Joint Legislative Budget Committee

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HOUSE OF REPRESENTATIVES

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JOINT LEGISLATIVE BUDGET COMMITTEE

Tuesday, June 28, 2005 9:30 a.m. House Hearing Room 4

MEETING NOTICE

- Call to Order
- Approval of Minutes of May 11, 2005.
- DIRECTOR'S REPORT (if necessary).
- EXECUTIVE SESSION
 - A. Arizona Department of Administration, Risk Management Services Consideration of Proposed Settlements under Rule 14.
 - B. Consideration of JLBC Staff Director Salary pursuant to A.R.S. § 38-431.03.
- 1. AHCCCS Review of KidsCare Behavioral Health Capitation Rate Changes.
- 2. DEPARTMENT OF ECONOMIC SECURITY
 - A. Review of Transfer of Appropriations for TANF Cash Benefit Monies.
 - B. Review of Transfer of Appropriations between Child Care Subsidy Line Items.
 - C. Review of Expenditure Plan for Discretionary Workforce Investment Act Monies.
- 3. DEPARTMENT OF HEALTH SERVICES Review of Children's Rehabilitative Services Capitation Rate Changes.
- 4. DEPARTMENT OF REVENUE Review of Ladewig Expenditure Plan.
- ARIZONA STATE RETIREMENT SYSTEM Review of FY 2006 Information Technology Expenditure Plan.
- 6. DEPARTMENT OF CORRECTIONS
 - A. Report on Employee Overtime Pay and the On-Call Pay Settlements.
 - B. Report on Monthly Bed Plan Update.

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

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MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

May 11, 2005

The Chairman called the meeting to order at 8:45 a.m., Wednesday, May 11, 2005, in House Hearing Room 4. The following were present:

Members: Representative Pearce, Chairman S

Representative Boone Representative Burton Cahill Representative Gorman Senator Burns, Vice-Chairman Senator Arzberger

Senator Bee Senator Cannell Senator Garcia Senator Harper Senator Waring

Absent: Representative Biggs

Representative Huffman Representative Lopez Representative Tully Senator Martin

APPROVAL OF MINUTES

Representative Pearce moved that the Committee approve the minutes of March 4, 2005. The motion carried.

ATTORNEY GENERAL (AG)

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

Mr. Nick Klingerman, JLBC Staff, said the Office of the Attorney General has notified the Committee of its intended uses of Antitrust Enforcement Revolving Fund monies in excess of \$183,600. The agency reports that of the available monies in the Antitrust Fund the AG intends to expend \$126,400 in excess of the \$183,600 expenditure limit in FY 2005.

<u>Senator Burns moved</u> that the Committee give a favorable review, as recommended by JLBC Staff, of the intended expenditures from the Antitrust Enforcement Revolving Fund. The motion carried.

B. Review of Allocation of Settlement Monies.

Mr. Nick Klingerman, JLBC Staff, said this item was for a review by the Committee of the allocation of settlement monies received from the Sempra Energy Company settlement agreement and the Institute for Financial Advantage Inc. consent judgment. The General Appropriation Act contains a footnote that requires Joint Legislative Budget Committee review of the allocation or expenditure plan for settlement monies over \$100,000 received by the Attorney General or any other person on behalf of the State of Arizona, and it specifies that the Attorney General shall not allocate or expend these monies until the JLBC reviews the allocations or expenditures.

<u>Senator Burns moved</u> that the Committee give a favorable review, as recommended by JLBC Staff, of the allocation plans from the Sempra settlement agreement and the Institute for Financial Advantage Inc. consent judgment The motion carried.

DEPARTMENT OF HEALTH SERVICES – Review of Expenditure Plan from the Vital Records Electronic Systems Fund.

Mr. John Malloy, JLBC Staff, presented the Department of Health Services request for Committee review of the expenditure plan from the Vital Records Electronic Systems Fund to digitize birth and death certificates. Statute requires that a detailed expenditure plan be submitted to JLBC or review prior to the expenditure of monies from this fund for the purchase of new information technology.

<u>Senator Burns moved</u> that the Committee give a favorable review, as recommended by JLBC Staff, to the Department of Health Services' expenditure plan for the Vital Records and Electronic Systems Fund. The motion carried.

DEPARTMENT OF PUBLIC SAFETY – Quarterly Review of the Arizona Public Safety Communication Advisory Commission (PSCC).

Mr. Martin Lorenzo, JLBC Staff, said this item was for Committee review of the third quarter expenditures and progress for the statewide interoperability design project. He said that it appears the project has fallen behind schedule according to DPS' original timeline submitted to the Committee in June 2004. As a result, the JLBC Staff recommends that the Committee request that the next DPS quarterly report include an updated design timeline with specific goal and objectives for completion during FY 2006.

Representative Pearce stated that the Committee would like a more detailed breakdown of what the monies were being spent on.

Representative Pearce asked why the department was utilizing these monies to purchase cars as he was under the impression from the last meeting that the recommendation was to utilize vehicles in DPS' existing fleet.

Mr. Lorenzo stated that they had already purchased 2 of the 3 vehicles in the 2nd quarter. However, as a result of the unfavorable review in the 2nd quarter expenditure report, they decided not to purchase the 3rd vehicle and utilize the cars in DPS' fleet.

<u>Senator Burns moved</u> that the Committee adopt the recommendation of the JLBC Staff, to include in the next DPS quarterly report, an updated timeline with specific goals and objectives for completion during FY 2006. The motion carried.

EXECUTIVE SESSION

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

At 8:58 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 9:08 a.m. the Committee reconvened into open session.

<u>Senator Burns moved</u> that the Committee approve the recommended settlement proposal by the Attorney General's Office in the case of Camacho v. State of Arizona, et al. The motion carried.

Chairman Burns adjourned the meeting at 9:10 p.m.

Respectfully submitted:	
	Cheryl Kestner, Secretary
	Richard Stavneak, Director
	Representative Russell Pearce, Chairman

Joint Legislative Budget Committee

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RUSSELL K. PEARCE CHAIRMAN 2005 ANDY BIGGS TOM BOONE MEG BURTON CAHILL PAMELA GORMAN STEVE HUFFMAN LINDA J. LOPEZ STEPHEN TULLY

DATE: June 16, 2005

TO: Representative Russell Pearce, Chairman

Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Stefan Shepherd, Assistant Director

SUBJECT: AHCCCS – REVIEW OF KIDSCARE BEHAVIORAL HEALTH CAPITATION RATE

CHANGES

Request

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

Recommendation

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

Analysis

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

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

Table 1			
	Current FY 2005	Proposed FY 2006	% Change
KidsCare			
Children	\$15.16	\$16.20	6.9%
SMI	21.64	22.06	<u>1.9%</u>
Average			6.7%
KidsCare Parents			
SMI	22.75	23.83	4.7%
GMH/SA	10.58	10.19	(3.7)%
Average			2.1%
Weighted Change			5.1%

RS/SS:ym



Our first care is your health care
ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

June 8, 2005

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

801 East Jefferson, Phoenix AZ 85034 PO Box 25520, Phoenix AZ 85002 phone 602 417 4000 www.ahcccs.state.az.us

Dear Representative Pearce:

The Arizona Health Care Cost Containment System (AHCCCS) respectfully requests to be placed on the Joint Legislative Budget Committee's (JLBC) agenda for its next scheduled meeting, for the purpose of reviewing changes to the TXXI (Kids Care and the Kids Care Parents) behavioral health capitation rates for the contract year 2006. This review is required in the footnotes to the General Appropriation Act.

