STATE OF ARIZONA

Joint Legislative Budget Committee

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JOINT LEGISLATIVE BUDGET COMMITTEE
Thursday, September 25, 2003
9:30 a.m.
House Hearing Room 4

AGENDA

- Call to Order

- Approval of Minutes of August 14, 2003.

- DIRECTOR'S REPORT (if necessary).

- EXECUTIVE SESSION
  A. Arizona Department of Administration, Risk Management Services - Consideration of Proposed Settlements under Rule 14.
  B. School Facilities Board Construction Cost Index - Consultation with attorneys for legal advice pursuant to A.R.S. § 38-431.03.

1. JLBC STAFF - Consider Approval of Index for Construction Costs.

2. AHCCCS - Review of Capitation Rate Changes

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

4. DEPARTMENT OF ECONOMIC SECURITY - Review of Expenditure Plan for Workforce Investment Act Monies.

5. TOURISM AND SPORTS AUTHORITY - Report on Activities.

6. DEPARTMENT OF REVENUE - Report on Ladewig Expenditures.

The Chairman reserves the right to set the order of the agenda.
09/19/03

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MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

August 14, 2003

The Chairman called the meeting to order at 9:35 a.m., Thursday, August 14, 2003, in House Hearing Room 4. The following were present:

Members:	Senator Burns, Vice-Chairman	Representative Pearce, Chairman
	Senator Bee	Representative Biggs
	Senator Cannell	Representative Burton Cahill
	Senator Harper	Representative Gray
	Senator Martin	Representative Huffman
		Representative Huppenthal
		Representative Lopez
Absent:	Senator Anderson	Representative Farnsworth
	Senator Arzberger	
	Senator Rios	
Staff:	Richard Stavneak, Director	Cheryl Kestner, Secretary
	Jake Corey	Paul Shannon
	Bethany Nicholas	Steve Schimpp
Others:	Richard Travis	Attorney General's Office
	Tim Fleming	Attorney, Legislative Rules Office
	Frank Hinds	State Risk Manager, ADOA
	Leslie Schwalbe	Deputy Director, Department of Health Services
	Tom Betlach	Deputy Director, AHCCCS
	Cathryn Echeverria	Office Chief, Office for Children with Special Health Care Needs, Department of Health Services

APPROVAL OF MINUTES

Senator Burns moved *that the Committee approve the minutes of June 5, 2003 and June 10, 2003.* The motion carried.

EXECUTIVE SESSION

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

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

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

At 11:10 a.m. the Committee reconvened into open session.

DEPARTMENT OF ADMINISTRATION (ADOA)

A. Review of Risk Management Deductible.

Mr. Paul Shannon, JLBC Staff, said that this item is a request for review of the deductible amounts charged to agencies for risk management losses. ADOA may impose a $10,000 deductible on claims made against Risk Management. The JLBC Staff recommends a favorable review be given to this item.

Senator Harper asked if ADOA wants the deductibles to go into their budget. Mr. Shannon said that the deductible is a device that ADOA can use if they believe that the agency that has claims made against them do not act appropriately in managing their business. ADOA has not assessed any deductible amounts against any claims so far because all the agencies covered by Risk Management have complied with the rules of Risk Management.

Senator Burns moved that the Committee give a favorable review to the Department of Administration's request that the Committee approve the current deductible amounts of up to $10,000 per risk management loss. The motion carried.

B. Review of Emergency Telecommunication Services Revolving Fund Expenditure Plan.

Mr. Paul Shannon, JLBC Staff, said this item deals with the state's 911 system. There was a federal communications requirement that 911 systems be able to identify the physical location of cell phones in making calls to 911. ADOA provides funds to counties and municipalities to provide the equipment for these 911 location systems. This is a review of their expenditure plan.

The JLBC Staff recommends a favorable review of the expenditure plan, however, there are a couple of issues. The first would be whether or not the Government Information Technology Agency (GITA) has oversight over the technical plans that are submitted to ADOA. GITA has indicated that they do not have statutory authority to review those plans. The plans are currently being reviewed by ADOA. There also is an issue of whether or not these plans should be reviewed on a fiscal year or a calendar year basis. The plans are submitted on a calendar year basis; this report is on a fiscal year basis and that will need to be investigated further.

Senator Martin said for information purposes, when this was first put in place there was an oversight committee that he chaired. ADOA currently does the oversight, but the FCC really tells them what they have to have. They serve more as a procurement function for the equipment that the FCC requires. Senator Martin said he has talked to GITA and to ADOA and they would both like to keep it the way it is rather than move it from ADOA to GITA.

Senator Burns asked how long range the expenditure plan is. Mr. Shannon said that they have provided information from FY 2003 with estimates projected out to FY 2010. In his experience working with these numbers the plans can change fairly dramatically over time.

Senator Burns asked how comfortable Mr. Shannon is with the resources to support the plan over that time frame. Based on Senator Martin's comments, it is not really clear what they will have to do. Mr. Shannon said that the tax that currently funds the cell phone portion of the system is set at 37¢ per month per cell phone connection through 2006. At that point, the tax is reduced to 28¢ per line. The expenditure plan they have submitted indicates that there will be sufficient funding until 2008 and then the tax is further reduced to 20¢ per line. At some point there may be a necessity to review the amount of the excise tax after FY 2007 to see if those amounts are sufficient.

In response to Senator Burns, Mr. Shannon said ADOA is currently reporting on an annual basis.

Senator Martin said that the Legislature took $15 million from this fund last year. Before they look at expanding the tax, he suggested they look at triggering excess revenues in future years back into that fund.

Representative Pearce said there would be some question as to what the fund was used for. He questioned whether they have a lot of staff or a lot of expenses and whether GITA has the ability to oversee this.

Mr. Shannon said that GITA has oversight of state expenditures on technology. ADOA provides funding for the implementation of 911 systems at the county and the municipality level and he believed that is GITA's take on their authority.

<u>Senator Burns moved</u> that the Committee give a favorable review as recommended by JLBC Staff to the Department of Administration's expenditure plan for the 911 systems. The motion carried.

<u>ATTORNEY GENERAL (AG)</u>

A. Review Allocation of Settlement Monies.

Mr. Richard Stavneak, JLBC Staff, said this is a review of an allocation of settlement monies that have been deposited into the Consumer Fraud Recovery Fund. There was a settlement with Qwest with regard to alleged deceptive practices. They have paid the state $1.7 million, will pay another $1 million a year from now and will pay another $1 million 2 years from now. This money is being deposited in the Consumer Fraud Recovery Fund. The monies are used for consumer fraud education, investigations and similar activities. An ORB provision was passed this year that allows the AG to also expend this money on direct salary expenses, which typically is not in statute, but they do have the ability at this time. The JLBC Staff recommends a favorable review.

<u>Senator Burns moved</u> that the Committee give a favorable review as recommended by JLBC Staff to the Attorney General's allocation plan for the Qwest settlement. The motion carried.

B. Review of Uncollectible Debts.

Mr. Stavneak said this item is a review of uncollectible debts. Annually the Attorney General appears before the Committee to discuss taking a certain amount of uncollectible debt off the state's books. That amount this year is approximately $9.5 million with $6 million due to corporations being defunct, $1.8 million due to bankruptcies and $900,000 due to insufficient resources. There is also an attachment in the JLBC agenda book from the Attorney General that gives each line item where the debt is being forgiven. The JLBC Staff recommends a favorable review.

<u>Senator Burns moved</u> that the Committee give a favorable review as recommended by JLBC Staff to the Attorney General's report on uncollectible debt, which allows the State Comptroller to remove debt certified by the Attorney General as uncollectible. The motion carried.

<u>ARIZONA COMMISSION ON THE ARTS</u> - Review of the Arizona Arts Endowment Fund and Private Contributions.

Mr. Steve Grunig, JLBC Staff, stated that the Arizona Commission on the Arts is required by statute to make an annual report on private monies that are donated for use in conjunction with public monies from the Arizona Arts Endowment Fund. The Arts Commission has submitted its report and requests that the Committee review it at this time. The information included in the Committee's packet indicates that net private donations to the Fund was $2.7 million in CY 2002. From 1996 through the end of 2002, private donors have contributed a total of $26,772,000 to the Arts Endowment Fund. The report appears to satisfy the statutory requirement and the JLBC Staff recommends a favorable review.

<u>Senator Burns moved</u> that the Committee give a favorable review as recommended by JLBC Staff to the Arizona Commission on the Art's report on the Arizona Arts Endowment Fund and Private Contributions. The motion carried.

<u>DEPARTMENT OF HEALTH SERVICES (DHS)</u>

A. Review of Behavioral Health Capitation Rate Changes.

Mr. Richard Stavneak, JLBC Staff, said this item involves behavioral health capitation rate increases. Any time in the Title XIX program the capitation rates are increased, which are the flat monthly payments that are made to health plans or Regional Behavioral Health Authority's (RBHA), the relevant departments are asked to come forward and give the Committee information on their proposed capitation rate increases. In this particular circumstance, the capitation rate increases are ranging across 3 different categories, about 11.7%. We had budgeted 4.5% for a capitation adjustment and the Executive had recommended 5%. In terms of the actuarial study, it ended up at slightly less than 12%. As a result that would cost us money over and above what we have in the budget. That additional cost is between $11-$15 million dollars. A year ago we dealt with a similar issue. One of the reasons capitation rates are going up is because we are moving some children out of the Department of Economic Security (DES) system into the DHS system and DHS is picking up their costs. The Committee recommended to the department that they seek about $2.6 million from DES to be reimbursed for those costs. That is something that the department chose not to proceed with. Also, as a matter of background information, we had a lump sum reduction totaling $12.5 million within the DHS budget. The Governor line-item vetoed that reduction. The intent of the Governor with that line item veto was to increase the DHS budget by about $12.5 million. The Governor had suggested in her veto communication that she would want to spend it on a number of discretionary programs within DHS. On page 4 of the JLBC memo, it outlines what those particular areas are. This is one of the line item vetoes that are being litigated.

Mr. Stavneak briefly described each of the options available to the Committee as shown on page 2 of the JLBC agenda book.

Senator Burns said that during session when they were working on this budget it was determined, with regard to RHBA's, that if they exceeded a certain amount it came back to DHS. Mr. Stavneak said he believes they are allowed to retain somewhere between 1% and 2% of their capitation rate.

Senator Burns asked how they are doing at this point.

