legislature without a decision made by this Committee. The motion carried.

ATTORNEY GENERAL

A. Review of Intended Use of Monies in the Antitrust Enforcement Revolving Fund.

Ms. Leah Ruggieri, JLBC Staff, said the Attorney General's Office is seeking a favorable review to expend from the Antitrust Enforcement Revolving Fund in excess of $208,200. They are expecting FY 2006 expenditures will be equivalent to $375,000.

Representative Pearce moved that the Committee give a favorable review to the Office of the Attorney General's intended expenditures of $375,000 of Antitrust Enforcement Revolving Fund monies. The motion carried.

B. Review of Allocation of Settlement Monies.

Ms. Leah Ruggieri, JLBC Staff, said the Attorney General's Office is seeking a favorable review of the allocation of settlement monies recently received from the Auto Connect settlement agreement. The settlement amount is equal to $170,000, the majority of which will be spent on the restitution to eligible consumers that purchased automobile service agreements from Auto Connection.

Representative Pearce moved that the Committee give a favorable review of the allocation plan from the Auto Connection settlement agreement. The motion carried

DEPARTMENT OF PUBLIC SAFETY - Quarterly Review of the Arizona Public Safety Communications Advisory Commission.

Mr. Martin Lorenzo, JLBC Staff, said this item is a review of the Arizona Public Safety Communications Advisory Commission (PSCC) FY 2006 2nd quarter expenditures. The FY 2006 2nd quarter total expenditures were approximately $109,900 of $4.1 million in available funding. Three staff positions continue to remain vacant and the PSCC drafted operational policies and procedures for the interoperability environment.

Representative Pearce moved that the Committee give a favorable review to the FY 2006 second quarter expenditures and progress for the statewide interoperability design project. Additionally, the Committee requested future quarterly reports include progress and activities relative to tasks identified in the Concept of Operations and timeline. The motion carried

ARIZONA DEPARTMENT OF TRANSPORTATION - Review of Third Party Report.

Bob Hull, JLBC Staff, said this item is a review of Arizona Department of Transportation (ADOT) third party quarterly report. Third parties are entities that ADOT contracts with to do certain Motor Vehicle Division (MVD) tasks. In the current year, they were given 3 additional FTE Positions to help with workload and third party quality assurance for title and registration. The House and Senate Appropriations Committees have adopted motions which would provide some additional resources for the third party program in FY 2007 to reduce or eliminate third party waiting lists and improve ADOT's quarterly reports as follows:

- Add $265,200 and 6 FTE Positions in FY 2007 for Motor Vehicle Division (MVD) staff to contract with 145 authorized title and registration third parties.
- Add $88,400 and 2 FTE Positions in FY 2007 for MVD staff to eliminate the vehicle identification number inspections waiting list.
- Expand the current third party reporting footnote to include data and waiting lists for other third parties besides the title and registration third parties.
- Add a footnote requiring that ADOT report to the JLBC for review by November 30, 2006, whether ADOT can review less than 10% of the third party title and registration transactions and still retain statistical validity.

Representative Biggs asked what happens if the budget is approved and the backlog is not taken care of.

Mr. Hull replied that there is a footnote that the Appropriations Committees have adopted that goes with each of the 2 additions of resources which addresses the department having to meet certain performance criteria or it is the intent of the Legislature that those resources would go away in FY 2008.

Representative Biggs asked how much the resources are.

Mr. Hull said it is $265,200 and 6 FTE Positions for title and registration third parties and $88,400 and 2 FTE Positions for vehicle identification number inspections third parties.

Representative Pearce asked if the positions were for doing the actual work and not auditor positions.

Mr. Hull replied that these positions are ADOT staff to monitor the third parties who would do the actual work.

Representative Pearce asked the department to address Representative Biggs' question on the backlog in third parties and the resources. He also asked if the backlog will be eliminated.

Penny Martucci, ADOT, Motor Vehicle Division (MVD), replied that there are approximately 109 traditional title and registration third parties on the waiting list. There are 371 third party vehicle identification number inspectors. If the moratorium was lifted, that is a lot of people waiting to be brought on. The moratorium was placed on title and registration third parties in 2002, and vehicle identification number inspections third parties in 2003 because there was not enough staff. The positions are a good start. The division can look at creating temporary positions to help take on some of the third parties. They want to eliminate some of the waiting list and get more help for their offices.

Representative Pearce said an issue is that third parties reduce the MVD workload so there is a shift in resources that should take place. There should not be a moratorium when bringing on third parties helps to improve service, save money, and give customers options. When bringing on third parties, ADOT should take the resources and move them to auditors. An auditor can manage and audit lots of third parties.

Ms. Martucci said the population and the amount of work required have increased and made things more difficult.

Representative Pearce said that workload is reduced by giving the work to third parties. It alleviates opportunities in resources. The third party program should be dealt with aggressively because it should free up services to do audits and expand the program. It would eliminate thousands of transactions that would have gone to MVD.

Ms. Martucci said that the positions will help, however, it may or may not solve the problem. They are willing to create some limited positions to help.

Representative Pearce moved that the Committee give an unfavorable review of the second quarter FY 2006 report since the results have not been satisfactory. The motion carried

ARIZONA BOARD OF REGENTS - Review of Progress Report on Phoenix Medical Campus and Report on Strategies to Prevent a State Doctor Storage.

Ms. Shelli Carol, JLBC Staff, said this item is a request from the Arizona Board of Regents for Committee review on the progress report on the University of Arizona Phoenix Medical Campus. The Phoenix Medical Campus project is on schedule and within budget. The University of Arizona and Arizona State University are in the process of hiring faculty and staff for the new campus.

Representative Pearce moved that the Committee give a favorable review of the progress report, with the provision that this review does not constitute endorsement of any level of General Fund appropriations for the Phoenix Medical Campus. The motion carried

The meeting adjourned at 5:07 p.m.