The TXXI membership was approximately 63,617 on April 1, 2004. Because membership is small, and the behavioral health penetration is only 4.24%, Mercer concluded that the encounter data is not sufficient for using as a base in preparing actuarially sound rates. Instead, Mercer used the TXIX behavioral health rate development as a proxy for determining appropriate capitation rates for TXXI behavioral health programs. The full Mercer report is attached for your review.

TXXI behavioral health capitation rate changes

Below please find a comparison of the CYE '05 actual rates and the CYE '06 proposed rates:

1	CYE '05	CYE '06	% Change
Kids Care (0-17years)	\$15.16	\$16.20	6.9%
Kids Care (18 yrs)	\$21.64	\$22.06	1.9%
Kids Care Parents SMI	\$22.75	\$23.83	4.7%
Kids Care Parents GMH/SA	\$10.58	\$10.19	- 3.7%

As detailed in the attached table the budgetary impact associated with the implementation of these new rates is an increase of \$753,800 or 5.1% above the current rates. This analysis simply compares the AHCCCS projected member months for Fiscal Year 2006 compared to the cost of the old rates versus the new rates.

Representative Pearce June 8, 2005 Page 2

If you have any questions, please feel free to call Patrice Spencer, Financial Coordinator – Behavioral Health Unit, AHCCCS at 602-417-4107.

Sincerely,

Kari Price

Assistant Director

Division of Health Care Management

c. Richard Stavneak, Director, Joint Legislative Budget Committee Staff
Anthony Rodgers, Director, AHCCCS
 Tom Betlach, Deputy Director, AHCCCS
 Jim Cockerham, Assistant Director, Division of Business and Finance, AHCCCS
 Eddy Broadway, Manager Behavioral Health Unit, DHCM, AHCCCS
 Patrice Spencer, Financial Coordinator Behavioral Health Unit, DHCM, AHCCCS

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DATE: June 21, 2005

TO: Representative Russell Pearce, Chairman

Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Eric Jorgensen, Fiscal Analyst

SUBJECT: Department of Economic Security – Review of Transfer of Appropriations from TANF

Cash Benefit Special Line Item.

Request

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

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

Table 1	DES Projected Shortfalls (in millions)			
		Funding Source		
	Projected	Proposed		
<u>Division/Line Item</u>	Shortfall	<u>Transfer</u>	Other Sources	
DBME				
Operating Budget	\$ 3.0	\$ 3.0	\$	
DCYF				
Adoption Services	2.5	1.2	0.5	
Children Services	14.9	7.8	8.9	
Perm. Guardianship	0.9			
Subtotal	17.8	9.0	9.4	
Total	\$20.8	\$12.0	\$9.4	

Recommendation

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

Analysis

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

TANF Cash Benefit Surplus

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

DBME Operating Shortfall

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

Adoption Services Shortfall

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

Children Services Shortfall

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

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

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

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

Permanent Guardianship Subsidy

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

RS/EJ:ck



ARIZONA DEPARTMENT OF ECONOMIC SECURITY

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Janet Napolitano Governor David A. Berns Director

MAY 05 2005

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



Dear Representative Pearce:

The Arizona Department of Economic Security (DES) requests to be placed on the agenda for the next Joint Legislative Budget Committee (JLBC) meeting for the review of two requested appropriation transfers between special line items (SLI).

TANF Cash Benefits

The General Appropriation Act (Laws 2004, 2nd Regular Session, Chapter 275) includes the following footnote:

Notwithstanding A.R.S. 35-173C, any transfer to or from the \$168,235,400 appropriated for Temporary Assistance for Needy Families Cash Benefits requires approval of the Joint Legislative Budget Committee.

DES is requesting a transfer of \$12 million from the Temporary Assistance for Needy Families (TANF) Cash Benefits SLI to address FY 2005 shortfalls in the Division of Benefits and Medical Eligibility (DBME) and the Division of Children Youth and Families (DCYF) to be distributed as follows:

DBME Operating	\$ 3.0 million
DCYF - Adoption Services	\$ 1.2 million
DCYF - Children Services	\$ 7.8 million
TOTAL	\$12.0 million

The strategies implemented by the Department to reduce TANF Cash Assistance caseloads have resulted in declines beyond originally projected levels. The FY 2005 budget assumed no caseload growth in TANF Cash Assistance; however, currently caseloads are projected to decline by approximately 5%. One of the key strategies implemented by the Department in an effort to reduce TANF Cash Assistance caseloads has been to offer diversion services to clients. Diversion consists of a one-time assistance payment to address barriers (such as the need for car repairs to maintain employment). The maximum that can be provided in one-time diversion assistance is 3 months of benefits (or approximately \$1,000). Beginning in FY 2005, DBME intensified efforts with TANF clients to identify applicants that are employment ready (or currently employed) that face a one-time barrier, which if addressed, eliminates the need for the client to enroll in TANF Cash Assistance.

DBME Operating

The efforts undertaken to reduce the TANF Cash Assistance caseload coupled with an increase to the Electronic Benefits Transfer (EBT) vendor have resulted in a projected \$3.0 million TANF shortfall in the DBME Operating line item. DBME eligibility workers now spend significantly more time in the interview process identifying TANF clients that are likely candidates for the diversion option. As a result, there has been a corresponding increase in costs allocated to TANF activities (Costs for DBME eligibility workers are allocated to the TANF program though an Arizona Random Moment Sample survey). Additionally, the department's EBT contract cost increased in FY 2005 when a new contract was entered into due to the expiration of the existing five year agreement. The savings realized in the TANF Cash Assistance SLI will be used to offset the projected shortfall in the DBME Operating line item.

Adoption Services

As reported in the DES 30th of the Month report, DCYF caseload growth in Adoption Services was unfunded in FY 2005. Caseload growth is currently at 8.4% and the projected shortfall is estimated to be \$2.5 million. The Department has identified \$500,000 in adoption bonus funds, which reduces the shortfall to \$2 million. With the approval of the requested transfer of \$1.2 million from TANF Cash Assistance, the remaining Adoption Services shortfall to be resolved by the department is approximately \$800,000. The use of TANF Cash Assistance funding to address the Adoption shortfall is only available in FY 2005, because the savings associated with the declining TANF Cash Assistance caseloads have already been incorporated into the FY 2006 budget recommendation.

Children Services

As reported in the DES 30th of the Month report, Children Services has a total FY 2005 shortfall of \$19.9 million. Of the total amount, \$11.9 million represents the FY 2004 line item veto monies that were not backfilled in FY 2005. The Department has been tasked with identifying strategies to address the \$11.9 million shortfall in FY 2005. Including the requested transfer from TANF Cash Assistance, the Department has identified the following sources to address \$11.9 veto funding: 1) \$7.8 million surplus in the DBME TANF Cash Benefits special line; 2) \$1.6 million from shifting children to the Title XIX Behavioral Health system; 3) \$1.0 million in one time food stamp recoupment monies; and 4) \$1.5 million in Title IV-B, part 2 prior year funds. The remaining Children Services shortfall to be resolved by the department is approximately \$8 million, of which \$5 million is to be resolved through programmatic changes and efficiencies in Children Services. The use of TANF Cash Assistance funding to address the Children Services shortfall is only available in FY 2005, because the savings associated with the declining TANF Cash Assistance caseloads have already been incorporated into the FY 2006 budget recommendation.