Ms. Leslie Schwalbe, Deputy Director, DHS, stated that it is actually 4% to 5% on the gains or losses; 5% on the Medicaid program and 4% on the non-Medicaid program. In terms of how the RHBA's are doing, she believes after paying for FY 2003 interest, there will be some money coming back and some money owed because of the risk corridor.

Senator Burns asked Ms. Schwalbe to explain the risk corridor. She said that if you make more than 5% it is owed back to the state. If you lose more than 5% we owe the contractor. What they anticipate happening at the end of FY 2003, is they do a financial/claims reconciliation and in November they will have the final number. Senator Burns asked what the biggest areas of loss are. Ms. Schwalbe said the biggest loss they sustain is in 2 populations: the kids population and the adult general mental health substance abuse population. Utilization is the key piece as to the loss. The actual number of people being served is greater and the number and intensity of services in growing. One of the biggest changes was in October 2001 when Proposition 204 passed and expanded Medicaid eligibility.

In response to Senator Burns, Ms. Schwalbe said the losses on the general mental health substance abuse side were greater than the children's program and there were some gains on the Seriously Mentally Ill (SMI) side. She said there have not been any significant eligibility changes in recent years. Senator Burns asked if they were changes in eligibility, would it be required federally or locally. Ms. Schwalbe said the purview of changes lies with the AHCCCS administration and the federal government under their state planning agreement.

Senator Burns stated that changing eligibility seems like a policy change, is AHCCCS setting policy in these particular areas.

Mr. Tom Betlach, Deputy Director, AHCCCS, said that AHCCCS, as well as DES, will determine eligibility based upon the level set in statute and the various programs that have been enacted by the Legislature. If the Legislature were to pass eligibility up to 100% that is the way AHCCCS would determine eligibility, based upon the guidelines that were established by the Centers for Medicare/Medicaid Services. All programs eligibility are determined by statute.

Representative Lopez asked if they are continuing to see increases in population both in children's and general mental health. Ms. Schwalbe said that they are seeing increases in both populations as a whole, even prior to the change from Proposition 204.

Mr. Stavneak said as a follow-up on Senator Burn's point, in terms of the eligibility, that is really defined by law. Most of what is driving these cost increases tend to be related to the cost of medical care, shifting the DES kids, and the premium tax. Another element of this is the Leff report, published several years ago, about the need to enhance Seriously Mentally Ill (SMI) services. There is a component of the SMI rate that includes increases related to being able to provide a greater length of care.

Ms. Schwalbe said the report does describe a gap in the need for persons with mental illness. The last couple of years we have been federalizing the services available for Medicaid populations, being able to draw down the federal money.

<u>Senator Burns moved</u> *that the Committee adopt options 2, 3, 4, as listed in the JLBC memo and described by Mr. Stavneak, which gave a favorable review to the Children's Behavioral Health (CBH), Seriously Mentally Ill (SMI), and General Mental Health/Substance Abuse (GMH/SA) Title XIX rate changes with the following stipulations:*

- *Offset the cost increase by obtaining Department of Economic Security (DES) payment for at least $2.6 million in capitation rate increases associated with the transfer of responsibility of behavioral health coverage from DES to DHS.*

- *If the courts uphold the legality of the Governor's action in vetoing DHS' lump sum reduction and offset for receipts, use these monies to pay for the costs of the capitation adjustment rather than through a supplemental.*

- *The review does not constitute an endorsement of a supplemental request, including the circumstance of the courts not upholding the legality of the vetoes.*

Senator Cannell stated that he opposed such a motion. He feels option 1 is the most appropriate, which is to give a favorable review to DHS' capitation adjustments with no conditions. We are making this motion on the basis of not knowing what will happen with the lawsuit. This is affecting children with crippling diseases and the behavioral health system is probably underfunded. If this motion passes we are throwing this back on DHS. They may not get any money but we do not know that. If they have to work with the funds they have, what will happen is these programs will not be funded. Programs that the Legislature passed in this budget will be affected adversely by this. We may lose some programs that this Legislature said we should fund.

Representative Pearce said that to accept option 1 would go beyond the budget and that would be an issue for the next session.

Representative Lopez said that DHS does have to come up with the money. They have to expend it, there is not an option not to. For the Committee to select options 3 and 4 as a caveat, is inappropriate especially since both of those would require legislative action on behalf of the entire Legislature. In terms of giving this a favorable review, it is up to the entire Legislature as a whole to decide whether or not they approve a supplemental.

The motion carried by a roll call vote of 6-3-0-7 absent. (*Attachment 1)*

Representative Burton Cahill stated that she agreed with Senator Cannell's remarks. She feels they will be doing a great disservice to a large part of the state's population.

B. Review of Children's Rehabilitative Services Capitation Rate Changes.

Mr. Richard Stavneak said this item is comparable to the previous DHS issue. We are slightly above the budget; we budgeted 4.9% and got about a 5.6% increase. The increase would cost from $160,000 to $1.2 million. The exact dollar amount will depend on what happens with enrollment during the course of the year. The Committee has the same comparable options as the previous item.

Senator Burns stated that the service providers do an actuarial study or has someone do it, and comes up with a figure that is either decreased or increased. He asked what kind of additional administrative workload is included in the providers need for additional funds. He asked if there are increases in reporting requirements that are being required by the department or is there an increase in services that are being required of the providers.

<u>Ms. Cathryn Echeverria, Office Chief, Office for Children with Special Health Care Needs, DHS</u>, said there has been an increase in reporting and quality management requirements. Those have been passed down to the contractors through AHCCCS and federal requirements. In the services area, there has not been an increase in the general service package from FY 2003.

Senator Burns asked when it comes to administrative increased requirements that are passed down by federal government, what kind of decision process is used to either agree or disagree with the level that is needed to satisfy the federal government. He asked whether it is a straight pass-through or does the department decide what requirement is needed to pass to the contractor to satisfy the federal government.

Ms. Echeverria said that they try to figure out how to get that information, is it something internal and they are able to use that resource or is it a lot of financial information that must come from the contractors because they are out there performing the services.

Senator Burns said then, as he understands it, there is some discretion within the department as to the level of administrative increases that are required by providers. Ms. Echeverria said that was correct.

Senator Cannell and Representative Burton Cahill again expressed their concern that options 2 and 3 would cost the state much more money later down the line and do a disservice to a large group of people.

<u>Senator Burns moved</u> *that the Committee adopt options 2 and 3 as listed in the JLBC memo, which gave a favorable review to the capitation rates for the Title XIX Children's Rehabilitative Services program with the following stipulations:*

- *If the courts uphold the legality of the Governor's action in vetoing DHS' lump sum reduction and offset for receipts, use these monies to pay for the costs of the capitation adjustment rather than through a supplemental.*
- *The review does not constitute an endorsement of a supplemental request, including the circumstance of the courts not upholding the legality of the vetoes.*

The motion carried by a roll call vote of 5-4-0-7. *(Attachment 1)*

ARIZONA CRIMINAL JUSTICE COMMISSION - Review of Victim Compensation and Victim Assistance Receipts.

Mr. Richard Stavneak said the Commission received about $1 million more than was anticipated in unclaimed restitution. These monies would be expended as grants to the counties to support the Crime Victim Compensation Programs. He stated that this is a review item for the Committee.

(The Committee lost their quorum so they continued to the next item until they regained a quorum.)

ARIZONA STATE RETIREMENT SYSTEM (ASRS) - Review of FY 2004 Information Technology (IT) Expenditure Plan.

Ms. Bethany Nicholas, JLBC Staff, said the ASRS is currently in the middle of an ongoing IT project and is requesting review of the $8.9 million portion of the expenditure plan. This portion of the plan will include video conferencing services, automated workflow process, additional services via the Internet, enhanced call routing systems, and a new financial accounting system. The Government Information Technology Agency (GITA) has approved the plan and reports that it is currently on schedule. The JLBC Staff recommends a favorable review.

The motion for the previous item was made:

<u>Senator Burns moved</u> *that the Committee give a favorable review to the Arizona Criminal Justice Commission's expenditure plan to expend the additional $1 million on grants to counties to support the Crime Victim Compensation Program as recommended by JLBC Staff*. The motion carried.

<u>Senator Burns moved</u> *that the Committee give a favorable review to the Arizona State Retirement System's expenditure plan submitted for the agency's IT plan as recommended by the JLBC Staff*. The motion carried.

Without objection the Committee adjourned at 12:05 p.m.

Respectfully submitted:

Cheryl Kestner, Secretary

Richard Stavneak, Director

Representative Russell Pearce, Chairman

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

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HOUSE OF
REPRESENTATIVES

DATE: September 19, 2003

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

THRU: Richard Stavneak, Director

FROM: Jake Corey, Fiscal Analyst

SUBJECT: JLBC STAFF – CONSIDER APPROVAL OF INDEX FOR CONSTRUCTION COSTS

Request

A.R.S. § 15-2041D.3c requires that the cost-per-square-foot factors used in the School Facilities Board (SFB) building renewal and new school construction financing "shall be adjusted annually for construction market considerations based on an index identified or developed by the Joint Legislative Budget Committee as necessary but not less than once each year." The SFB is requesting a two-year adjustment since the Committee did not approve any adjustment in FY 2003.

Summary

The Committee has at least three options:

1) Approve an increase in the cost-per-square-foot factors based on the Marshall Valuation Service (MVS) construction cost index for "Class C – Masonry Bearing Walls," which has been used for prior adjustments. Approving a two-year adjustment may have a new construction cost of $344,500 in FY 2004 and an additional $6.5 million once fully implemented over the next four years. A majority of schools fall into the Masonry Wall category. The MVS data is for the city of Phoenix only, and, as a single measure, tends to fluctuate over time.

2) Approve an increase in the cost-per-square-foot factors based on the average of the MVS index for three different structure classes (Masonry Walls, Wood Frame, Metal Frame). Approving a two-year adjustment may cost an estimated $275,600 in FY 2004 and an additional $5.2 million once fully implemented over the next four years. The MVS three class average is broader based and fluctuates less over time than the Masonry Wall index. As with the Masonry Wall index, the data for the three class average are for the city of Phoenix only.

3) Approve an increase in the cost-per-square-foot factors based on a national index for state and local government structures. Approving a two-year adjustment may cost an estimated $222,600 in FY 2004 and an additional $4.2 million once fully implemented over the next four years. Of the three

options, this is the only index that provides data specific to government structures. This index reflects a national estimate as Arizona figures are not available.