Respectfully submitted:

Yvette Medina, Secretary

Richard Stavneak, Director

Senator Robert Burns, Chairman

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

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

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PHOENIX, ARIZONA 85007

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HOUSE OF REPRESENTATIVES

DATE: March 23, 2006

TO: Senator Bob Burns, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Kimberly Cordes-Sween, Fiscal Analyst

SUBJECT: Arizona Department of Corrections – Consider Approval and/or Review of Transfer of Appropriations

Request

Laws 2005, Chapter 286 requires that any transfer to or from the amount appropriated for the Private Prison Per Diem Special Line Item shall require review by the Joint Legislative Budget Committee.

The Arizona Department of Corrections (ADC) requests Committee review to transfer $16 million from the Private Prison Per Diem Special Line Item to the All Other Operating Expenditures line item of the operating budget to pay for inmate health services costs.

Recommendation

The Committee has at least the following 3 options to consider:

1. Transfer $16 million from the Private Prison Per Diem Special Line Item to the All Other Operating Expenditures line in the operating budget, as requested by the Department of Corrections. This option would leave an estimated $12.5 million shortfall in the Private Prison Per Diem line. At that level, the department would be unable to make payments to private prison contractors in April, May and June. This option requires Committee review.
2. Transfer $10 million from Personal Services, $1.7 million from Employee Related Expenditures, and $4.3 million from the Private Prison Per Diem Special Line Item to the All Other Operating Expenditures line. Additional funding would be necessary to cover June expenses for these items. This option uses the department estimate of the health care shortfall, but pro rates the transfer among all other lines. Since this transfer requires the shift of monies from Personal Services and Employee Related Expenditures, this option requires Committee approval.

(Continued)

3. Transfer $4 million from the Private Prison Per Diem Special Line Item to All Other Operating Expenditures. The JLBC estimate of the All Other Operating Expenditures shortfall is $9.2 million. The remaining $5.2 million would be addressed by supplemental or further internal transfers. This option requires Committee review.

Private Prison Per Diem Transfer

Option 1:			
Transfer From:		Transfer To:	
Private Prison Per Diem	$16,000,000	All Other Operating Expenditures	$16,000,000
Option 2:			
Transfer From:		Transfer To:	
Private Prison Per Diem	$ 4,300,000	All Other Operating Expenditures	$16,000,000
Personal Services	9,986,400		
Employee Related Expenditures	1,713,600		
Total	$16,000,000	Total	$16,000,000
Option 3:			
Transfer From:		Transfer To:	
Private Prison Per Diem	$4,000,000	All Other Operating Expenditures	$4,000,000

Analysis

Health care operating expenses, excluding Personal Services and Employee Related Expenditures, are funded from the $200.3 million All Other Operating Expenditures line. Besides health care, this line funds food, provisional beds, contracted provisional beds, utilities and general operating costs.

ADC requests the transfer of $16 million from the Private Prison Special Line Item to the All Other Operating Expenditures line in the operating budget to pay for health care expenses. According to the department, this transfer of monies would cover the following items:

Health Care Expenses

	Total
Hospital Services	$ 9,600,000
Pharmaceuticals	2,880,000
Physician Services	1,760,000
Registry & Temporary Agencies	1,280,000
Psychiatry	480,000
Total	**$16,000,000**

The $16 million is part of the department's request for a $26.6 million FY 2006 supplemental for health care Other Operating Expenses. The extent of the health care shortfall is difficult to analyze as there is no specific legislative intent with regard to health care costs within the $200.3 million All Other Operating Expenditures line.

The Department of Corrections currently projects total health care All Other Operating Expenditures of $62.1 million by the end of FY 2006. The JLBC Staff projects a total cost of $59.4 million based on year-to-date actual expenses. During the first 6 months of FY 2006, health care All Other Operating Expenditures increased by 6.1% over the FY 2005 cost of $56 million. JLBC Staff applied the 6.1% increase to the FY 2005 total All Other Operating Expenditures to provide the FY 2006 year end cost estimate of $59.4 million. The department's FY 2006 cost estimate is 10.9% higher than the total FY 2005 cost.

(Continued)

The JLBC estimate of $59.4 million is part of an overall All Other Operating Expenditure estimate of $209.5 million, which results in a $9.2 million shortfall, compared to a $200.3 million current All Other Operating Expenditure budget (including the February 2006 JLBC transfer of $18.4 million).

Fund Shift Options

In anticipation of receipt of the health care supplemental request, the department would like to transfer monies from the Private Prison Per Diem Special Line Item to the All Other Operating Expenditures line in the operating budget to temporarily cover health care expenses. According to the department, once a supplemental is approved, the fund shift would be reverted back to the Private Prison Per Diem line to cover funding obligations to private prison contractors.

A fund shift of $16 million out of the Private Prison line would leave $39.7 million to pay for 3,100 private beds. According to JLBC estimates, the $16 million requested fund shift would leave at least a $12.5 million shortfall in the Private Prison Per Diem Special Line Item. The JLBC Staff currently estimates that the department will require $52.2 million for this line based on current private bed use. With this option, the department would run out of funding for private prisons by April 2006.

With option 2, a combination of 3 transfers, including $10 million from Personal Services, $1.7 million from Employee Related Expenditures and $4.3 million from the Private Prison Per Diem Special Line Item, totals the department's estimated health care shortfall of $16 million. This option pro rates funding to all lines in order to incur budgetary shortfalls only in June 2006. In FY 2006 the Department of Corrections received a Modified Lump Sum budget structure and, pursuant to A.R.S. § 35-173, transfers to or from the Personal Services and Employee Related Expenditures lines are permitted only if approved by the Joint Legislative Budget Committee. As a result, this option, unlike the others, requires Committee approval.