Child Care Subsidy

The General Appropriation Act (Laws 2004, 2nd Regular Session, Chapter 275) includes the following footnote:

The amounts appropriated for Day Care Subsidy and Transitional Child Care shall be used exclusively for child care costs unless a transfer of monies is approved by the Joint Legislative Budget Committee. Monies shall not be used from these appropriated amounts for any other expenses of the Department of Economic Security unless a transfer of monies is approved by the Joint Legislative Budget Committee.

DES is requesting a transfer of \$4 million from the Day Care Subsidy SLI to the Transitional Child Care SLI, both of which are within the Division of Employment and Rehabilitation Services. This amount is necessary,

The Honorable Russell K. Pearce, Chairman Page 3

based on current projections, to cover anticipated expenditures for the applicable caseloads. This transfer between Child Care SLIs is larger than the prior year due to the caseload shift occurring between mandatory populations as a result of the Department's efforts to reduce TANF caseloads. As the Department is successful in reducing the need for TANF Cash Assistance, families are immediately transitioning to the TCC program. Through February 2005, the TCC population has grown 13.3% over the prior year while TANF case loads have declined 3.7%. The TCC program provides subsidies to families no longer receiving TANF Cash Assistance for up to two years and is a statutorily mandated program.

If you have any questions, please contact me at (602) 542-5678.

GBers

Sincerely,

David A. Berns

Director

DB:GL

C:

The Honorable Robert Burns, Vice-Chairman, Joint Legislative Budget Committee Richard Stavneak, Director, Joint Legislative Budget Committee Gary Yaquinto, Director, Governor's Office of Strategic Planning and Budgeting Clark Partridge, State Comptroller, Arizona Department of Administration

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DATE: June 20, 2005

TO: Representative Russell Pearce, Chairman

Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Eric Jorgensen, Fiscal Analyst

SUBJECT: Department of Economic Security – Review of Transfer of Appropriations

Between Child Care Subsidy Line Items

Request

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

Recommendation

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

Analysis

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

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

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

RS/EJ:ck



ARIZONA DEPARTMENT OF ECONOMIC SECURITY

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Janet Napolitano Governor David A. Berns Director

MAY 05 2005

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



The Arizona Department of Economic Security (DES) requests to be placed on the agenda for the next Joint Legislative Budget Committee (JLBC) meeting for the review of two requested appropriation transfers between special line items (SLI).

TANF Cash Benefits

The General Appropriation Act (Laws 2004, 2nd Regular Session, Chapter 275) includes the following footnote:

Notwithstanding A.R.S. 35-173C, any transfer to or from the \$168,235,400 appropriated for Temporary Assistance for Needy Families Cash Benefits requires approval of the Joint Legislative Budget Committee.

DES is requesting a transfer of \$12 million from the Temporary Assistance for Needy Families (TANF) Cash Benefits SLI to address FY 2005 shortfalls in the Division of Benefits and Medical Eligibility (DBME) and the Division of Children Youth and Families (DCYF) to be distributed as follows:

DBME Operating	\$ 3.0 million
DCYF - Adoption Services	\$ 1.2 million
DCYF - Children Services	\$ 7.8 million
TOTAL	\$12.0 million

The strategies implemented by the Department to reduce TANF Cash Assistance caseloads have resulted in declines beyond originally projected levels. The FY 2005 budget assumed no caseload growth in TANF Cash Assistance; however, currently caseloads are projected to decline by approximately 5%. One of the key strategies implemented by the Department in an effort to reduce TANF Cash Assistance caseloads has been to offer diversion services to clients. Diversion consists of a one-time assistance payment to address barriers (such as the need for car repairs to maintain employment). The maximum that can be provided in one-time diversion assistance is 3 months of benefits (or approximately \$1,000). Beginning in FY 2005, DBME intensified efforts with TANF clients to identify applicants that are employment ready (or currently employed) that face a one-time barrier, which if addressed, eliminates the need for the client to enroll in TANF Cash Assistance.

DBME Operating

The efforts undertaken to reduce the TANF Cash Assistance caseload coupled with an increase to the Electronic Benefits Transfer (EBT) vendor have resulted in a projected \$3.0 million TANF shortfall in the DBME Operating line item. DBME eligibility workers now spend significantly more time in the interview process identifying TANF clients that are likely candidates for the diversion option. As a result, there has been a corresponding increase in costs allocated to TANF activities (Costs for DBME eligibility workers are allocated to the TANF program though an Arizona Random Moment Sample survey). Additionally, the department's EBT contract cost increased in FY 2005 when a new contract was entered into due to the expiration of the existing five year agreement. The savings realized in the TANF Cash Assistance SLI will be used to offset the projected shortfall in the DBME Operating line item.

Adoption Services

As reported in the DES 30th of the Month report, DCYF caseload growth in Adoption Services was unfunded in FY 2005. Caseload growth is currently at 8.4% and the projected shortfall is estimated to be \$2.5 million. The Department has identified \$500,000 in adoption bonus funds, which reduces the shortfall to \$2 million. With the approval of the requested transfer of \$1.2 million from TANF Cash Assistance, the remaining Adoption Services shortfall to be resolved by the department is approximately \$800,000. The use of TANF Cash Assistance funding to address the Adoption shortfall is only available in FY 2005, because the savings associated with the declining TANF Cash Assistance caseloads have already been incorporated into the FY 2006 budget recommendation.

Children Services

As reported in the DES 30th of the Month report, Children Services has a total FY 2005 shortfall of \$19.9 million. Of the total amount, \$11.9 million represents the FY 2004 line item veto monies that were not backfilled in FY 2005. The Department has been tasked with identifying strategies to address the \$11.9 million shortfall in FY 2005. Including the requested transfer from TANF Cash Assistance, the Department has identified the following sources to address \$11.9 veto funding: 1) \$7.8 million surplus in the DBME TANF Cash Benefits special line; 2) \$1.6 million from shifting children to the Title XIX Behavioral Health system; 3) \$1.0 million in one time food stamp recoupment monies; and 4) \$1.5 million in Title IV-B, part 2 prior year funds. The remaining Children Services shortfall to be resolved by the department is approximately \$8 million, of which \$5 million is to be resolved through programmatic changes and efficiencies in Children Services. The use of TANF Cash Assistance funding to address the Children Services shortfall is only available in FY 2005, because the savings associated with the declining TANF Cash Assistance caseloads have already been incorporated into the FY 2006 budget recommendation.

Child Care Subsidy

The General Appropriation Act (Laws 2004, 2nd Regular Session, Chapter 275) includes the following footnote:

The amounts appropriated for Day Care Subsidy and Transitional Child Care shall be used exclusively for child care costs unless a transfer of monies is approved by the Joint Legislative Budget Committee. Monies shall not be used from these appropriated amounts for any other expenses of the Department of Economic Security unless a transfer of monies is approved by the Joint Legislative Budget Committee.