The current new construction cost estimates should not require SFB to seek supplemental funding in the current year as its existing $250 million budget would cover this cost. Beginning in FY 2005, the index adjustment could also increase the cost for the building renewal formula. The cost will depend on the building renewal formula calculation, which has either been suspended or modified in the past several years. We will have more cost information on this subject at the JLBC meeting.

Analysis

This section includes background information regarding the SFB inflation index and an explanation of the options available for the current index.

Background Information

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

At its February 2000 meeting, the Committee approved the MVS construction cost index for Class C structures (masonry bearing walls) for Phoenix for the period from July 1st through June 30th of each year. At that time, the relevant MVS index was 3.5%, so the Committee approved that index for the subsequent budgetary period. Later that year (during September 2000), the Committee approved an additional 4.6% "catch up" adjustment based on revised data from MVS. At its August 2001 meeting, the Committee again used the MVS index for Class C structures. At that time, the relevant MVS index was 0.6%.

At the August 2002 Committee meeting, the SFB requested a 4.8% adjustment based on the MVS index for Class C structures. The Committee did not take action on the item at that meeting, electing instead to defer action until the Committee had received from SFB its demographic assumptions, proposed construction schedule, and new school construction cost estimates for FY 2004. The Committee heard the item again at its December 2002 meeting. At that meeting the Committee elected not to approve an adjustment in the cost-per-square-foot factors.

Due to the decision not to approve an adjustment for FY 2004, five school districts have brought suit against the Committee, claiming the Committee has failed to perform its statutory duty under A.R.S. § 15-2041D.3c to adjust the index not less than once per year. The districts have asked the Court to order the Committee to immediately adjust the index. (See Attachment 1)

Options for the Current Index

The JLBC Staff has identified at least three possible construction indexes. There is a graph on page 4 of the three indexes from FY 2000 to FY 2003.

Phoenix Masonry Construction

The MVS index for "Class C – Masonry Bearing Walls" structures for Phoenix for FY 2002 is 4.8%, and for FY 2003 is 1.7%. The total increase over the last two years would be 6.5%. School buildings typically fall into the Class C structure category. Class C structures are characterized by masonry or reinforced concrete construction and generally include office buildings of three stories or less. The MVS does not have state-wide information. The MVS Class C index has a greater likelihood, as a single construction measurement, of year-to-year fluctuation. (See page 4)

Three-Class Average Phoenix Construction Costs

A second potential index is the average of the MVS index for "Class C – Masonry Bearing Walls," "Class D – Wood Frame," and "Class S – Metal Frame and Walls" structures for Phoenix. The 3-class average for FY 2002 is 3.5%, and for FY 2003 is 1.7%. The total increase over the last two years would be 5.2%. Class D structures are characterized by wood frame and wall construction, while Class S structures are characterized by metal frame and wall construction. Using the average of the MVS index for the three classes provides a broader perspective on construction cost changes for small, non-residential buildings and is more likely to include all the types of buildings used within school construction. As a broader measure, the annual cost fluctuation should be less and it would better reflect cost pressures in the overall construction industry. As with the first option, this measure is specific to Phoenix and does not include state-wide data.

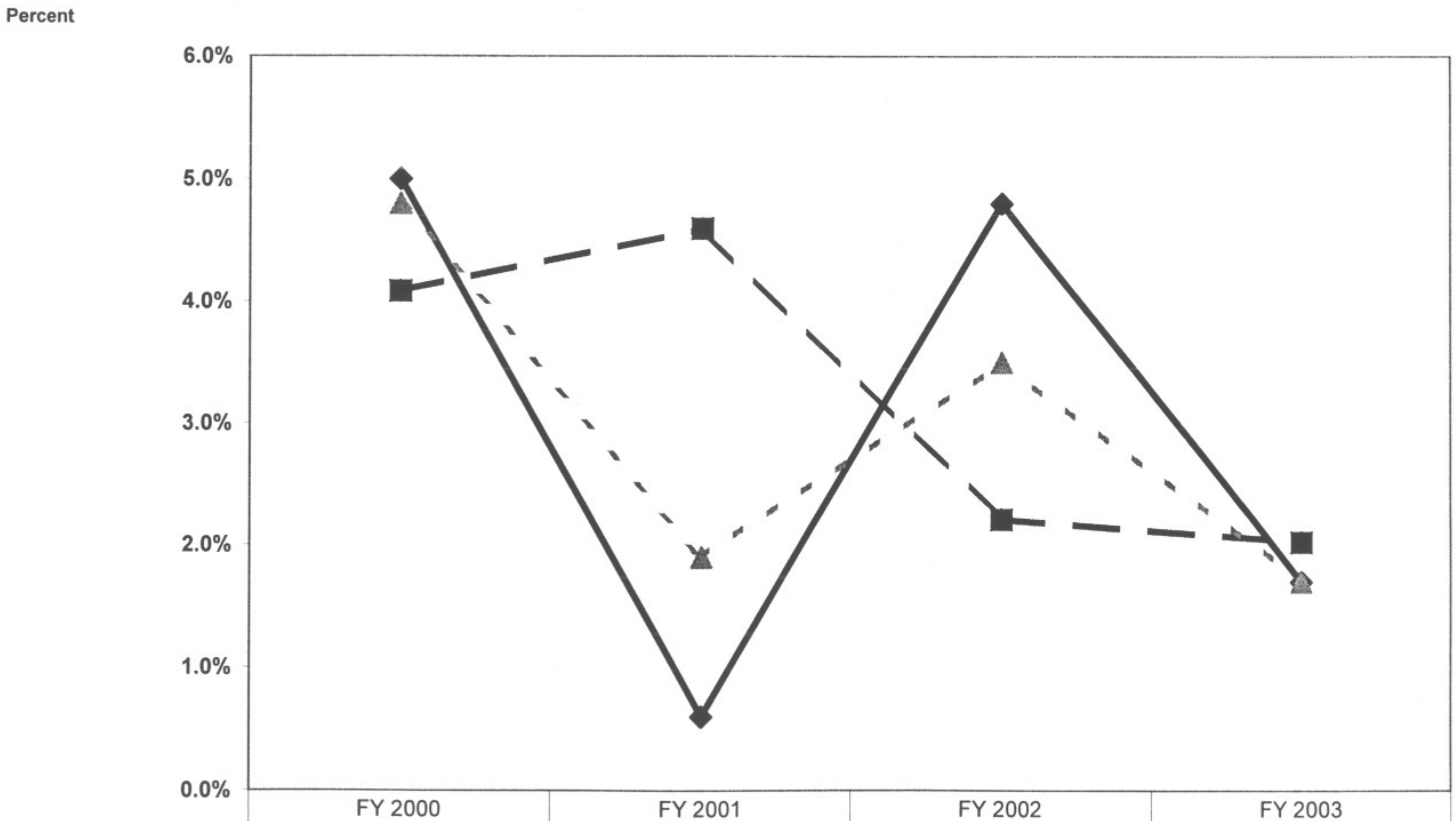
U.S. State and Local Structures

A third potential index comes from the U.S. Department of Commerce: Bureau of Economic Analysis (BEA). Their index for "State and Local Government Investment – Structures" for FY 2002 is 2.2%, and for FY 2003 is 2.0%. The total increase over the last two years would be 4.2%. This index measures price changes for all U.S. state and local gross investment in structures, which includes all buildings. Unlike the MVS data, this index only measures government activity, so it may better reflect school district market conditions. This data, however, is only available nationwide.

As a point of comparison, the Consumer Price Index increased 1.8% in FY 2002 and 2.2% in FY 2003. Therefore, it appears that inflation for general consumer goods and products was lower than inflation in the construction industry in FY 2002, but higher in FY 2003.

RS/JC:ck

School Construction Indexes



	FY 2000	FY 2001	FY 2002	FY 2003
Marshall Class C	5.0%	0.6%	4.8%	1.7%
S & L Gvt. - Structures	4.1%	4.6%	2.2%	2.0%
Marshall 3 Class Avg.	4.8%	1.9%	3.5%	1.7%

Marshall Class C 'S & L Gvt. - Structures Marshall 3 Class Avg.

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AUG 1 9 2003

COURT SEAL
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IN THE SUPERIOR COURT OF THE STATE OF ARIZONA

IN AND FOR THE COUNTY OF MARICOPA

MAYER UNIFIED SCHOOL DISTRICT; ELOY ELEMENTARY SCHOOL DISTRICT; CHINO VALLEY UNIFIED SCHOOL DISTRICT; GLOBE UNIFIED SCHOOL DISTRICT and CARTWRIGHT ELEMENTARY SCHOOL DISTRICT, Plaintiffs, vs. JOINT LEGISLATIVE BUDGET COMMITTEE, an agency of the Arizona Legislature, Defendant.	CV2003-015808 Case No.: **COMPLAINT** (Non-classified Civil)

Plaintiffs allege that:

1. This is an action filed by Plaintiff School Districts to enforce the Joint Legislative Budget Committee's ("JLBC") funding obligations established by the Students FIRST legislation. That legislation was enacted by the Arizona Legislature in 1998 to establish a general and uniform public school system pursuant to the Arizona Constitution, Article XI, Section 1. Defendant has failed to perform its mandatory, nondiscretionary obligation under law to adjust the cost per square foot in the building

renewal and new school construction financing formulas. A.R.S. § 15-2041(D)(3)(c). The statute specifically provides that:

> The cost per square foot shall be adjusted annually for construction market considerations based on an index identified or developed by the joint legislative budget committee as necessary but *not less than once each year*.

A.R.S. § 15-2041(D)(3)(c) (emphasis added).

2. This action is brought pursuant to A.R.S. § 12-2021 *et seq*. and the Rules of Procedure for Special Actions.

<u>The Parties</u>

3. The Plaintiffs are school districts organized pursuant to Arizona law and are political subdivisions of the State of Arizona.

4. The JLBC is a legislative agency established by statute. It consists of members from both the House of Representatives and the Senate and is responsible for making recommendations to the Legislature relating to the state budget. A.R.S. § 41-1271 *et. seq.* The JLBC is also responsible for annually adjusting the construction market index for building renewal financing and new school construction. A.R.S. § 15-2041(D)(3)(c).