In option 3, of $9.2 million, $4 million would be covered from the Private Prison Per Diem Special Line Item and $5.2 million from a supplemental or internal transfer of funding. With this option, the department would have sufficient funding remaining for private prison contract costs, but would require addressing the remaining $5.2 million by internal transfers or further supplemental funding by June 2006.

RS/KC:ar

Arizona Department of Corrections

1601 WEST JEFFERSON
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JANET NAPOLITANO
GOVERNOR

DORA B. SCHRIRO
DIRECTOR

RECEIVED
FEB 24 2006
JOINT BUDGET COMMITTEE

February 24, 2006

The Honorable Robert Burns
Chair, Joint Legislative Budget Committee
Arizona Legislature
1700 West Washington
Phoenix, Arizona 85007

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

Gentlemen:

The purpose of this letter is to request placement on the agenda of the next meeting of the Joint Legislative Budget Committee to approve a transfer of funds in the amount of $16 million from the Private Prison appropriation, the only remaining account with sufficient available funds, to the All Other Operating Expenses appropriation to cover immediate inmate health services liabilities. The transfer of $16 million is sought immediately in order to manage cash flow pending the legislature's approval of the department's supplemental appropriation request. This transfer will need to be reversed to cover May and June obligations in private prisons upon receipt of a supplemental appropriation for inmate health services.

Needless to say, the supplemental request is important and managing the Department's cash flow until the supplemental is considered is our immediate concern.

I appreciate your consideration and timely action.

Sincerely,

Dora Schriro

Dora Schriro

cc: The Honorable Janet Napolitano, Governor
The Honorable Ken Bennett, President, Arizona State Senate
The Honorable James Weiers, Speaker, Arizona House of Representatives

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE
SENATE

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HOUSE OF
REPRESENTATIVES

DATE: March 23, 2006

TO: Senator Bob Burns, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Kevin Bates, Fiscal Analyst

SUBJECT: Arizona Department of Corrections – Report on Public-Private Bed Cost Comparison

Summary

The department recently contracted with Maximus, a consulting firm, to evaluate the methodology that the Arizona Department of Corrections (ADC) uses for its statutorily-required public-private bed cost comparisons.

- Maximus observed that the current ADC methodology “does not enable the accurate comparison of ADC operated prison costs to private prison costs.” Maximus made recommendations for adjustments to make the comparison more accurate.
- Based on some of these recommendations, ADC produced a brief preliminary public-private comparison and found that the average daily per capita private bed cost was $5.59, or 12.8%, more expensive than public beds.
- While Maximus reviewed the ADC comparison and reported that it “reasonably presents” the difference in costs of public and private beds, it noted that additional adjustments were still necessary. Based on a “cursory review,” Maximus estimated that these further changes would increase the public bed daily cost by less than $2.
- Maximus also recommended that the public cost be adjusted for capital construction expenses, which is already reflected in the private vendor costs. While the model makes some adjustment for asset depreciation, this does not fully capture new construction costs. Making this capital adjustment will reduce or may eliminate the existing public-private differential.
- Maximus also suggested that ADC release a detailed methodology describing the process used to calculate costs of public and private beds. Any in-depth analysis of the comparison should await the release of that material.

(Continued)

Background

A.R.S. 41-1609.01 is the primary statute that governs how to evaluate and measure private prison costs. It requires that the Arizona Department of Corrections (ADC) accept a private prison contract proposal only if the proposal offers a savings to the state and offers a level and quality of services that are at least equal to the state. The cost methodology and service levels used for these evaluations are to be developed by the department.

Statute also requires that ADC shall conduct a service and cost comparison of existing private prison contracts, comparing them to similar public facilities. The service comparison is to be made every other year, and the cost comparison is to be conducted every 5 years.

Maximus was hired to evaluate 3 different reports. The Operating Per Capita Cost Report is a breakdown of the direct and indirect costs allocated to every public and private prison facility housing Arizona inmates. The Per Capita report also illustrates the costs by custody level and shows historical costs, appropriations and average daily populations. The Public-Private Cost-Comparison Report is a statutorily-required analysis that takes the information from the Operating Per Capita Cost Report and makes adjustments to ensure an "apples-to-apples" comparison. The Private Prison Cost Model is a prospective methodology that allows the department to forecast the costs of adding new beds to the current system.

<u>Operating Per Capita Cost Report</u>
Maximus found that ADC's methodology for the Operating Per Capita Report was reasonable but needed improvement. Maximus recommended that ADC add narratives and exhibits to more clearly and quickly present the information contained within the report. Maximus recommended showing direct and indirect costs by the major cost components to allow more detailed analysis and scrutiny of ADC's costs. Also recommended was the development of a detailed manual with written explanations of the report's methodologies, assumptions, procedures, timelines and sources of data.

<u>Public-Private Cost Comparison Report</u>
Maximus indicated that the report should use as its starting point the operating budgets of the private and a comparable public facility, adding and subtracting costs where necessary to appropriately allocate costs to both ADC and private facilities and to exclude those costs that do not provide an "apples-to-apples" comparison.

Maximus' recommended that the comprehensive costs of a public facility should include 3 components: 1) direct and indirect operating costs, 2) asset depreciation and 3) support services provided by non-ADC agencies. These costs should be taken from and reconciled to the Operating Per Capita Cost Report. Costs recommended to be excluded from public costs consisted of: 1) inmate intake, 2) transportation, 3) high-cost health care, and 4) the work incentive pay plan because these were not borne by private facilities.

Using data from the Operating Per Capita Cost Report, ADC conducted a preliminary comparison of public and private costs, indicating that private beds were more costly to operate than public beds. This comparison was made by comparing the average cost of low-custody, level-2 state beds to the average cost of 3 private facilities: Marana Community Correctional Treatment Facility, Florence West and Phoenix West. These 3 private facilities house inmates convicted of DUI and substance abuse offenses. Using FY 2004 data, ADC concluded that the average cost of the 3 private facilities was $5.59 per person per day, or 12.8%, more expensive than the average cost of the level-2 public beds. Using FY 2003, data, the private beds were shown to be $6.13 per person per day, or 14.2%, more expensive than public beds.