DES is requesting a transfer of \$4 million from the Day Care Subsidy SLI to the Transitional Child Care SLI, both of which are within the Division of Employment and Rehabilitation Services. This amount is necessary,

The Honorable Russell K. Pearce, Chairman Page 3

based on current projections, to cover anticipated expenditures for the applicable caseloads. This transfer between Child Care SLIs is larger than the prior year due to the caseload shift occurring between mandatory populations as a result of the Department's efforts to reduce TANF caseloads. As the Department is successful in reducing the need for TANF Cash Assistance, families are immediately transitioning to the TCC program. Through February 2005, the TCC population has grown 13.3% over the prior year while TANF case loads have declined 3.7%. The TCC program provides subsidies to families no longer receiving TANF Cash Assistance for up to two years and is a statutorily mandated program.

If you have any questions, please contact me at (602) 542-5678.

GBers

Sincerely,

David A. Berns

Director

DB:GL

C:

The Honorable Robert Burns, Vice-Chairman, Joint Legislative Budget Committee Richard Stavneak, Director, Joint Legislative Budget Committee Gary Yaquinto, Director, Governor's Office of Strategic Planning and Budgeting Clark Partridge, State Comptroller, Arizona Department of Administration

Joint Legislative Budget Committee

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HOUSE OF REPRESENTATIVES

RUSSELL K. PEARCE CHAIRMAN 2005 ANDY BIGGS TOM BOONE MEG BURTON CAHILL PAMELA GORMAN STEVE HUFFMAN LINDA J. LOPEZ STEPHEN TULLY

DATE: June 20, 2005

TO: Representative Russell Pearce, Chairman

Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Eric Jorgensen, Fiscal Analyst

SUBJECT: Department of Economic Security – Review of Expenditure Plan for Discretionary

Workforce Investment Act Monies

Request

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

Recommendation

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

Analysis

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

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

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

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

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

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ARIZONA DEPARTMENT OF ECONOMIC SECURITY

1717 W. Jefferson • P.O. Box 6123 • Phoenix, AZ 85005

Janet Napolitano Governor David A. Berns Director

MAY 27 2005

The Honorable Russell K. Pearce, Chairman Joint Legislative Budget Committee Arizona House of Representatives 1700 West Washington Phoenix, Arizona 85007

Dear Representative Pearce:

The Arizona Department of Economic Security (DES) requests to be placed on the agenda for the review of federal Workforce Investment Act (WIA) projects funded with WIA discretionary monies. The proposed project would utilize \$184,900 in prior year unexpended WIA discretionary funding. These WIA discretionary funds are subject to the footnote below, which allows for discretionary WIA monies above the appropriated level to be expended following JLBC review:

"All federal workforce investment act discretionary funds that are received by the state in excess of \$3,266,600 are appropriated to the workforce investment act - discretionary special line item. Excess monies may not be spent until a proposed expenditure plan for the excess monies has been reviewed by the joint legislative budget committee."

Project Description

The Governor's Council on Workforce Development has recommended funding for the Jobs for Arizona Graduates (JAG) program, which serves teens who are at risk of, or have dropped out of, high school. The program will provide support and services to teens to assist them in attaining graduation or a GED when applicable. This program furthers the purpose and goals of the WIA through working with teens to insure graduation (or GED completion), which assists employers by providing a workforce that has, at a minimum, attained a high school education.

The funding would provide services such as (1) targeted classroom instruction on career preparation staffed by in-school staff; (2) training in key employability competencies; (3) mentoring and referral for additional support services (when required) to assist students to overcome barriers that prevent them from completing the requirements for a high school

The Honorable Russell K. Pearce, Chairman Page 2

diploma and/or securing employment or pursuing postsecondary education; (4) job placement assistance and follow-up services. These services have been found successful in assisting at-risk teens in completing their high school education or GED. The Department is working with the Council and identified provider to develop performance measures, and will forward those measures when complete.

If you have any questions, please contact me at (602) 542-5678.

Sincerely,

David A. Berns

of Ole Berry

Director

C:

The Honorable Robert Burns, Vice-Chairman, Joint Legislative Budget Committee Richard Stavneak, Director, Joint Legislative Budget Committee Clark Partridge, State Comptroller, Arizona Department of Administration Gary Yaquinto, Director, Governor's Office of Strategic Planning and Budgeting

Joint Legislative Budget Committee

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HOUSE OF REPRESENTATIVES

RUSSELL K. PEARCE CHAIRMAN 2005 ANDY BIGGS TOM BOONE MEG BURTON CAHILL PAMELA GORMAN STEVE HUFFMAN LINDA J. LOPEZ STEPHEN TULLY

DATE: June 21, 2005

TO: Representative Russell Pearce, Chairman

Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: John Malloy, Fiscal Analyst

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

Rate Changes

Request

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

Recommendation and Summary

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

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

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

(Continued)

Analysis

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

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

^{1/} Represents rates for services only. The administrative components of the rates are not shown here

The rate adjustments are developed using the following assumptions:

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

(Continued)

^{2/} Rate change for services only.

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

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

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

RS/JM:ck

Arizona Department of Health Services

JUN 0 1 2005

Office of the Director

150 North 18th Avenue, Suite 500 Phoenix, Arizona 85007-3249 (602) 542-1025 (602) 542-1062 FAX



JANET NAPOLITANO, GOVERNOR SUSAN GERARD, DIRECTOR

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

Dear Representative Pearce:

Pursuant to a footnote in the General Appropriation Act, the Arizona Department of Health Services respectfully requests to be placed on the Joint Legislative Budget Committee's (JLBC) agenda for its next scheduled meeting. We want to discuss proposed changes to the Children's Rehabilitative Services capitation rates for FY 2006.

You will find attached our certification letter for the proposed rates prepared by William M. Mercer, Incorporated (Attachment 1). The information was sent to the Arizona Health Care Cost Containment System for their review and a copy of their approval letter is attached (Attachment 2). The rates have been modified from FY 2005 to reflect changes in member month enrollments. There also is a 10.0% maximum limit set on revenue collections from member month growth. This revenue limit for FY 2006 is similar to the maximum revenue risk bands that have been part of this capitation program. In addition, the rates were adjusted to reduce administrative fees from 9.1% to 8.0% based on historical costs and adjustments for regulatory oversight expectations for FY 2006.

Attachment 3 and Attachment 4 identify the currently estimated State Fiscal Year 2006 member months and funding allocations by site. The information shows estimated State Match funding needs will not exceed the FY 2006 legislative appropriation based on current estimates that will be revised as actual data become available.

We have summarized in a table the FY 2005 approved capitation rates and the FY 2006 proposed capitation rates (Attachment 5). If you need additional information, please contact Theresa Garcia, Budget Director at 602-542-1266.

Sincerely,

Sušan Gerard

Director

SG:ale Attachments

Government Human Services Consulting

3131 East Camelback Road, Suite 300 Phoenix, AZ 85016-4536 602 522 6500 Fax 602 957 9573 www.mercerHR.com

May 16, 2005

Cathryn M. Echeverria
Office Chief
Arizona Department of Health Services
Public Health & Prevention Services
Office for Children with Special Health Care Needs
Children's Rehabilitative Services
150 N. 18th Ave.
Suite #330
Phoenix, AZ 85007-3243

FINAL AND CONFIDENTIAL

Subject:

Title XIX, Title XXI, and Proposition 204 Capitation Rates for State Fiscal Year 2006

Dear Ms. Echeverria:

The Arizona Department of Health Services (ADHS), Office for Children with Special Health Care Needs (OCSHCN), Children's Rehabilitative Services (CRS) program contracted with Mercer Government Human Services Consulting (Mercer) to develop capitation rates for the Title XIX, Title XXI, and Proposition 204 populations. These rates are used by the Arizona Health Care Cost Containment System (AHCCCS) to compensate CRS and the CRS contractors for CRS members determined Title XIX, Title XXI, or Proposition 204 eligible during the State Fiscal Year (SFY). For the SFY beginning July 1, 2005, and ending June 30, 2006 (SFY 2006), Mercer has developed capitation rates following the process described in this letter.