<u>Background</u>

5. In accord with the Arizona Constitution, the Students FIRST legislation attempts to establish and maintain a "general and uniform public school system." Ariz. Const. Art. XI, § 1. The mandate is accomplished through the Students FIRST legislation in two ways. First, the Legislature created minimum adequacy standards for capital facilities and empowered the School Facilities Board to oversee compliance with those standards. *Hull v. Albrecht,* 192 Ariz. 34, 960 P.2d 634 (Ariz. 1998). Second, the School Facilities Board distributes state funds from several new funding sources to (1) bring existing facilities up to standards through the Deficiency Corrections Fund, (2) construct new facilities for growing districts through the New School Construction Fund, and (3) maintain all capital facilities at the level of adequacy established by

the minimum adequacy standards through the Building Renewal Formula and a soft capital allocation. A.R.S. §§ 15-2021, 15-2041, 15-2031, 15-962.

6. The only funds affected by the construction index are new school and building renewal funds. Both funds are determined by formulas which use the cost per square foot amount established in statute. A.R.S. §§ 15-2031(6) and 15-2041(D). The building renewal formula is based upon the age of the building, square footage, and any renovations completed on the buildings. A.R.S. § 15-2031(D) & (G). The new school construction fund provides funding for new schools based upon student growth and available square footage. A.R.S. § 15-2041(D). These calculations determine the amount of funding that will be available.

7. Part of the financing formula of Students FIRST provides that at least once each year the JLBC is required to adjust the cost per square foot factors that are used to determine distributions for new school construction and building renewal monies as a result of construction market considerations. A.R.S. § 15-2041(D)(3)(c) specifically requires that the factors

> shall be adjusted annually for construction market considerations based on an index identified or developed by the joint legislative budget committee as necessary but not less than once each year.

8. Pursuant to A.R.S. § 15-2041(D)(3)(c), in February 2000, JLBC chose the Marshall Valuation Service construction cost index ("MVS"). At that time, the JLBC approved the relevant MVS index at 3.5% for the subsequent budgetary period. Later that year, in September 2000, JLBC approved an additional 4.6% increase based on revised data from MVS. The last adjustment was at JLBC's August 2001 meeting when the relevant MVS index of 0.6% was approved. There has been no adjustment since August 2001. Therefore, two years have elapsed since the last adjustment in violation of A.R.S. § 15-2041(D)(3)(c) which requires an adjustment at least once a year.

9. The Defendants have a mandatory, nondiscretionary duty established by Arizona law to annually approve an adjustment in the cost index.

10. The Plaintiffs have demanded that the Defendants perform their mandatory, nondiscretionary duty to adjust the cost per square foot factor used in the building renewal and new school construction financing formulas.

11. The Defendant has failed to perform its mandatory, nondiscretionary duty to annually approve an adjustment in the cost index.

12. The Plaintiffs have been harmed and will continue to be harmed in the future by the Defendants' failure to provide the full funding necessary to both maintain adequate capital facilities and to construct new schools.

WHEREFORE, Plaintiffs request that the Court:

1. Order the Defendants to immediately adjust the relevant index;
2. Order the Defendants to prospectively comply with A.R.S § 15-2041(D)(3)(c);
3. Award the Plaintiffs their attorneys' fees and costs; and
4. Order such other and further relief as may be necessary and proper.

DATED this 19th day of August, 2003.

ARIZONA CENTER FOR LAW
IN THE PUBLIC INTEREST

Timothy M. Hogan
202 East McDowell Road, Suite 153
Phoenix, Arizona 85004
Attorneys for Plaintiffs

STATE OF ARIZONA SCHOOL FACILITIES BOARD
MEMORANDUM

TO: Senator Robert Burns, Chair
Representative Russell Pearce, Vice Chair
Richard Stavneak, JLBC Staff Director

FROM: William Bell, Executive Director

DATE: 9/16/03

SUBJECT: INDEXING OF SCHOOL CONSTRUCTION COSTS

The School Facilities Board staff requests to placed on the August JLBC agenda for the purpose of approving the cost of construction index factor.

A.R.S. 15-2041, Section D, Subsection 3(c), states in part "...The cost per square foot shall be adjusted annually for construction considerations based on an index identified or developed by the joint legislative budget committee as necessary but no less than once each year."

In August 2001, JLBC approved a 0.6 percent increase based on the Marshall Evaluation Service index for class C (masonry bearing walls) construction in the Phoenix Market. The increase reflected inflation between July 2000 and July 2001. In October 2002, the JLBC approved a 0.0% construction cost inflation factor for the statutory cost per square foot.

As requested, we have provided the inflation figures listed in the Marshall index. The July 2001 to July 2002 increase in building costs is shown at 4.8 percent, and the July 2002 to July 2003 increase is 1.75%. The impact of these increases on the dollars per square foot provided is reflected in Table 1.

Table 1

Grade Level	Current Amount	FY 03 Adjusted Amount 4.8%	FY 04 Adjusted Amount 1.75%	Cumulative Adjusted Amount 6.55%
K - 6	$98.01	$102.71	$99.73	$104.43
7 - 8	$103.47	$108.44	$105.28	$110.25
9 - 12	$119.80	$125.55	$121.90	$127.65

The increase will affect both the building renewal and new construction programs.

WB/CC

DATE: September 15, 2003

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

THRU: Richard Stavneak, Director

FROM: Beth Kohler, Fiscal Analyst
Tim Sweeney, Fiscal Analyst

SUBJECT: ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM – REVIEW OF CAPITATION RATE CHANGES

Request

Pursuant to General Appropriation Act footnotes in both Acute and Long-Term Care, the Arizona Health Care Cost Containment System (AHCCCS) is required to report capitation and fee-for-service inflationary rate increases with a budgetary impact to the Committee for its review prior to implementation.

Summary

The proposed rates are based upon an actuarial study, which is required by the federal government. JLBC Staff estimates that the proposed changes would have a General Fund cost of approximately $30 million to $39 million above the FY 2004 appropriated amounts. These proposed rates represent increases above the current rates of approximately 13.9%. In comparison, the FY 2004 budget assumed capitation rate increases of approximately 7.1%, and the Executive recommended a 5.6% increase. AHCCCS has reported that, after some additional work, they may revise the proposed rates described in this memo. Preliminary estimates indicate that these revisions could reduce the cost of the rate increase by $(3) million.

AHCCCS has identified a General Fund cost of approximately $42 million in FY 2004 related to these capitation rate increases. AHCCCS reports that, due to numerous uncertainties including enrollment trends and Tobacco Tax collections, this number may change later this fall as they get a better sense of these variables.

To offset a portion of this cost, AHCCCS is proposing to use, through a series of financial transactions, approximately $18 million in General Fund monies freed up in FY 2003 by the temporary increase in the Medicaid Federal Matching Assistance Percentage (FMAP). The use of these monies would result in a net General Fund cost for the capitation rate increase of $24 million. The enacted FY 2004 budget, however, assumed that all of these monies would be reverted to the General Fund. The savings that AHCCCS is proposing to use are one-time in nature and would need to be filled-in on a permanent basis in FY 2005. We recommend that a decision to use the FMAP savings for the capitation rate increase should be made by the full Legislature. Please see the Attachment for a letter from the JLBC Staff to AHCCCS on this subject.

The Committee has the at least following choices:

1. A favorable review of AHCCCS' capitation adjustments with no conditions. AHCCCS would likely view this option as an endorsement of any future supplemental request or an endorsement of AHCCCS' proposal to use the federal match rate savings discussed above.

2. A favorable review with any combination of the following stipulations:

    a) The review does not constitute an endorsement of any potential supplemental request, or of the proposal to use the federal match rate savings discussed above.

    b) AHCCCS shall provide further information to the Committee about its decision not to implement fully the cost-sharing options. These options were proposed by AHCCCS, favorably reviewed by the Committee at its December 19, 2002 meeting, and enacted by the Legislature as part of the FY 2004 budget. We are in the process of examining whether there are technical problems related to the implementation of the cost-sharing options.

    c) AHCCCS shall report to the Committee by December 31, 2003 on the savings associated with changing the statutory components of rate setting (including, but not limited to, the outpatient hospital services cost-to-charge ratio, and the inpatient hospital tiered per diem rates). These statutory provisions have limited AHCCCS's flexibility in setting rates. We understand that AHCCCS may have a preliminary estimate of these potential savings at the time of the Committee meeting.

    d) AHCCCS shall report to the Committee by December 31, 2003 on how we can improve the timeliness of the projections of the capitation rate increases. As noted above, the FY 2004 budget assumed capitation rate increases of 7.1%, and the proposed increases are, on average, 13.9%. One option is to have AHCCCS report preliminary capitation rate adjustments by March 31 of each year. This requirement would also apply to the Department of Economic Security and the Department of Health Services Title XIX programs.

3. An unfavorable review. Given the federal guidelines that the capitation rates be actuarially sound, AHCCCS would most likely implement these rates even with an unfavorable review.

Analysis

Title XIX is a federal entitlement program and states are required to provide reimbursement rates in managed care programs that are actuarially sound. AHCCCS contracts with an actuarial firm, which uses claims and encounter data and projected enrollment to determine the actual cost of services and thereby recommends increases or decreases in capitation and Fee-For-Service (FFS) rates.

The weighted average rate increase across all populations is 13.9%. Of this increase, roughly 6% is related to changes in the utilization of medical services, 4% is related to increases in the cost of these services (medical inflation), and 2% is related to the addition of the premium tax. These increases appear consistent with the average changes we have seen in national healthcare data.

The remaining 1.9% results from "rebasing" the rates, which occurs once every 3 years. In non-rebase years, actuaries use utilization and inflation data to trend the current year capitation rates forward. In rebase years, the rates are essentially zero-based and trended forward as appropriate.

The increases should also be considered in the context of the overall health care market. While AHCCCS reports that health plan profits have been essentially flat over the past 9 years, the average health plan has generated profits for the last 5 years. From Contract Year (CY) 1998 to CY 2002, the average health plan profit has ranged from 0.25% to 1.9%. Data from the first quarter of CY 2003 indicates that health plans are experiencing a loss of 0.3%. However, because this is calculated using only one quarter of data, it is difficult to determine whether this loss will continue throughout the entire contract year. Rates are sufficiently profitable that enough health plans participate in the program that members continue to have a choice in plans. We are working to better understand the impact of rebasing in light of the profits experienced by the health plans over the past few years.