(Continued)

ADC did not account for certain costs, like asset depreciation, inmate intake and transportation, labor relations, information technology and administrative services in this comparison. Maximus estimated that these adjustments would have added less than $2 to the daily public per capita cost. The department has not released details on how the adjustments were calculated.

As noted below, this comparison does not include capital costs.

Private Prison Cost Model
To comply with A.R.S. 41-1609.01(G), ADC must use a cost model to determine whether any private prison bids under consideration offers a cost savings to the state. Maximus looked at 2 cost models: an historical model developed by the Arizona Office of Excellence, and a projected model developed by ADC. Maximus determined that neither model allows an equitable cost comparison analysis or reasonably determines any potential cost savings.

Maximus recommended that the historical model should not be used because an historical cost analysis comparing past ADC costs to new private contractor costs will inevitably lead to an incorrect decision. This model does not allow for savings from improvements in such areas as prison design, construction, maintenance, or operations to be reflected in the public cost.

Instead, Maximus recommended that ADC's projected model be modified and asked ADC to analyze costs as if the department itself was bidding on the prison project. Several improvements to the model were recommended:

- Avoid reallocating existing costs to any new facility or project
- Develop a site-specific construction and depreciation cost estimate
- Develop a site-specific estimate of operating costs
- Include in ADC costs any start-up expenses, such as staff training prior to the open date
- Include a comprehensive manual with written explanations of the report's methodologies, assumptions, procedures, timelines and sources of data.

Capital costs could significantly alter the public-private cost comparison. The current private per diem reflects the vendor's cost to build or lease a facility. The existing public daily per capita cost does not include this component. In deciding whether to build a private or public facility in the future, it would be necessary to adjust the comparison for this factor. These public construction costs will vary, depending on the size of the facility and whether it is cash- or debt-financed. Maximus has factored asset depreciation into its cost comparison, but ADC has not yet released the details of this particular adjustment or how it relates to fully capturing capital costs.

RS/KB:lm

Arizona Department of Corrections

1601 WEST JEFFERSON
PHOENIX, ARIZONA 85007

JANET NAPOLITANO
GOVERNOR

DORA B. SCHRIRO
DIRECTOR

February 8, 2006

The Honorable Janet Napolitano
Governor of the State of Arizona
1700 West Washington
Phoenix, Arizona 85007

Dear Governor Napolitano.

The Arizona Department of Corrections (ADC) retained MAXIMUS, Inc. an independent accounting firm with a national reputation for cost modeling, to review the department's preparation and applications of its Per Capita Operating Cost Report and Private Prison Cost Models and to provide recommendations for improvement.

MAXIMUS reviewed the department's preparation and utilization of its FY 2003 and FY 2004 Per Capita Operating Cost Reports and its methodologies for conducting cost comparisons to determine whether privatization provides a cost savings to the department prior to contracting for private beds.

The MAXIMUS report includes recommendations in three sections. First, MAXIMUS recommended improvements to the development of the Operating Per Capita Cost Report and restricting its usage solely to that purpose. Second, MAXIMUS recommended that the department adopt the State Versus Private Prison Cost Comparison report to determine retrospectively whether privatization provided a cost savings to the department per ARS 41-1609.01 (L). Third, MAXIMUS recommended the department discontinue use of the historical Private Prison Cost Model and improve the development of the projected Private Prison Cost Model to determine whether privatization provides a cost savings to the Department before contracting for permanent private beds per ARS 41-1609.01 (G). The department agrees with and is adopting all of the recommendations in the MAXIMUS report. Copies of the report and the department's response to MAXIMUS are attached.

Further, the department has completed a comparison of public versus private bed costs for FY 2003 and FY 2004 establishing the ADC-operated, level 2 bed costs are appreciably lower than comparable in-state private beds. MAXIMUS has reviewed the department's comparisons of costs and concluded ADC continues to demonstrate ability to utilize the appropriate methodologies and procedures required to develop accurate, reasonable comparisons of cost to maintain male inmates in a State versus private prison.

Copies of the department's FY 2003 and FY 2004 comparisons of public versus private bed costs and their review by MAXIMUS are provided as well.

If additional information is required, please do not hesitate to contact me.

Sincerely,

Dora Schriro

Dora Schriro

Attachments
cc: The Honorable Robert Burns, Chair, Joint Legislative Budget Committee
The Honorable Russell K. Pearce, Chair, Joint Legislative Budget Committee

REPORT ON THE EVALUATION OF

ARIZONA DEPARTMENT OF CORRECTIONS'

OPERATING PER CAPITA COST REPORT

AND

PRIVATE PRISON COST MODEL

February 2006

MAXIMUS
HELPING GOVERNMENT SERVE THE PEOPLE

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SECTION I

EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

This Report provides the findings and recommendations of an independent evaluation of the methodologies employed by the Arizona Department of Corrections (ADC) in the preparation and application of its Operating Per Capita Cost Report and Private Prison Cost Model. This Report and the evaluation upon which it is based were conducted and prepared at ADC's request by MAXIMUS, Inc. Information on MAXIMUS and the consultant assigned to conduct the evaluation is provided in Appendix A.

Operating Per Capita Cost Report

ADC annually prepares an Operating Per Capita Cost Report (Cost Report). The purpose of the Cost Report is to provide the average daily operating cost incurred by ADC during a fiscal year to incarcerate an inmate. Information provided in the Cost Report has also been utilized to compare state versus private prison costs. The Cost Report provides information on the average daily population and per capita operating cost of both ADC operated prisons and private contract prisons. In addition to providing information at the department level, the Cost Report provides information by security level, complex, and unit. The objective of the evaluation of the Cost Report is to ensure the methodology utilized by ADC to distribute direct and indirect costs accurately and reasonably reflects the operating costs incurred by ADC to perform its responsibilities.