Background

CRS is primarily a children's program for Arizona residents under the age of twenty-one with chronic and disabling, or potentially disabling, conditions. The program provides statewide services through four regional contractors, each with its own hospital and physician support network. In addition to the four regional clinic sites, services are provided through outreach clinics operated by each contractor. Medical services not related to a child's CRS eligible condition are provided through the child's AHCCCS health plan.

Prior to July 1, 2000 (the start of SFY 2001), CRS negotiated annual fixed price contracts with its contractors to provide services to Title XIX, Title XXI, and State-Only funded eligible members. To better match payment with the risk of the membership enrolled with each

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Page 2 May 16, 2005 Cathryn M. Echeverria Children's Rehabilitative Services

contractor, CRS converted its reimbursement methodology to a capitated system for Title XIX and Title XXI eligible members. As a result, three capitation rates were developed for compensating CRS contractors beginning in SFY 2001. The three rates were developed for each contractor based upon a member's CRS enrollment diagnosis. The three rates represent compensation for providing services to members with specific diagnoses that have historically represented relatively High, Medium, and Low costs to the CRS contractor. The High, Medium, and Low capitation risk group structure included small numbers of the QMB Plus, Medicaid (Non QMB and Non SLMB), and SLMB Plus dual eligible populations. No other dual eligible populations are enrolled in the program. In Mercer's opinion, the High, Medium, and Low capitation rate cells, which vary by contractor region, most appropriately match payment with risk in the CRS program, and hence provide a greater level of actuarial soundness than other approaches. The three tier rate structure will continue to be used for SFY 2006.

Maximum Capitation Revenue Limits

Enrollment policy and process requirement changes that were implemented during SFY 2001 improved the systematic re-enrollment of eligible CRS members. Successful adherence to those changes resulted in an increase in continuous enrollment and reported member months since the initial implementation. Partially as a result, it was determined necessary in the past to develop maximum capitation revenue limits related to member month growth to prevent potential contractor overcompensation.

As the incremental impact of those enrollment changes on the program faded over time, the overriding in-favor consideration for the maintenance of maximum capitation revenue limits is the nature of the CRS contractor service delivery system. As previously mentioned, each regional contractor has its own clinic site, as well as its own hospital and physician support network. In addition to the regional clinic sites, services are also provided through outreach clinics operated by each contractor. This delivery system model has a significantly higher proportion of fixed costs when compared to a typical delivery system model. The marginal variable cost of adding additional CRS eligible members to the largest program (Title XIX) is a smaller proportion of total cost than normally seen. Hence, maximum capitation revenue limits make sense for Title XIX. The Title XXI and Proposition 204 populations are too small for this fixed versus variable cost approach to apply.

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Page 3 May 16, 2005 Cathryn M. Echeverria Children's Rehabilitative Services

As a result of the above consideration, in Mercer's opinion it is necessary to continue a maximum capitation revenue limit for SFY 2006 for the CRS contractors to prevent potential inappropriate overpayment of total capitation dollars. The SFY 2006 maximum capitation revenue limit is similar in approach to the limits that were in place for the five previous SFYs, and will be applied in a similar manner. For SFY 2006, it was determined that in aggregate contractors will not be allowed to keep Title XIX capitation revenue due to member month growth that is in excess of 10.0 percent. Due to regional growth pattern variation, the limits vary by contractor, from 8.9 percent for Tucson to 10.5 percent for Phoenix. Over the three years SFY 2002 to SFY 2005, Title XIX member month growth has risen at the compounded annual rate of 10.1 percent.

Similar to SFY 2001 through SFY 2005, the maximum capitation revenue limit will also apply to the administrative load portion of the Title XIX capitation rates, which represents the CRS administrative costs of ensuring the delivery of cost effective services in a managed care environment.

SFY 2006 Capitation Rate Development Methodology — Overview

For each of the four years SFY 2002 through SFY 2005, contractor capitation rates were updated based upon application of claim and administrative cost trend factors, evaluation of program requirement changes, and incorporation of adjustments for such items as underwriting profit/risk/contingency loading and maximum capitation revenue limits. Contractor encounter data was used in the development of some claim utilization and unit cost trend factors, but while appropriate and useful for other reporting purposes, was determined to lack sufficient completeness and reliability to be used for rate-setting purposes. SFY 2006 marks a watershed year for the CRS capitation rate development process in that for the first time contractor encounters (SFY 2004) are used as the base data source. Therefore, the SFY 2006 rates have been entirely re-based.

Base Data

The SFY 2004 contractor encounter data was valued using Medicaid (AHCCCS) fee schedule allowed amounts, incorporating a "lesser of" methodology. This means that if a contractor's liability for a claim from a provider was below the AHCCCS allowed amount, the lower value

Government Human Services Consulting

Page 4
May 16, 2005
Cathryn M. Echeverria
Children's Rehabilitative Services

would be utilized. The base encounters were further reduced by Third Party Liability (TPL) cost avoidance and any pay-and-chase recoveries.

With the three years of encounter data, SFY 2002 through SFY 2004, CRS Administration and Mercer performed a thorough analysis and re-established High, Medium, and Low diagnostic groupings for each contractor. Based upon the three years of data, per member per month (PMPM) costs were regrouped into the three categories. Once the updated groupings were determined, the base SFY 2004 data was adjusted accordingly, increasing the matching of payment to underlying risk. For each contractor, the adjustments were done on a budget-neutral basis, meaning no dollars were gained or lost in the process.

Base Data Adjustments

1. Unpaid Claims Liability

The SFY 2004 base data utilizes encounters with dates of service beginning July 1, 2003, and ending June 30, 2004. Encounters were initially analyzed with a run-out period of 7.5 months beyond that June 30, 2004 endpoint, with data extracted in the middle of February 2005. The next step in the base data analysis process was review of the CRS contractors' expense component for claims incurred but unpaid, hereinafter called the unpaid claims liability (UCL). The UCL is the sum of claims incurred but not reported, plus those claims reported but not yet paid. Statutory accounting recognizes an incurred medical expense for the period as the result of the sum of claims paid in the period, plus the change in the accrued liability for the UCL between the beginning and the end of the period. This calculation pushes the correction of the estimation error of the beginning UCL into the expense recognized in the current period. However, the expense that should be recognized in base data development is calculated from claims incurred in the SFY 2004 experience period, both claims paid in SFY 2004 and the accrued liability for the UCL as of the end of SFY 2004.

A review of the contractor's SFY 2004 encounters at the end of April 2005 indicated that there were outstanding claims as of the mid-February 2005 data extract. The level of outstanding claims varies by contractor. The overall adjustment for SFY 2004 encounters received beyond the mid-February 2005 data extract was 1.40 percent.