AHCCCS is proposing rate increases for the Traditional Medicaid population, the Title XIX Waiver Group (previously the MN/MI population), the Arizona Long-Term Care System (ALTCS) EPD rates, and KidsCare rates.

Acute Care

AHCCCS has two sets of capitation rates for Acute Care. This population represents members who are covered under the Temporary Assistance for Needy Families (TANF) (very-low-income households) and Supplemental Security Income (SSI) (low-income elderly and disabled households) eligibility categories, and includes a portion of Proposition 204 households (up to 100% of the federal poverty level). The following table shows the rate changes for the main capitation category. Regular capitation rates were budgeted to increase by 7.1%, however, actuaries now report the expected increase to be 13.7%. The rates shown reflect a weighted average of the rates paid per member per month to the health plans. In addition, the table shows the JLBC Staff estimate of the additional costs as a result of the higher than budgeted inflation.

Monthly Regular Capitation Rates

Populations	Current Rate	Budgeted Rate *	Proposed Rate	%
Age <1	$351.69	$376.66	$362.52	3.1%
Age 1 – 13	81.38	87.16	91.46	12.4%
Age 14 – 44 (Female only)	146.98	157.42	163.22	11.1%
Age 14 – 44 (Male only)	104.93	112.38	114.53	9.2%
Age 45+	287.56	307.98	328.52	14.2%
SSI with Medicare	197.42	211.24	243.91	23.7%
SSI without Medicare	409.78	438.87	511.28	24.8%
Family Planning	20.48	21.93	14.21	(30.6)%
Deliveries	5,041.48	5,399.43	5,644.88	12.0%
Average Rate Increase				13.7%
Change in Cost from Budgeted to Proposed Rate (Acute Care only)			$11-14 million	General Fund
			$37-40 million	Total Funds

* rates adjusted to include premium tax

Driving the 13.7% adjustment in the capitation rates are increases in both the costs of providing services to members, and the rate at which members utilize those services. AHCCCS and the actuaries' report that, on average, utilization of services is increasing by approximately 5.2%-6.2%, which contributes to roughly 57-65% of the total capitation rate increase. In addition, the costs of providing the services is increasing by approximately 3.4%-4%, which contributes to roughly the remaining 35-43% of the overall capitation rate increase. Also included in the cost component is the addition of the premium tax, which was funded in the FY 2004 budget.

Title XIX Waiver Group

The Title XIX Waiver Group represents members eligible under the old Medically Needy / Medically Indigent (MN/MI) program. The Medically Needy population is commonly referred to as the "spend-down" population, in which people with extremely high medical costs can qualify for AHCCCS on a short-term basis. The Medically Indigent population represents single adults and childless couples up to 100% of the federal poverty level. The current budgeted amounts assumed capitation rate increases of 7.1%, however, AHCCCS now expects the FY 2004 rates for these populations to increase, on average, by 15%.

This 15% adjustment is, again, based on increases in both the costs of providing services to members, and the rate at which members utilize those services. AHCCCS and the actuaries report that, on average, utilization of services is increasing by approximately 5.5%, which contributes to roughly 51% of the total capitation rate increase. In addition, the costs of providing the services is increasing by approximately 5.5%, which contributes to roughly the remaining 49% of the overall capitation rate increase.

The JLBC Staff estimates that these rate increases will cost $19 million to $25 million General Fund ($55 million to $60 million in Total Funds) above budgeted rates.

Long-Term Care (ALTCS)

ALTCS services are provided through a system of 7 program contractors who competitively bid to provide long-term care services to eligible individuals. In all counties, except Maricopa, there is one program contractor that is responsible for coordinating and managing all of the clients long-term and acute care needs. In Maricopa County there are 3 program contractors, and therefore, Maricopa residents are given an enrollment choice.

The approved FY 2004 budget provided for a 7.1% increase, however, AHCCCS expects regular ALTCS capitation rates to increase by only 5.2%. Based on enrollment projections used in developing the FY 2004 appropriation, the capitation rate change will result in State Match savings of approximately $(0-1) million and Total Funds savings of approximately $(2) million below budgeted levels. Of the State Match savings, approximately half would be realized by the state, and half by counties in the form of lower county contributions.

KidsCare (Federal Title XXI)

Beginning in FY 2003, the capitation rates paid for KidsCare members are identical to those paid to Traditional Medicaid members. The JLBC Staff estimates the cost of the larger than anticipated capitation rate increases would generate additional General Fund costs of approximately $400,000. Lower than expected enrollment growth in FY 2003, however, would offset this cost, based on the

FY 2004 enrollment growth assumed in the FY 2004 appropriation. Under these revised caseload estimates for FY 2004, the KidsCare program would have savings of approximately $(200,000) below budgeted levels.

Cost Summary

The following table summarizes the JLBC Staff estimate of the General Fund cost of the proposed capitation rate increases.

Summary of Additional General Fund Costs of Capitation Rate Increases

	Cost (Savings) Relative to FY 2004 Appropriation Capitation Rate Increases (including revised caseload)
Acute Care Capitation	$11-14 million
Title XIX Waiver Group	19-25 million
ALTCS Capitation	(0.5) million
KidsCare	(0.2) million
Total General Fund Cost	**$30-39 million**

As discussed in the *Summary* section, AHCCCS has indicated that they may revise these proposed rates, which could reduce the cost of the rate increase by $(3) million, for a total cost of $27 million - 36 million.

Other Issues

AHCCCS reports that the statutory mandates related to rate setting may be contributing to the increases in capitation rates. A.R.S. §36-2903.01 mandates that inpatient hospital stays be paid using a tiered per diem methodology that is adjusted annually for inflation, and that outpatient hospital services be paid using a hospital-specific cost to charge ratio. AHCCCS is developing an estimate of the extent to which these mandates affect the inpatient hospital and outpatient rates.

The approved FY 2004 budget assumed approximately $14 million in savings due to the implementation of cost-sharing strategies developed by AHCCCS. AHCCCS is currently implementing several, but not all, of these strategies. Implementation is on hold pending input from the federal Centers for Medicare & Medicaid Services (CMS) for KidsCare co-payments for children and parents. AHCCCS does not plan to implement the KidsCare and Waiver Group enrollment fees. As a result, the total level of savings assumed in the approved FY 2004 budget will likely not occur. The JLBC Staff is continuing to research this issue to determine the affect of these changes and possible options regarding cost-sharing.

RS/TS:ck

September 19, 2003

Mr. Anthony D. Rodgers, Director
Arizona Health Care Cost Containment System
801 E. Jefferson Street
Phoenix, AZ 85007

Dear Mr. Rodgers:

Thank you for your September 5, 2003 letter informing us that AHCCCS has received reimbursements totaling $21 million from the federal government for the Title XIX Medicaid programs between April and June 2003. These amounts are related to changes in the federal Medicaid match rate in the Job Growth and Tax Relief Act of 2003.

We understand your letter to mean that the federal reimbursements will offset FY 2003 General Fund expenditures. That approach would be consistent with legislative intent regarding the federal Medicaid match rate change. In discussions with your staff, however, they indicated that these monies would ultimately be used to offset the unbudgeted cost of FY 2004 capitation rate adjustments through a series of financial transactions. The enacted FY 2004 budget assumed that the federal match rate savings would fully revert to the General Fund.

We, therefore, view the ultimate use of the match rate savings for any unbudgeted FY 2004 capitation costs as being inconsistent with current legislative intent. In addition, AHCCCS's plan for the FY 2004 capitation adjustments would essentially use one-time funding to address an ongoing cost. As a result of both of these factors, we believe that the Legislature should participate in any decisions regarding the use of the match rate savings.

We received a similar letter from the Department of Health Services, but they do not currently have a plan to spend the reimbursements on FY 2004 costs. We have not received a similar letter from the Department of Economic Security. We have sent both agencies a copy of this letter for their information.

(Continued)

Please let us know if you need any additional information, including supporting material regarding legislative intent.

Sincerely,

Richard Stavneak

Richard Stavneak
Director

RS:ss
xc: David Jankofsky, Director, OSPB
Clark Partridge, State Comptroller, ADOA
Cathy Eden, Director, Department of Health Services
David Berns, Director, Department of Economic Security

Janet Napolitano, Governor
Anthony D. Rodgers, Director

AHCCCS

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

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phone 602 417 4000
www.ahcccs.state.az.us

September 10, 2003

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

Dear Representative Pearce:

The Arizona Health Care Cost Containment System (AHCCCS) respectfully requests to be placed on the agenda of the next Joint Legislative Budget Committee (JLBC) meeting to review the following items.

- Acute Care Capitation Rates
- Long Term Care Capitation Rates
- Fee For Service Rate Adjustments
- Title XXI Behavioral Health Capitation Rate Adjustments

Acute Care

As required by the Federal Balanced Budget Act of 1997, Title XIX and Title XXI Managed Care programs must have actuarially sound capitation rates. This past year AHCCCS had to go through a Request for Proposal process to award contracts for the next five years to Managed Care Organizations. This letter and attachments provide detail on the rates that were established and awarded as part of the procurement process.

A couple of other summary points need to be considered as part of the overall review.

1. From Contract Year ending 1999 through 2003 the average acute care Title XIX prospective capitation rate increase was 4% while studies show that commercial rates averaged a 13.2% increase over the same time period (Graph attached).
2. A recent report by the Kaiser Family Foundation found that "(B)etween spring 2002 and spring of 2003 monthly premiums for employer-sponsored health insurance rose 13.9%, the third consecutive year of double digit premium increases and the highest premium increase since 1990".
3. Since Contract Year 1995 the AHCCCS health plans have in totality broken even. (Graph attached)

Traditional Medicaid (TANF/1931 and SSI Populations)

In total, these rates have increased by 13.36% for Contract Year 2004 (Table attached). The following five components account for 86% of the overall increase.

1. Pharmacy accounts for 23% of the overall increase. This is due to a combination of increased utilization and costs. Several months ago AHCCCS contracted with the Lewin Group to conduct a thorough analysis of the pharmacy benefit to evaluate current practices, results and opportunities. The results of this study are anticipated to be available next month.

2. The Outpatient and Emergency Room components account for 17% of the overall rate increase. This is mainly driven by increased costs with smaller adjustments made for utilization. It is important to note that the AHCCCS Administration is limited in controlling the costs side of this component due to the currently required statutory formula that bases payment on cost to charge ratios. AHCCCS is in the process of completing a study on these rates to determine if other rate methodologies would be more appropriate in controlling costs.