Findings

In our opinion the methodologies utilized in the development of the FY 2003 Cost Report resulted in a reasonable cost analysis for FY 2003. Although recommendations for improvements have been identified, the application of the recommended improvements would result in less than a two percent (2%) decrease in the overall average daily operating costs of ADC operated prison and a decrease of approximately one percent (1%) in the overall average daily operating cost of a private prison.

Our review identified costs that had either been incorrectly classified or allocated that would have decreased the overall average daily operating costs for ADC operated prisons by approximately sixty-two cents (62¢). Costs that had been incorrectly classified were costs related to inmate intake and transportation. Based on the overall average FY 2003 ADC operated prison cost for all custody levels, this would have been an adjustment of less than two percent (2%). Costs that had been incorrectly allocated to private prisons would have decreased the average cost for contracted level 2 male inmate beds by less than forty-five cents (45¢) and increased ADC's overall average daily operating costs by approximately five cents (5¢). Based on the overall average FY 2003 private prison cost, this would have been an adjustment of approximately one percent (1%). The effect to ADC's overall average daily operating cost would have been less than one-tenth of one percent.

Although in our opinion the Cost Report presents a reasonable cost analysis, it does not enable the accurate comparison of ADC operated prison costs to private prison costs. The Cost Report only includes costs appropriated to ADC. It does not include costs of central support services provided by other Arizona state agencies in support of ADC operations or asset depreciation on ADC facilities. The Cost Report also includes costs of inmate intake, transportation, high health, and the work incentive pay plan only in the average daily cost of ADC operated prisons. These costs should be excluded from ADC costs in developing a cost comparison. Costs of inmate intake and transportation benefit both ADC and private prisons. Costs of inmate health are borne disproportionately by ADC operated prisons. Costs of the work incentive pay plan are borne solely by ADC operated prisons. In order to provide information on which a valid cost comparison could be made in response to ARS 41-1609.01 (L), a separate, distinct report should be developed that includes all costs, and appropriately allocates costs to both ADC and private prisons and/or excludes costs not borne by both ADC and private prisons.

Recommendations Related to Cost Report

As a result of our review, MAXIMUS has identified the following recommended improvements to the format of the Cost Report and methodologies utilized to develop information presented in the Cost Report:

- Additional Narratives - Narratives should be added stating the objectives of the Cost Report, clarifying the methodologies, and describing the purpose of and the information presented on each exhibit.

- New and Reordering Exhibits - Current Cost Report exhibits are not conducive to presenting a clear cost analysis or presented in an order that provides key information for readers with limited time. Exhibits should be developed and presented in an order that supports the objectives of the Cost Report.

- Redesign Exhibit - Exhibits should be either redesigned or new exhibits added that present direct costs by major cost components. The average daily costs should also be presented by major cost components. This will allow a reader to better analyze ADC costs and enable ADC to document their costs and validate their appropriation requests. Exhibits presenting information on private prisons should identify costs by permanent and emergency beds, and by major cost components.

- Classifying Costs - Currently costs associated with inmate intake and transportation are classified as direct costs of the ADC prison unit or complex incurring the expenses. These costs should not be direct costs utilized in the development of a unit's per capita cost. These costs benefit both ADC and private prisons, and should be tracked and identified as a separate cost category in the Cost Report.

- Indirect Cost Allocations - Review of the responsibilities and duties of the units currently classified as indirect costs identified costs that are inappropriately allocated to private prison or for which a more appropriate allocation base should be utilized.

Due to the relatively small costs of these services, the total estimated effect of recommended changes to the overall average daily operating cost for ADC prisons would be an increase of less than five cents (5¢). The estimated effect to the overall private prison operating cost would be a reduction of less than forty-five cents (45¢).

- Documentation of Procedures - A comprehensive manual should be developed that includes written details regarding methodologies, assumptions, procedures, time lines, and sources of the data presented in the Cost Report.

Recommendations Related to Development of a State Versus Private Prison Cost Comparison

As previously stated, in order to provide information on which a valid comparison could be made in response to ARS 41-1609.01 (L), a separate, distinct report should be developed that includes all costs, and appropriately allocates costs to both ADC and private prisons and/or excludes costs not borne by both ADC and private prisons. The report should provide comparison exhibits for each custody bed level being compared. Exhibits should provide the average per capita cost based on the total costs incurred by the State to incarcerate an inmate in the custody level being compared. Total costs should include appropriate ADC operating costs, asset depreciation, and costs of services provided by other state agencies in support of ADC. State and private prison costs associated with the same custody level beds should be used to develop the comparison. For example, a cost comparison of private prison level 2 male permanent inmate beds should use the costs associated with ADC level 2 male permanent inmate beds for comparison. Following are recommendations for the development of a state versus private prison cost comparison report (Comparison Report).

- Report Format - The Report should include narratives clearly stating the objective(s) of the Comparison Report, and provide descriptions of the methodology and exhibits; and exhibits presenting costs by custody level by major cost components.

- Cost to be Included - The comprehensive costs of each custody level should be comprised of three principal components: ADC direct and indirect operating costs, asset depreciation, and costs of central support services provided by other Arizona state agencies in support of ADC operations. ADC direct and indirect operating costs should be acquired from and reconciled with the Operating Per Capita Cost Report for the fiscal year on which a comparison is being developed. Costs of current period improvement and equipment should be deducted and depreciation on the original construction, improvements and equipment should be added. Costs of central support services identified in the statewide cost allocation plan should also be included.