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Page 5 May 16, 2005 Cathryn M. Echeverria Children's Rehabilitative Services

2. Completion for "Omissions"

As part of its 1115 waiver provisions, AHCCCS performs annual data validation studies of encounters. AHCCCS tests for completeness, accuracy, and timeliness of encounter submissions based upon statistically valid sampling of both professional and facility encounters, comparing them against medical records. Mercer utilized the results of the most recently completed data validation study (Contract Year 2002) to develop factors to apply to the base CRS data to further complete the encounters for these "omissions". Since the AHCCCS study was not CRS-specific, Mercer and CRS Administration took a conservative approach. The CRS factors, which vary by professional and facility encounters, are approximately half those shown by AHCCCS. The overall rate impact this correcting adjustment is 2.25 percent.

3. "Non-encounterable" Costs

In addition, the adjusted base SFY 2004 data reflects contractor costs not captured by encounters, but historically reported by the contractors under medical service expenses rather than administrative expenses. These "non-encounterable" costs include those for such providers as social workers and interpreters, as well as services such as telephone and tele-video interventions, counseling, care coordination activities, and member/family education. The overall non-encounterable adjustment is 3.53 percent of the base SFY 2004 encounters.

The CRS program falls under Arizona's 1115 waiver. 1115(a)(2) services are considered State Plan services for 1115 populations for the duration of the demonstration waiver, and hence no adjustment is required. Further, CRS had previously surveyed each of the four contractors regarding any supplementary non-State plan services provided. The results indicated no adjustment was required.

Trend to SFY 2006

The SFY 2004 encounter cost data was trended forward two years to SFY 2006. The trend factors recognize changes in cost per service (unit cost) and utilization of health care services from the SFY 2004 base period to SFY 2006. Unique trends were applied separately for ten consolidated categories of service (COS). Trends ranged from a low of 1.6 percent for Inpatient (-2.0 percent utilization and 3.7 percent unit cost; 0.98 x 1.037 = 1.016) to a high of 19.5 percent for Pharmacy (5.0 percent utilization and 13.8 percent unit cost; 1.05 x 1.138 = 1.195). The weighted annual trend adjustment for SFY 2004 to SFY 2006 was 5.5 percent (1.4 percent

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utilization and 4.1 percent unit cost). COS trend factors were developed on a state-wide basis. Contractor trends varied solely due to differing COS distributions.

Mercer relied heavily on historical CRS encounter information, and also utilized its professional experience in working with other state Medicaid programs, outlooks in the commercial marketplace that influence Medicaid programs, regional and national economic indicators, and general price/wage inflation in developing trends. The 5.5 percent weighted trend compares very favorably with the 8.2 percent trend used for SFY 2005 rate development.

Program Changes from SFY 2004 to SFY 2006

Several program changes not reflected within the SFY 2004 base data will impact the CRS contractors for SFY 2006.

SFY 2005 Change

Beginning SFY 2005, chest vests (primarily for cystic fibrosis) became a covered expense for the CRS contractors. Mercer gathered actual and estimated utilization and unit cost data from the contractors and CRS Administration in order to determine the potential SFY 2006 impact of this program change. Mercer estimated the PMPM impact of this program change to be approximately \$0.98 for Phoenix and \$0.75 for Tucson. The remaining two CRS contractors do not serve eligible members with cystic fibrosis at this time.

SFY 2006 Changes

1. Medicare Part D

Under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), a prescription drug benefit will be provided by Medicare for the Medicare/Medicaid dual eligible population. This change will be effective January 1, 2006. Under this program, prescription drug expenditures for dual eligibles by a state Medicaid program will be significantly reduced. As CRS is a children's program, it has very few dual eligibles enrolled. Historical dual eligible prescription drug expenditures were reviewed and trended forward to make an estimate of the impact of MMA to the SFY 2006 capitation rates, incorporating that the MMA is effective for the second half of SFY 2006. The analysis indicates an overall \$0.12 reduction to the SFY 2006 claim costs.

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2. Telemedicine Fees

In an effort to maximize the availability of a limited number of specialist providers, the CRS contract requires that each contractor participate in Telemedicine activities. The telemedicine connection between the four contractors requires telecom and access fees. These costs previously fell within the CRS Administration component of the rates. For SFY 2006 these expenditures were classified under the regional contractor program expenditures. There is no impact in federal match by appropriately moving these responsibilities to the CRS contractors, since the same federal match rate applies.

3. Enrollment Services

The CRS contractors must maintain staff to screen and assist families with the eligibility process, including completion of the financial application, and coordinating with the Department of Economic Security for enrollment into the Title XIX or Title XXI program. Contractors also must verify and re-determine eligibility, and if applicable assist families through the re-determination process. These costs previously fell within the CRS Administration component of the rates. There is no impact in federal match by appropriately moving these responsibilities to the CRS contractors, since the same federal match rate applies.

4. EQRO BBA Compliance

Requirements under the Balanced Budget Act (BBA) of 1997 with regards to External Quality Review Organization (EQRO) protocol compliance will necessitate the hiring of additional contractor staff. The CRS program recently underwent a thorough BBA compliance assessment, which identified specific corrective actions to be implemented. Based on that assessment and the necessary corrective actions, it is assumed Phoenix and Tucson will each require one full-time (FTE) Compliance Officer due to increased federal and state compliance requirements. It is assumed Flagstaff and Yuma will each require one-half FTE.

Loading for Contractor Administration and Underwriting Profit/Risk/Contingency

CRS contractors range from the relatively large (Phoenix, with projected CRS SFY 2006 revenue of approximately \$37 million) to the quite small (Yuma, with projected CRS SFY 2006 revenue of under \$2 million). Combining these economies-of-scale differences with the relatively high care-focused administrative expenses CRS contractors must incur, generates varying and

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Children's Rehabilitative Services

somewhat higher than normal administrative loads than a traditional acute care program. Across all contractors, the SFY 2006 administrative expense load is 15.0 percent of the capitation rate. This percentage is calculated prior to the 2006 program changes related to telemedicine fees, enrollment services, and EQRO BBA compliance described above.

An underwriting profit/risk/contingency loading of 2.5 percent was applied uniformly to all CRS contractors. As the four regional contractors are private, non-profit entities, there should be an assumed margin for contribution to entity surplus and adverse claim risk contingency. The 2.5 percent is consistent with the assumptions used for Title XIX and Title XXI for Behavioral Health Services, another ADHS carve-out program, as well as for the AHCCCS acute care contractors.

CRS Administration

AHCCCS has placed CRS Administration at risk for the provision of CRS covered services for SFY 2006. Accordingly, the capitation rates were developed to include compensation to CRS for the cost of ensuring the delivery of all CRS covered services. The capitation rates paid to CRS for this \$60 million program include an 8.0 percent administrative load, which was negotiated between AHCCCS and CRS Administration. The administrative load represents the CRS costs of ensuring the efficient delivery of services in a managed care environment, and is based upon historical CRS costs and accounts for continued regulatory oversight cost expectations for SFY 2006. The 8.0 percent is a reduction of 1.1 percent from SFY 2005's level of 9.1 percent.

Certification of Rates

Mercer certifies that the Title XIX, Title XXI, and Proposition 204 CRS capitation rates for SFY 2006 presented below and in the attachments to this letter were developed in accordance with generally accepted actuarial practices and principles by actuaries meeting the qualification standards of the American Academy of Actuaries for the populations and services covered under the managed care contract. Rates developed by Mercer are actuarial projections of future contingent events. Actual contractor costs will differ from these projections. Mercer has developed these rates on behalf of CRS to demonstrate compliance with the Centers for Medicare & Medicaid Services (CMS) requirements under 42 CFR 438.6(c) and are in accordance with applicable laws and regulations.