3. New statutory mandates account for 16% of the total capitation increase.

4. Inpatient hospital accounts for 16% of the overall total increase. This component was increased to reflect higher utilization as well as the statutorily mandated inflation increase to the Tiered Per Diem rates.

5. Increased utilization of physician services accounts for 14% of the overall capitation increase. Since AHCCCS has frozen the fee for service fee schedules as a way to help contain costs, the entire increase for this component was driven by utilization. In general increased utilization of physician services can be viewed as a positive since it represents a less expensive alternative to already overcrowded emergency rooms.

Title XIX Waiver Group
This population reflects both the medical expense deduction group and childless adults between 0-100% of the Federal Poverty Level. The state was able to receive Title XIX Medicaid funding as a result of the waiver entered into by the state to implement Proposition 204 for these previously 100% state funded groups.

There are a couple of important background issues associated with this population. As a result of Proposition 204 creating a new program, the state did not have good utilization and encounter data for this population until recently. The initial rates established were reduced by 40% in April of 2002 in reaction to the rapid population growth and preliminary Managed Care Organization financial results. In the spring of 2003, it became apparent that the utilization and financial requirements for this population were higher than the revised capitation rate that was established. In the first special session of the Forty-sixth Legislature, supplemental funding was provided to help cover a reconciliation of this rate.

For Contract Year 2004 the Title XIX Waiver Group rates are increasing by 31%. When adjusted to reflect the reconciliation made at the end of Fiscal Year 2003 and the reconciliation that will occur in Fiscal Year 2004, this amount is reduced to 15%. The attachment titled Utilization Patterns of Acute Care Services provides some comparisons of this population to other AHCCCS populations that delineate the greater utilization of the expansion population as compared to the TANF population. In addition to the utilization and the April 2002 decrease, the major drivers of these rates are similar to acute. One important difference worth noting is that the Title XIX waiver group rates were adjusted downward by $19 million total funds to reflect the anticipated impact of cost sharing and new mandatory copays for this population.

Long Term Care
For State Fiscal Year 2004 AHCCCS was appropriated a 5.5% increase for Long Term Care capitation adjustments. The actual increase to the prospective capitation rate for the ALTCS program is 5.2%. The program continues to experience a favorable shift from nursing facilities to Home and Community Based Services (HCBS). In 1999, AHCCCS had 9,192 members in Nursing Facilities (NF) and today the number has decreased 10% to 8,304. During this same time period the population has grown 24% from 16,241 to 21,350.

Fee for Service Rate Adjustments
For SFY 2004, AHCCCS was appropriated a 3.2% increase for FFS inpatient hospital rate increases. The actual FFS increase for inpatient hospital rates will be 3.8%. The hospital increase is based on the Data Resources Inc. Center for Medicare and Medicaid Services Prospective Hospital Market Basket, as defined in A.R.S. 36-2903.01.

For ALTCS, no increases were granted since the Administration has frozen the fee schedule for FFS NF and HCBS in an attempt to contain costs. Attached please find documentation that meets the statutory requirements of ARS 36-2959 which requires the Administration to "contract with an independent consulting firm for an annual study of the adequacy and appropriateness of the Title XIX reimbursement rates to service providers for the elderly and physically disabled program".

Title XXI Behavioral Health Capitation Rate Adjustments
In a letter dated July 18, 2003, AHCCCS requested JLBC review of the Title XXI Behavioral Health capitation rates. The committee has previously reviewed the Title XIX rates.

Impact to SFY 2004 Budget
Even though the rates for the acute care population including both traditional as well as expansion populations are higher than the specific budgeted rates, it is too early to determine if additional supplemental funding is required for State Fiscal Year 2004. AHCCCS will be analyzing caseload projections in the first part of November and provide any required updates to both OSPB and JLBC for Fiscal Year 2004 as well as Fiscal Year 2005.

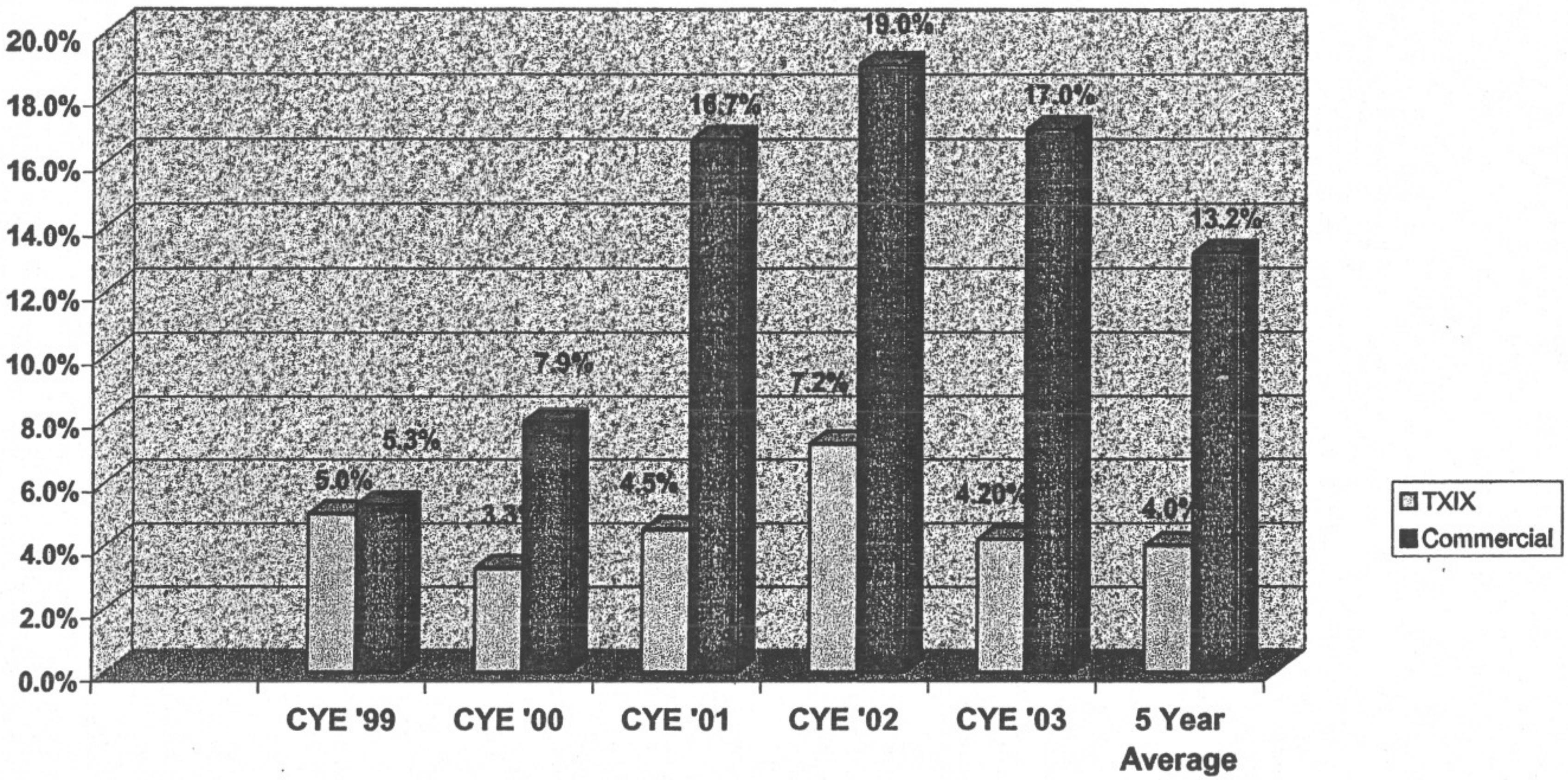
If you have any questions with regard to any of these issues please contact Tom Betlach at 417-4483.

Sincerely,

Anthony D. Rodgers
Director

C: Richard Stavneak, Director, Joint Legislative Budget Committee
David Jankofsky, Director, Office of Strategic Planning & Budget

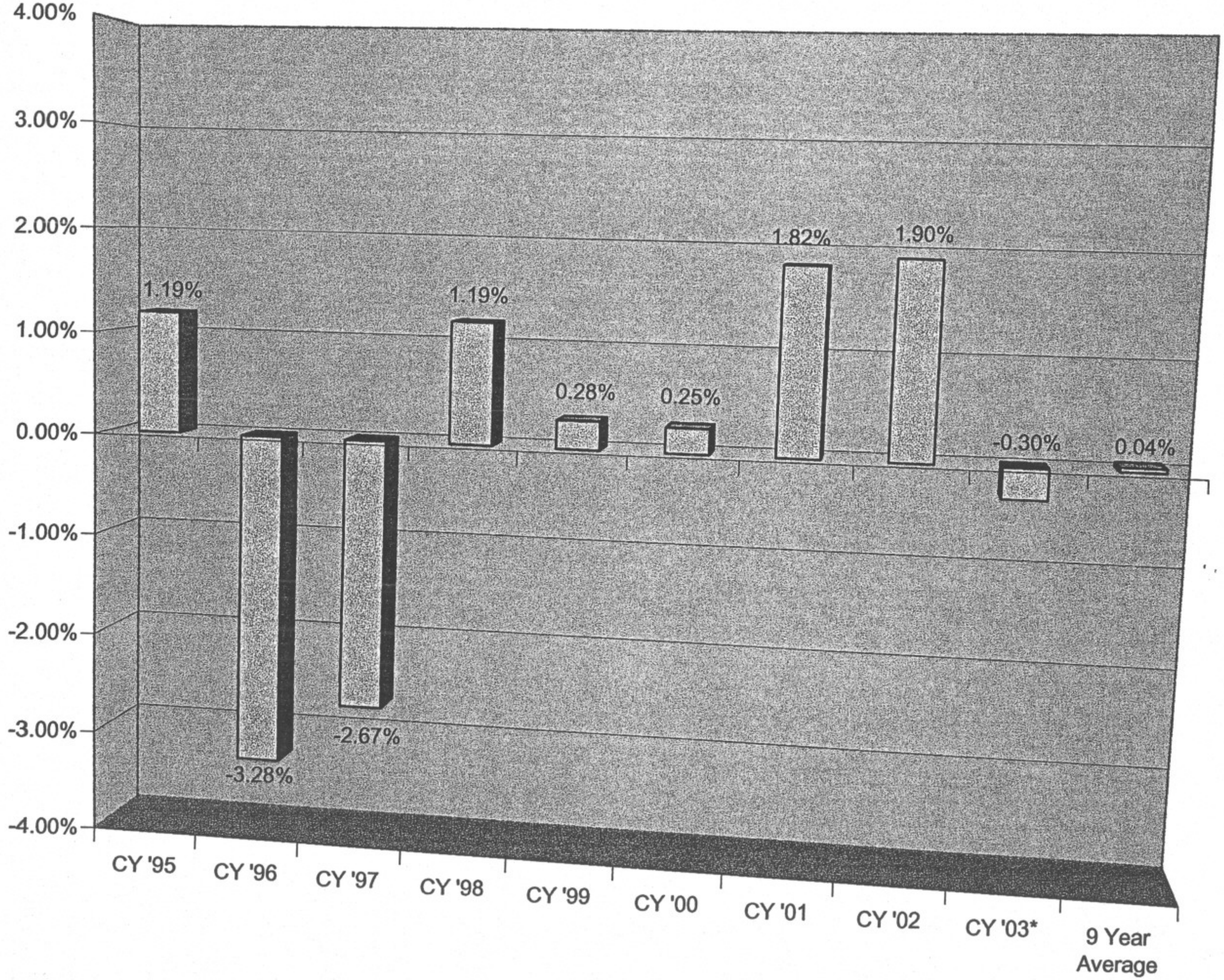
Increases to Acute Care Prospective Capitation