- Costs to be Excluded - The Cost Report includes costs of inmate intake, transportation, high health, and the work incentive pay plan (WIPP) only in the average daily cost of ADC operated prisons. These costs should be excluded in developing a cost comparison. All inmates, whether incarcerated in ADC or private prisons, are processed through ADC inmate intake. Transportation costs are related to transporting inmates between intake and their assigned prison (both ADC and private), ADC prison to ADC prison; and ADC prison to private prisons. In most private prison contracts health cost are capped at $10,000 per inmate. In addition, inmates identified as high health risk are not sent to private prisons. WIPP costs are payments to inmates for services.

- Documentation of Procedures - A comprehensive manual should be developed that includes written details regarding methodologies, assumptions, procedures, time lines, and sources of the data presented in the Comparison Report.

Private Prison Cost Model

ADC contracts with private operators to incarcerate certain inmate populations. Prior to contracting with private prison operators, ADC is required per ARS 41-1609.01 (G) to conduct a comparative analysis between ADC's projected operating costs and bids submitted by private prison operators to determine whether cost savings through privatization may be achieved. ARS 41-1609.01 (G) states: "A proposal shall not be accepted unless the proposal offers cost savings to the state. Cost savings shall be determined based upon the standard cost comparison model for privatization established by the Director." In order to comply with ARS 41-1609.01 (G), ADC has developed a Private Prison Cost Model (Cost Model) that is intended to provide a consistent, reasonable cost comparison and determine whether cost savings through privatization may be achieved. The objective of the evaluation of the Cost Model is to ensure the methodologies incorporated within the Cost Model result in an equitable and reasonable cost comparison.

Findings

Cost models have been developed on historical costs and on projected costs. The historical Cost Model developed by the Arizona Office of Excellence utilizes average daily per capita cost information from the most recently published Operating Per Capita Cost Report and projected facility construction costs to develop costs used in the analysis. The projected Cost Model developed by ADC utilizes projected average daily operating costs and facility construction costs to develop costs. In our opinion neither methodology currently results in an equitable cost comparison analysis or reasonably determines the potential cost savings to be achieved through privatization.

Historical Cost Model

In our opinion, the Cost Model based on historical costs should not be utilized in the development of a privatization analysis. The utilization of ADC historical costs and a private contractor bid based on new construction results in an inequitable cost comparison and may result in an inappropriate decision to privatize. This Cost Model does not allow ADC to properly project costs of building and operating a new state owned facility with enhanced security designs and technology. Although the current historical Cost Model does utilize projected new facility construction costs, it does not include any allowances for improved facility operating and maintenance or security. A new facility should have significantly lower operating and maintenance costs than an older, existing facility, especially during the first ten to twenty years.

Projected Cost Model

In our opinion, cost models utilizing projected costs for developing comparative analyses provide the most appropriate cost comparisons. The ADC-developed Cost Model based on projected costs should be modified and utilized for developing cost comparison analyses. In effect, ADC should develop their costs as if they were bidding on providing the requested services.

ADC's current projected Cost Model attempts to compare the additional costs that ADC would incur in operating a new facility to the additional cost that would be incurred through service contracting. However, the current projected Cost Model could potentially results in an understatement of ADC costs and on overstatement of contractor costs. Potential understated ADC costs include construction, start-up, and some operating costs. Potential overstated contractor costs include costs associated with ADC central support costs that have been added to the contractor bid for comparison purposes.

Recommendations for Improvements

Our review has identified the following recommended improvements that should be incorporated into the projected Cost Model:

- Costs to be Included - In developing a privatization analysis only additional costs should be included in the analysis. Costs attributed to an ADC operated facility should only include additional ADC costs that may be incurred as a result of operating a new facility. Also, only additional costs associated with a new private contract facility should be added to a private contractor's bid.
- Construction Costs - In order to develop a projected construction cost and annual depreciation, a construction cost estimate should be developed for the size of facility being analyzed.
- Start-Up Costs - The construction and opening of a new ADC operated facility would require the employment and training of staff prior to the acceptance of inmates. These start-up costs should be estimated and included in ADC's costs.
- Operating Costs - In order to develop a valid estimate of operating costs, a budget should be developed for the size of facility and the specific site being analyzed.
- Central Administrative Support - A cost estimate for any additional central administrative costs that may be required as a result of opening a new state operated facility should be developed and included in the cost analysis.
- Contractor Support - Currently in the projected Cost Model, costs have been added to the private contractor's bid for support provided by central office units. The method

utilized to determine these costs was to utilize one seventh of the total current costs of applicable services. This could result in an overstatement of the contractor's bid. Only additional costs that may be incurred by ADC should be added.

- Documentation of Procedures - A comprehensive manual should be developed that includes written details regarding methodologies, assumptions, procedures, time lines, and sources of the data utilized in the Cost Model.

Report Format

In addition to the Executive Summary, the Report is comprised of the following three sections:

- Operating Per Capita Cost Report
- State versus Private Prison Cost Comparison
- Private Prison Cost Model

MAXIMUS

HELPING GOVERNMENT SERVE THE PEOPLE®

February 7, 2006

Mr. Doug MacFarlane
Division Director, Support Services
Arizona Department of Corrections
1601 West Jefferson, MC 328
Phoenix, Arizona 85007

Dear Mr. MacFarlane:

At the request of the Arizona Department of Corrections (ADC), MAXIMUS, Inc. has completed a review of schedules prepared by ADC that provide a state versus private cost comparison of Level 2 male inmate beds. The cost comparison is based on actual costs and inmate data incurred during the State fiscal year ended June 30, 2004 (FY 2004). Only costs appropriated to ADC are included in the comparison. The schedules that were reviewed are provided as Exhibit A.