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Risk Category

Contractor	High	Medium	Low
Phoenix	\$550.66	\$323.02	\$155.33
Tucson	\$465.77	\$336.68	\$169.13
Flagstaff	\$257.42	\$150.29	\$101.22
Yuma	\$311.31	\$136.66	\$75.91

Michael & Mordstrom ASA, MADA

If you have any questions or would like to discuss this information further, please call me at 602 522 6510.

Sincerely,

Michael E. Nordstrom, ASA, MAAA

MEN/jc

Copy:

Cynthia Layne, CRS Cheryl Prescott, CRS Branch McNeal, Mercer Sean Elcock, Mercer Gabe Smith, Mercer

Attachments



Our first care is your health care
ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

801 East Jefferson, Phoenix AZ 85034 PO Box 25520, Phoenix AZ 85002 phone 602 417 4000 www.ahcccs.state.az.us

May 19, 2005

Ms. Cathryn Echeverria Chief OCSHCN Children's Rehabilitation Services (CRS) 150 N. 18th Avenue, Suite 330 Phoenix, Arizona 85007-3243

Dear Cathryn:

AHCCCSA has reviewed the attached capitation rates for CRS effective July 1, 2005 through June 30, 2006. Based on the methodology used by William M. Mercer (Mercer) to develop the rates and information provided by CRS, AHCCCSA has approved the attached rates.

A letter will be sent to the Centers for Medicare and Medicaid Services (CMS) attaching the CRS capitation rates and the CMS Capitation Rate checklist along with your contract renewal for their review and approval.

In order for the attached rates to be loaded into the AHCCCS system for payment, they need to be approved by CMS, reviewed by the JLBC and we need to have a signed contract in effect for the period July 1, 2005 through June 30, 2006.

Please notify Nancy Neroni (<u>nancy.neroni@azahcccs.gov</u>) when the JLBC has completed their review of the rates. Upon their review, and receipt of a signed contract, the rates will be provided to the AHCCCSA Information Services Division and will be loaded into the system.

If you have any questions, please don't hesitate to contact me at 602.417.4568.

Sincerely,

Kathy Rodharn Finance Manager

Division of Health Care Management

c: Kari Price Nancy Neroni

Joint Legislative Budget Committee

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DATE: June 20, 2005

TO: Representative Russell Pearce, Chairman

Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Bob Hull, Principal Research/Fiscal Analyst

SUBJECT: Department of Revenue – Review of Ladewig Expenditure Plan

Request

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

Recommendation

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

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

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

Analysis

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

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

Summary of Ladewig FY 2003 & FY 2004 Expenditures and FY 2005 - FY 2007 Estimates							
	Expend	<u>litures</u> 1/	Estimates				
	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007		
DOR Administration	\$ 8,587,100	\$3,741,600	\$3,000,000 2/	\$ 1,758,900 ³ /	\$ 2,566,300		
Plaintiff Attorneys	2,000,000	$2,000,000^{4/}$	6,000,000	4,900,000	4,900,000		
Taxpayer Payments	0	0	125,700,000	51,600,000	91,700,000		
Total Expenditures	\$10,587,100	\$5,741,600	\$134,700,000 ⁵ /	\$58,258,900	\$99,166,300		
Ending Balance	\$ 4,412,900	\$671,300 ⁶ /					

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

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

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

DOR's Estimated Administration Cost in FY 2006				
Personal Services	\$321,000			
Employee Related Expenditures	73,800			
Professional & Outside Services ^{1/}	395,000			
Travel	200			
Other Operating Expenditures ^{2/}	634,700			
Total	\$1,424,700			

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

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

Current Status

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

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

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

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

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

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

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

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

- stand, but make no more in FY 2006 & FY 2007, or; 3) let the FY 2005 overpayments stand, and continue the overpayments in FY 2006 & FY 2007.
- The court has ordered DOR to keep separate track of their administration cost for overpayments.
 The court is expected to rule in September 2005 how to handle DOR's administration cost for the overpayments.
- DOR reports that the total cost may be reduced by a couple of million dollars as taxpayer disputes are settled, but does not yet have these figures.

RS/BH:ym

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



Janet Napolitano Governor

Gale Garriott
Director

June 6, 2005

Representative Russell Pearce, Chairman Joint Legislative Budget Committee 1700 West Washington Phoenix, AZ 85007



Dear Representative Pearce:

The Department of Revenue requests a place on the agenda for the next JLBC meeting to review the Department's expenditure plan for the <u>Ladewig v. State of Arizona</u> lawsuit.

As required by Chapter 333, Laws 2005, before the expenditure of any FY 2005-2006 funding for the administration of the Ladewig settlement, the Department of Revenue is required to present an expenditure plan to the Joint Legislative Budget Committee for review. Prior to the JLBC meeting the expenditure plan will be provided to Bob Hull of the JLBC staff.

We look forward to the opportunity to review the Ladewig expenditure plan and will gladly meet with you or your staff to discuss any questions or provide any additional information that may be required. Please do not hesitate to contact either Leigh Cheatham (716-6918) or Reed Spangler (716-6883) for any additional assistance.

Sincerely,

Gale Garriott

Director

GG:st

cc: Senator Robert Burns

Bob Hull, JLBC

Bret Cloninger, OSPB

Ladewig Budget Request		FY06	
Permanently Assigned Staff	\$	97.000.00	2 full-time employees
Professional & Managerial Staff	\$	70,000.00	Staff other than mainframe programming, TIA and audit costs
Mainframe Programming	\$	4,000.00	Staff to program and maintain DOR's mainframe computer system
TIA Staff	\$	10,000.00	TIA staff to permanently assigned to project for claimant calls through out FY06
DOR Support staff	\$	30,000.00	Staff to maintain files, data storage, PDF/fiche quality check & print 1099s
Cost of DOR Overtime		110,000.00	Staff to research tax records and calculate refunds, and re-issue payments
Personal Services	\$	321,000.00	
Employee Related Expenditures	\$	73,800.00	23% overall rate
SQL Consultant	\$	85.000.00	Consultant to modify, enhance and maintenance of a Ladewig SQL database - 1 consultant for 1,000 hours
Temporary Personnel	2.00	165,000.00	Temporary staff to answer phones in TIA, post warrants/1099's, enter returned warrant information and update WITS/Ladewig database
Imaging Income Mail/WEB Hosting	\$	80,000.00	Vendor to input data from misc correspondence, image mail for DOR, and maintain the binary warehouse service storage
Special Master Court Appointed	\$	65,000.00	Court appointed
Professional & Outside Services	\$	395,000.00	
Travel	\$	200.00	Travel by staff to meetings
Travel	\$	200.00	
US Postmaster (PO Box 29099 Rental	\$	850.00	Renewal date February 2006
US Postmaster (Outgoing Postage)	\$	530,000.00	Postage for mailing warrants (BY July 20, 2005), 1099s and additional letters
Mailing Vendor & Printing Vendor	\$	410,000.00	Printing of warrants (by July 20, 2005), 1099's and additional letters
Phone for Ladewig	\$	2,000.00	Ladewig phone number (602) 542-0700
Mainframe	\$	10,000.00	ADOA charges for the use of the DOR mainframe
Consumable supplies	\$	15,000.00	Office supplies, toner for reader/printers and copiers
Equipment maintenance	\$	1,000.00	Maintenance contracts on equipment
Other Operating Expenditures	\$	968,850.00	
Administration Total	\$ 1,	758,850.00	