Years 1999-2001 Commerical increases from the Mercer/Foster Higgins National Survey of Employer-Sponsored Health Plans--Western region companies with more than 500 employees

Years 2002-2003 data from Milliman 2002 HMO Intercompany Rate Survey

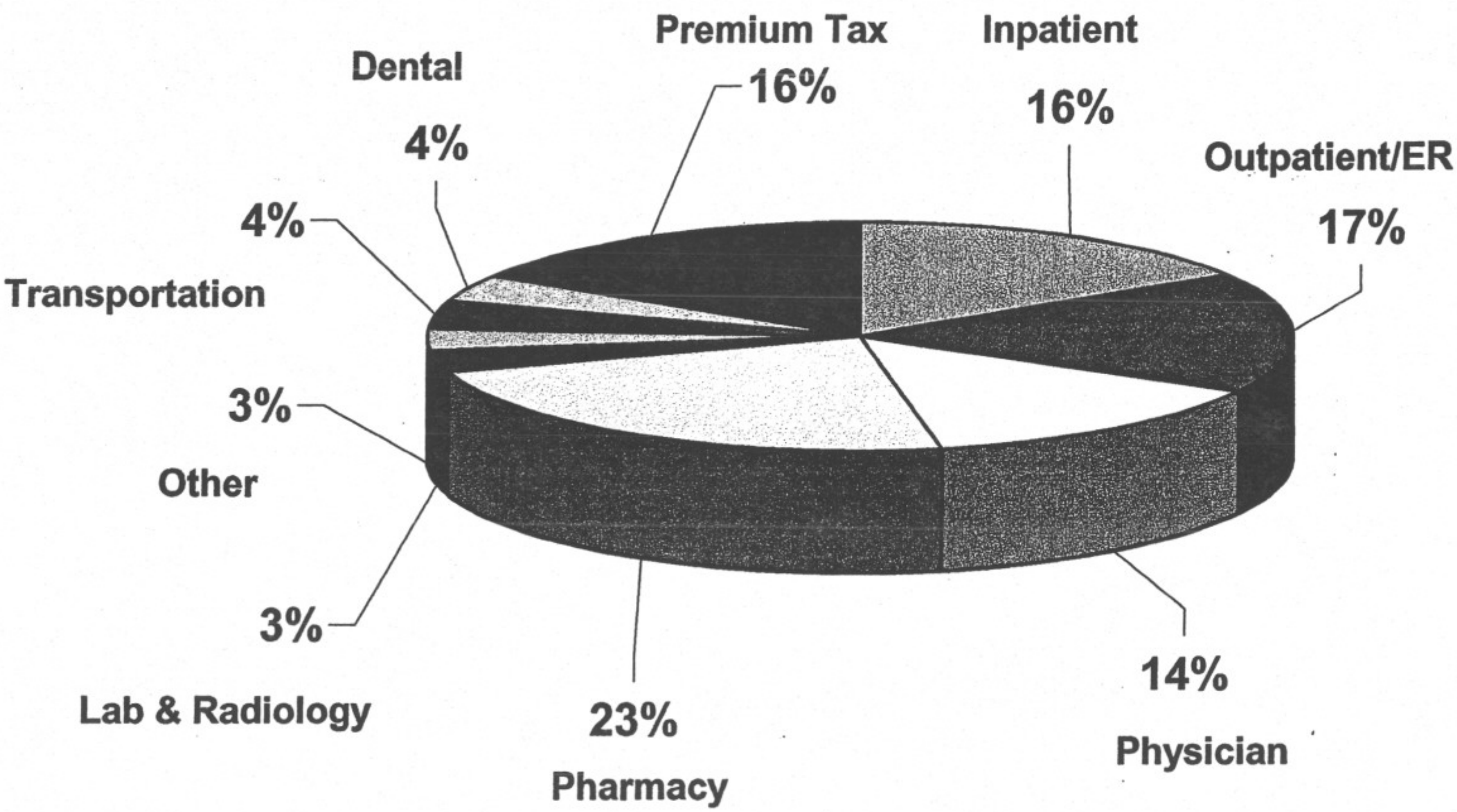
AHCCCS Acute Care Health Plans
Profit Margins CYE '95-CYE '03



*CYE '03 is as of 3/31/03

S:\Fin\Dmt\Rates 2004/Budget\profit margins CYE '95 - CYE '03.xls

Title XIX - TANF & SSI
CYE 04 Capitation Rate Impact
Increases by Service Category



Overall Rate Increase 13.3%

Acute Capitation Rate Analysis (Awarded Rates--pending approval)
Point in Time Comparison--no member growth factor
CYE '04

As of 9/5/03

Title XIX Waiver Group		1/1/03 enrollment/ payments	Average Cap Rate '03	Total Dollars	Awarded Rates	New Annual Dollars	Difference	% Increase
	+ Prospective-MED	45,535	$ 219.64	$ 10,001,307	$ 749.30	$ 34,119,376	$ 24,118,068	241.15%
	+ PPC-MED	6,237	$ 166.25	$ 1,036,901	$ 1,610.07	$ 10,042,007	$ 9,005,105	868.46%
	+ Hospitalized Supp-MED	5,700	$ 13,482.67	$ 76,851,219	$ 9,513.74	$ 54,228,318	$ (22,622,901)	-29.44%
			$ -					
	Total MED			$ 87,889,428		$ 98,389,700	$ 10,500,272	11.95%
	+ Prospective-non-MED	1,016,850	$ 219.64	$ 223,340,934	$ 388.83	$ 395,381,786	$ 172,040,852	77.03%
	+ PPC -non-MED	108,016	$ 166.25	$ 17,957,660	$ 564.47	$ 60,971,792	$ 43,014,132	239.53%
	+ Hospitalized Supp-non-MED	575	$ 13,482.67	$ 93,030,423	$ -	$ -	$ (93,030,423)	-100.00%
	Total non-MED			$ 334,329,017		$ 456,353,577	$ 122,024,560	36.50%
	Total TWG			$ 422,218,445		$ 554,743,277	$ 132,524,832	31.39%
	Less Estimated TWG Settlement			$ 60,000,000		$ -	$ (60,000,000)	-100.00%
	Adjusted Total TWG			$ 482,218,445		$ 554,743,277	$ 72,524,832	15.04%
TXIX								
	* <1	44,784	$ 351.69	$ 189,001,020	$ 362.52	$ 194,821,148	$ 5,820,129	3.08%
	* 1-13	291,274	$ 81.38	$ 284,446,537	$ 91.46	$ 319,679,040	$ 35,232,503	12.39%
	* 14-44F	126,011	$ 146.98	$ 222,253,161	$ 163.22	$ 246,810,185	$ 24,557,024	11.05%
	* 14-44M	56,413	$ 104.93	$ 71,032,993	$ 114.53	$ 77,531,771	$ 6,498,778	9.15%
	* 45+	14,293	$ 287.56	$ 49,321,141	$ 328.52	$ 56,346,436	$ 7,025,295	14.24%
	* SSI w/Med	37,951	$ 197.24	$ 89,825,463	$ 243.91	$ 111,079,541	$ 21,254,078	23.66%
	* SSI w/o Med	48,230	$ 409.78	$ 237,164,273	$ 511.28	$ 295,908,413	$ 58,744,140	24.77%
	* SFP	7,256	$ 20.48	$ 1,783,235	$ 14.21	$ 1,237,293	$ (545,941)	-30.62%
	+ Delivery Supplemental Paymen	2,208	$ 5,041.48	$ 133,599,220	$ 5,644.88	$ 149,589,320	$ 15,990,100	11.97%
	Total Prospective-non-TWG			$ 1,278,427,043		$ 1,453,003,148	$ 174,576,105	13.66%
	+ PPC'<1	12,577	$ 1,291.59	$ 16,244,883	$ 1,106.29	$ 13,914,285	$ (2,330,598)	-14.35%
	+ PPC'1-13	169,428	$ 33.91	$ 5,745,292	$ 39.66	$ 6,719,501	$ 974,209	16.96%
	+ PPC '14-44F	102,627	$ 144.54	$ 14,833,681	$ 155.38	$ 15,946,155	$ 1,112,475	7.50%
	+ PPC '14-44M	43,721	$ 86.12	$ 3,765,272	$ 125.72	$ 5,496,633	$ 1,731,361	45.98%
	+ PPC '45+	10,485	$ 211.74	$ 2,220,001	$ 289.14	$ 3,031,506	$ 811,505	36.55%
	+ PPC 'SSI w/Med	7,826	$ 29.70	$ 232,441	$ 32.69	$ 255,842	$ 23,401	10.07%
	+ PPC 'SSI w/o Med	23,156	$ 85.73	$ 1,985,156	$ 82.36	$ 1,907,121	$ (78,035)	-3.93%
	PPC All non-TWG rate codes	377,646		$ 45,026,726		$ 47,271,043	$ 2,244,317	4.98%
	Total Title XIX-non-TWG			$ 1,323,453,768		$ 1,500,274,190	$ 176,820,422	13.36%
Other								
	HIFA Parents-TXXI	15,000	$ 160.00	$ 2,400,000	$ 177.39	$ 2,660,912	$ 260,912	10.87%
	HIV/AIDS Supp	650	$525	$ 4,095,000	$ 755.46	$ 5,892,588	$ 1,797,588	43.90%
Grand Total Capitation				$ 1,752,167,213		$ 2,063,570,967	$ 311,403,754	17.77%
	Less Estimated TWG Settlement			$ 60,000,000		$ -	$ (60,000,000)	-100.00%
	Adjusted Total Capitation			$ 1,812,167,213		$ 2,063,570,967	$ 251,403,754	13.87%