In our opinion the State Versus Private Cost Comparison of Level 2 Male Inmate Beds (Exhibit A) reasonably presents a comparison of the FY 2004 costs incurred by ADC to maintain a male inmate in a level 2 bed in ADC operated prisons and private contract prisons. Our opinion is based on a review of ADC's FY 2004 Operating Per Capita Cost Report, organization charts, organizational duties and responsibilities, and methods for identifying and allocating costs. Cost information included in the cost comparison reconciles to the FY 2004 Per Capita Cost Report and to ADC's actual financial information as recorded on the Arizona Uniform Statewide Accounting System (USAS). Average daily population (ADP) is in accordance with ADC's "Institutional Capacity and Committed Population" report.

All ADC appropriated direct and indirect costs that are applicable to Level 2 prison facilities have been identified and utilized in developing the cost comparison. Direct costs are costs directly incurred by and/or for the benefit of an ADC prison unit and payments to private contractors. Indirect costs are costs of ADC administration and support units, and program operational support units that benefit multiple ADC prison units and/or private contract prison units. Indirect costs benefiting only ADC operated prison units have been allocated only to ADC operated prison units based either on ADP or number of assigned full-time equivalent positions. Indirect costs benefiting both ADC operated prison units and private contract prison units have been allocated based on ADP.

As previously noted, the cost comparison only includes FY 2004 costs appropriated to ADC. Costs of central support services provided by other Arizona state agencies in support of ADC operations and asset depreciation on ADC facilities and equipment have not been included. Also, inmate intake and transportation costs have been incorrectly included in ADC's costs because ADC does not track inmate intake or transportation costs as separated cost centers. Based on our cursory review, the inclusion of central support and asset depreciation costs and the exclusion of inmate intake and transportation costs attributable to level 2 male inmate beds would increase ADC's average daily costs by less than $2, an increase of less than 5%.

This is the second year MAXIMUS has reviewed the level 2 male inmate beds comparison. ADC continues to demonstrate an ability to utilize the appropriate methodologies and procedures required to develop an accurate, reasonable comparison of the cost to maintain a male inmate in a State versus private prison. The reconciliation of all expenditure data to the annual per capita cost report and to USAS financial information, and the use of ADP information from published reports ensure the validity of the financial and ADP information on which the comparison is based. The allocation of indirect costs only to State and private prisons benefiting from each services and using allocation bases that reasonably represent benefit received ensure that only appropriate indirect costs are allocated to private prisons. Continuation of current methodologies and procedures should enable ADC to develop accurate cost comparisons in future years.

If you have any questions concerning our review or opinion, please contact us. MAXIMUS appreciated this opportunity to be of service to the Arizona Department of Corrections.

Sincerely,

Joel E. Nolan

Joel E. Nolan, CGFM
Vice President

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EXHIBIT A

STATE OF ARIZONA
DEPARTMENT OF CORRECTIONS
STATE VERSUS PRIVATE
COMPARISON OF LEVEL 2 MALE INMATE BEDS
BASED ON FY 2004 DATA

	STATE BEDS			AVERAGE - PRIVATE BEDS		
	ADP	TOTAL COST	DAILY AVG	ADP	TOTAL COST	DAILY AVG
DIRECT COSTS:						
Direct Costs / Contract Costs	6,750 [1]	$105,022,997 [2]	$42.51	1,250 [3]	$20,833,086	$45.54
High Cost Health	6,750	(4,634,615)	(1.88)			0.00
Work Incentive Pay Plan	6,750	(2,696,065)	(1.09)			0.00
Sub-Total Direct Cost		97,692,317	39.54		20,833,086	45.54
Private Prison Monitoring			0.00	1,250	821,985	1.80
Total Direct Costs		97,692,317	39.54		21,655,071	47.33
INDIRECT COSTS						
Office of the Director						
Emp Relations / Equal Opportunit	6,750	74,115	0.03			
Other Director Services	6,750	568,215	0.23	1,250	106,221	0.23
Pris Ops - Central Office	6,750	469,395	0.19	1,250	88,451	0.19
Programs	6,750	444,690	0.18	1,250	82,538	0.18
Security	6,750	123,525	0.05	1,250	24,682	0.05
Offender Svcs	6,750	691,740	0.28	1,250	129,217	0.28
Health Svcs - Central Office	6,750	765,855	0.31	1,250	141,410	0.31
OHU	6,750	123,525	0.05			
Inspect & Invest Bureau	6,750	765,855	0.31	1,250	142,320	0.31
Administrative Services						
Information Tech Svcs	6,750	1,087,020	0.44			
Fleet and Facility Maint.	6,750	148,230	0.06			
Rent/Risk Mgt	6,750	3,063,420	1.24			
Other Admin. Services	6,750	617,625	0.25	1,250	115,176	0.25
Human Res / Dev	6,750	988,200	0.40			
Total Indirect Costs		9,931,410	4.02		830,014	1.81
TOTAL COSTS		$107,623,727	$43.56		$22,485,085	$49.15

[1] Comparison does not include Rast (Level 4 cell environment) and Level 2 Female inmates.
[2] Costs based on Department appropriations only.
Costs of support services provided by other state agencies in support of ADC operations and asset depreciation are not included.
Inmate transportation costs are included in ADC's costs.
[3] Comparison does not include Return to Custody Beds.

Arizona Department of Corrections

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JANET NAPOLITANO
GOVERNOR

DORA B. SCHRIRO
DIRECTOR

February 8, 2006

Joel E. Nolan
Vice President, Cost Services Division
MAXIMUS, Inc.
2226 W. Northern Avenue, Suite C 207
Phoenix, Arizona 85021

RE: ADC response to "Report on the Evaluation of Arizona Department of Corrections Operating Per Capita Cost Report and Private Prison Cost Model"

Dear Mr. Nolan:

The Arizona Department of Corrections (ADC) issued a request for proposals and selected Maximus, Inc. to evaluate the methodologies by which the ADC compares the costs of various prison operating structures and review its financial data for FY 2003 and FY 2004. The ADC received your report this month and has reviewed the document in its entirety.