Prepared by DOR 6/1/05

Joint Legislative Budget Committee

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DATE: June 20, 2005

TO: Representative Russell Pearce, Chairman

Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Eric Jorgensen, Fiscal Analyst

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

Expenditure Plan

Request

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

Recommendation

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

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

Analysis

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

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

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

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

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

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

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

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

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

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

Table 1	FY 20	006 Appropria	tion Expendit	ure Plan ^{1/}			
	Development Expenses Operating Expenses						
	Document	Software/	Original	Document	Software/		
	Imaging	<u>Hardware</u>	<u>Plan</u>	Imaging	<u>Hardware</u>		
FTEs			18	2		20	
Personal Services			\$1,150,200	\$64,200		\$1,214,400	
Employee Related			274,100	20,700		294,800	
Expenses							
Professional Services	\$3,452,900				26,000	3,478,900	
License/Maintenance							
and OOE			765,100	3,600		768,700	
Equipment		300,500	250,000	13,400		563,900	
Total	\$3,452,900	\$300,500	\$2,439,400	\$101,900	\$26,000	\$6,320,700	

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

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

RS/EJ:ck

ARIZONA STATE RETIREMENT SYSTEM



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TOLL FREE OUTSIDE METRO PHOENIX AND TUCSON 1-800-621-3778

Paul Matson Director

May 24, 2005

The Honorable Russell K. Pearce Chairman, Joint Legislative Budget Committee Arizona House of Representatives 1700 W. Washington Phoenix, AZ 85007



RE: JLBC Review of the ASRS IT Expenditure Plan for FY 06

Dear Chairman Pearce:

I am requesting that the Joint Legislative Budget Committee (JLBC), at its next meeting, review the proposed expenditure plan of FY06 appropriations for the Arizona State Retirement System (ASRS) Information Technology (IT) Plan. Pursuant to the footnote to the agency's appropriation, the ASRS is required to submit an expenditure plan to the JLBC for review before the expenditure of the appropriation.

Enclosed is the ASRS IT Expenditure Plan for FY06. The plan outlines expenditures in the areas of IT/User FTEs and Employee-Related Expenditures, Professional and Outside Services, Other Operating Expenditures and Equipment. This plan is in line with the cost estimates included in the Project Investment Justification (PIJ) and assumes project expenditures will continue through FY 08.

If you have any questions or need additional information, please contact Martha Rozen at (602) 240-5355. Thank you in advance for the Committee's consideration.

Sincerely,

Paul Matson

ph mation

Director

PM/MNR/mcc

The Honorable Russell K. Pearce Chairman, Joint Legislative Budget Committee Page 2 of 2

Enclosures:

- o IT Expenditure Plan FY 2006
- o Project Status Report RT 01002 Imaging
- o Project Status Report RT 03001 ASRS Financial Accounting System
- o Project Status Report RT 01001 Public Employees Retirement Information System (PERIS)
- o Project & Investment Justification PERIS
- o Project & Investment Justification ASRS Imaging System
- o Project & Investment Justification ASRS Financial system
- o Project & Investment Justification Network & Software Upgrade
- C: Martha Rozen, Administrative Services Eric Jorgensen, JLBC Analyst Matt Gottheiner, OSPB Analyst

Arizona State Retirement System Administrative Services Division IT Expenditure Plan FY 2006 Prepared by: Martha Rozen 5/24/2005

IT Expenditure Plan - FY 2006

Fiscal Year 2006	IT Plan Operating Costs	Records Mgt. Document Imaging	PIJ-Network and Software Upgrade	Document Imaging	TOTAL
FTEs	18	2			20
Personal Services *	\$1,150,200	\$64,200		1	
Employee Related Expenses *	\$274,100	\$20,700			
Professional & Outside Svcs.			\$26,000	\$3,452,900	
Travel		18			
Other Operating Expenses	\$765,100	\$3,600	2		
Equipment	\$250,000	\$13,400	\$300,500		
Total	\$2,439,400	\$101,900	\$326,500	\$3,452,900	\$6,320,700

\$2,867,800

Staffing 14 FTEs for PERIS

4 FTEs for Document Imaging

2 FTEs for Records Management

Continued use of Professional and Outside (Services) contractors through a number of Vendors

Equipment

Purchase/replace identified software and hardware according to Project Investment Justification documents.

Internal Planning

Attached are the Public Employees Retirement Information System (PERIS), Financial Management Systems (FMS), and Document Imaging Milestone/Deliverable schedules that are prepared and submitted regularly to GITA.

These schedules, as they are updated, will be available upon request.

^{*} Does not yet include adjustments for increases for employees' salaries, increases for Employee Related Expenditures for retirement contributions, and increases for Employee Related Expenditures for anticipated insurance changes.

Arizona State Retirement System Administrative Services Division IT Plan Special Line Item Prepared by: Martha Rozen 06/07/2005

IT Plan Special Line Item

	Total Remaining Appropriated Funds as of 5/31/05	FY 06 Appropriation	Total	Funds FY02	Funds FY03	Funds FY04	Funds FY05	Funds FY06
06 IT Plan Operating Costs		\$2,439,400						
06 Records Mgmt. Document Imaging		\$101,900						
06 PIJ-Network & Software Upgrade		\$326,500						
06 Document Imaging		\$3,452,900	* 9 j					
Total	\$13,830,200	\$6,320,700	\$20,150,900	\$218,900	\$2,740,500	\$3,035,900	\$7,834,900	\$6,320,700
Expenditures in June 05 (and 13th Month) Planned Expenditures June 06				\$218,900	\$ 300,000 \$2,440,500	\$400,000 \$2,635,900		
Balance Forward				\$0	\$0	\$0	\$6,634,900	\$3,452,900

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DATE: June 20, 2005

TO: Representative Russell Pearce, Chairman

Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Kevin Bates, Fiscal Analyst

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

Pay Settlements

Request

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

Recommendation

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

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

(Continued)

Analysis

On-Call Payments

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

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

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

Overtime

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

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

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

RS:KB:ss

Arizona Department of Corrections



1601 WEST JEFFERSON PHOENIX, ARIZONA 85007



June 3, 2005

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



Dear Chairman Pearce:

Pursuant to the requirement in HB 2387 (Laws 2005, Chapter 6), a report on the status of the payment of the claims to resolve on-call pay settlements and compensatory time is provided to you.

In August 2004, ADC paid the remaining compensatory time liabilities accrued in FY 2003-04 amounting to \$7.8 million, which was reimbursed to the ADC's FY 2004-05 budget by a supplemental appropriation of \$7.5 million in Chapter 6.

Also in Chapter 6 was an appropriation of \$10.0 million from the Risk Management Fund and \$2.5 million from the General Fund to pay on-call settlement claims.

Most of the payments of \$12.5 million to the 1,143 employee claimants in the on-call settlements were paid in April and May by the Department of Administration with the last of the checks issued by ADOA on May 13. Six checks were returned "addressee unknown" although given the circumstances no additional interest accrues on these last remaining checks. ADC is working with claimant counsel to obtain current addresses for these individuals as quickly as possible. As of today, we have obtained current addresses for three of the six.

Sincerely,

Dora Schriro