The report recommends that the ADC improves the Per Capita Cost Report and limits its usage, strengthens the Private Prison Cost Model to meet the requirements of ARS 41-1609.01 (G), and adopts specific cost comparisons of the operation of state and private prison beds to respond to ARS 41-1609.01 (L). The ADC agrees with all of the recommendations concerning each of the three reports and has determined that most of them can be implemented immediately. In several instances however, additional financial reports must be developed to capture detailed data effective FY 2007. In all instances, recommendations will be implemented in full in time to produce FY 2007 reports. Information about the implementation of each recommendation follows.

Recommendations for Improvement: Operating Per Capita Cost Report

Section II, Page 12, <u>Report Format - Additional Narrative</u>: It is recommended that narratives be added stating the objectives of the Cost Report, clarifying the methodologies, and describing the purpose of and the information presented on each exhibit.

Response: ADC agrees to implement immediately. The narrative was included in the FY 2004 Per Capita Cost Report.

Section II, Page 12, <u>Report Format - New and Reordering Exhibits</u>: Exhibits should be developed and presented in an order that supports the objectives of the cost report.
Response: ADC agrees to implement immediately. Exhibits will be presented in a manner that supports the objectives of the cost report beginning with the FY 2005 Operating Per Capita Cost Report.

Section II, Page 13, <u>Report Format - Redesign Exhibits</u>: Exhibits should be either redesigned or new exhibits added that present direct costs by major cost component.
Response: ADC agrees to implement the accounting structure will be modified and added to capture costs beginning in FY 2007.

Section II, Page 14, <u>Methodology Improvements - Classifying Costs</u>: Currently, costs associated with inmate intake and transportation are classified as direct costs of the ADC prison unit or complex incurring the expenses. These costs should not be direct costs utilized in the development of a unit's operating per capita cost. These costs benefit both ADC and private prisons, and should be tracked and identified as a separate cost category in the cost report.
Response: ADC agrees to implement. The accounting structure will be modified to capture these costs appropriately beginning FY 2007.

Section II, Page 14, <u>Methodology Improvements - Indirect Cost Allocations</u>: Certain indirect costs (labor relations, information technology, and administrative services) should be reallocated.
Response: ADC agrees to implement immediately. The identified indirect costs were reallocated in the FY 2004 Per Capita Cost Report.

Section II, Page 15, <u>Documentation of Procedures</u>: Develop a comprehensive manual including written detailed regarding methodologies, assumptions, procedures, time lines, and sources of data presented in the Per Capita Cost Report.
Response: ADC agrees to implement immediately. The manual will be completed and included with the FY 2005 Per Capita Cost Report.

Recommendations for Improvement: State Versus Private Prison Cost Comparison

Section III, Page 19, <u>Narratives</u>: Narratives should be developed stating the objectives of the comparison report, clarifying the methodologies, and describing the purpose of and the information on each exhibit.
Response: ADC agrees and will include appropriate narratives in cost comparison reports beginning in FY 2006.

Section III, Page 19, Exhibits: Exhibits should be developed presenting direct and indirect costs by major cost component or service.
Response: ADC agrees and will present direct and indirect costs by major component beginning in FY 2006.

Section III, Page 20, Cost Identification - Costs to be Included: The comprehensive costs of each custody level should be comprised of three principal components: ADC direct and indirect operating costs, asset depreciation, and costs of central support services provided by other Arizona State agencies in support of ADC operations.
Response: ADC agrees and will include these components in cost comparison reports beginning in FY 2006.

Section III, Page 21 Cost Identification - Costs to be Excluded: The Cost Report only includes costs of inmate intake, transportation, high cost health and the work incentive pay plan in the average daily cost of the ADC operated prisons. These costs should be excluded in developing a cost comparison.
Response: ADC agrees and excluded High Cost Health and WIPP in the FY 2003 and FY 2004 cost comparison reports. Inmate intake and transportation will be excluded beginning FY 2007 after accounting structure is modified.

Section III, Page 22, Documentation of Procedures: MAXIMUS recommends the development of a comprehensive manual that includes written details regarding methodologies, assumptions, procedures, time lines, and sources of the data presented in the Comparison Report.
Response: ADC agrees and will include a comprehensive manual beginning with reports generated for FY 2006.

Recommendations for Improvement: Private Prison Cost Model

Section III, Page 27, Discontinue the Usage of the Historical Cost Model: Only the projected Cost Model should be utilized for developing comparative analysis.
Response: ADC agrees that only the revised projected cost model will be employed in all future cost comparisons and that the historical cost model will be discontinued.

Section III, Page 27, Costs to be Included: ADC should only include additional costs incurred as the result of operating a new facility.
Response: ADC agrees and will employ in all future cost comparisons.

Section III, Page 27, Projected Construction Costs: Construction cost estimates should be specific to the size of the facility and its site.
Response: ADC agrees and will employ in all future cost comparisons.

Section III, Page 27, Start-Up Costs: Start-up costs should be estimated and included in ADC's costs.

Response: ADC agrees and will employ in all future cost comparisons.

Section III, Page 27, Operating Costs: A budget should be developed for the size of and the site of the facility being analyzed.
Response: ADC agrees and will employ in all future cost comparisons.

Section III, Page 28, Central Administrative Support: Only the personal services costs of additional staff and other operating costs should be developed.
Response: ADC agrees and will employ in all future cost comparisons.

Section III, Page 28, Contractor Support: ADC should only add actual additional costs to contract.
Response: ADC agrees and will employ in all future cost comparisons.

Section III, Page 28, Comprehensive Manual: Develop a comprehensive manual including written detailed regarding methodologies, assumptions, procedures, time lines, and sources of data presented in the Private Prison Cost Report.
Response: ADC agrees and will employ in all future cost comparisons.

Sincerely,

Douglas E. Macfarlane
Division Director
Support Services

DEM/cp