* Enrollment
+ Member Months/Payments

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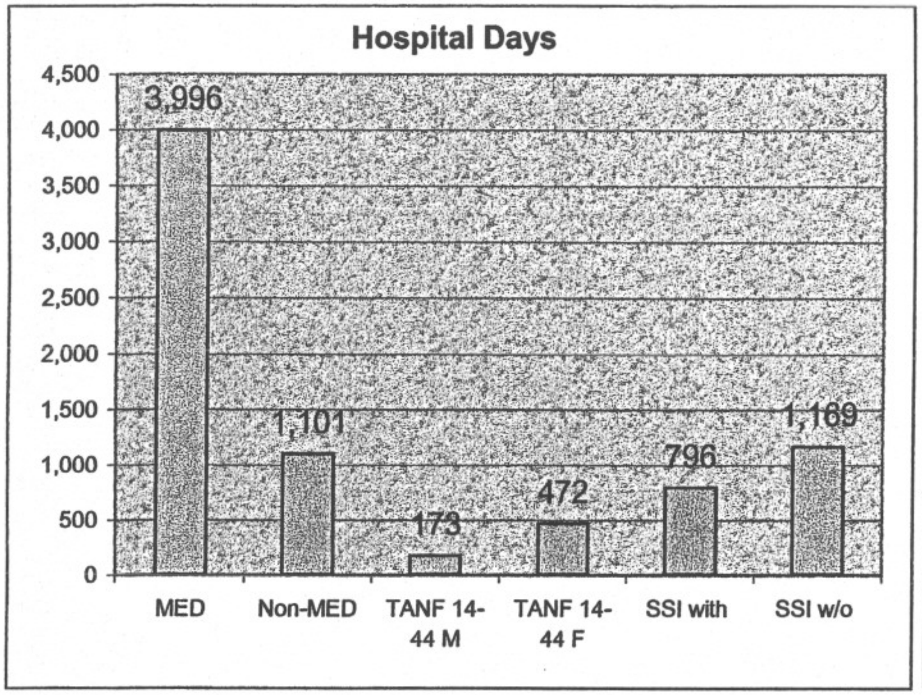
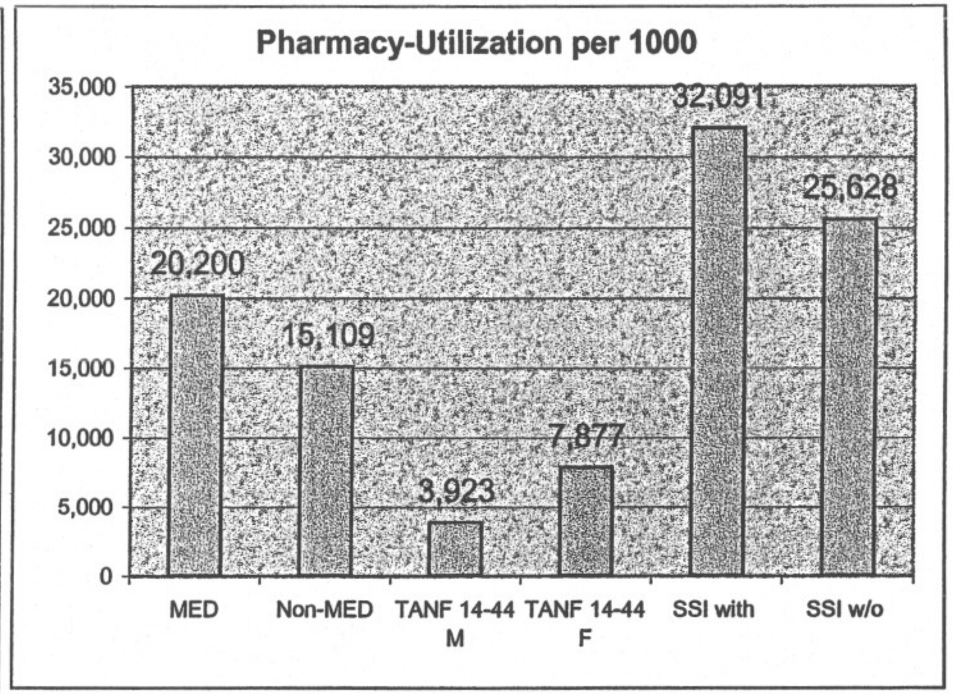
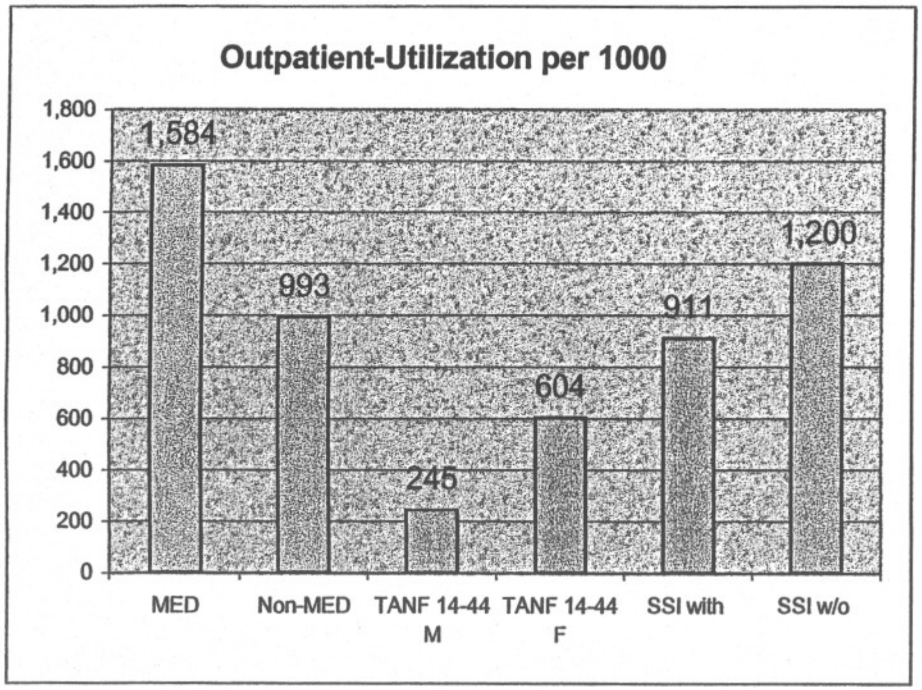
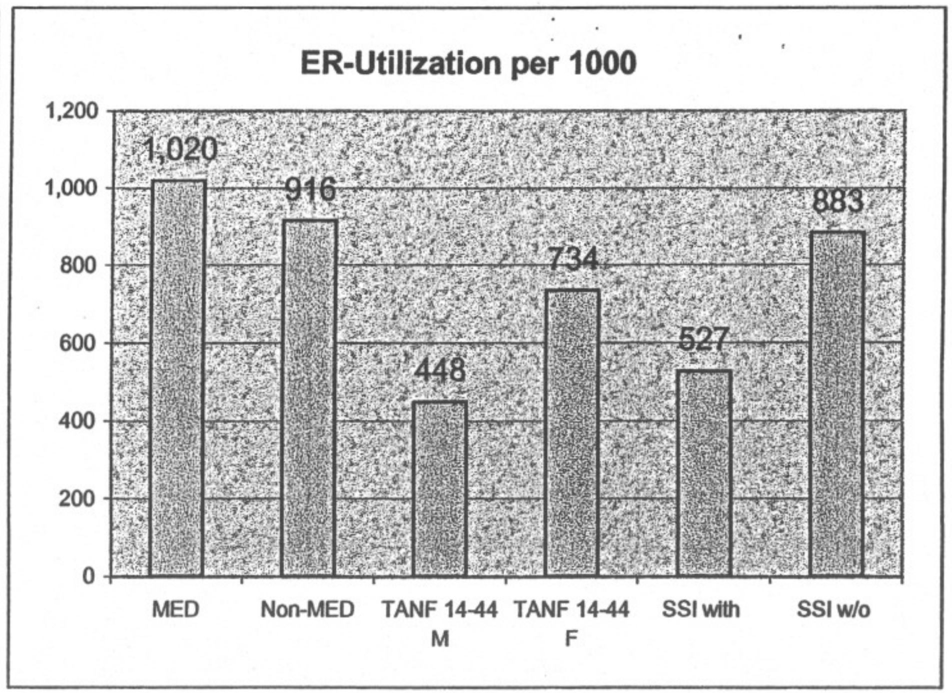
Utilization Patterns of Acute Care Services
Prospective Time Period Only - October 2001 through June 2002









EP&P Consulting, Inc.

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Phone (202) 628-1134 Fax (202) 628-1140 www.eppconsulting.com

September 4, 2003

The Honorable Russell Pearce, Chairman
Joint Legislative Budget Committee
1716 West Adams St.
Phoenix, AZ 85007

Dear Representative Pearce:

EP&P Consulting, Inc. (EP&P) has reviewed AHCCCS' Title XIX reimbursement rates for services provided to the elderly and physically disabled through the Arizona Long Term Care System (ALTCS) for dates of service on and after October 1, 2003. The Arizona Health Care Cost Containment System Administration (Administration) has proposed to freeze fee-for-service (FFS) nursing facility (NF) and home- and community-based (HCBS) rates. This is a strategy that a number of states are adopting in this economic climate. Because AHCCCS has granted these providers significant increases in the two prior years, we believe a rate freeze will not adversely impact access to services or quality of care. A rate freeze is consistent with the principals of economy and efficiency which should guide state purchasing and reimbursement decisions. During the past two fiscal years, the Administration increased the FFS NF rates 13.85% and FFS HCBS rates 20.73%.

The proposed AHCCCS FFS rates for services provided to the elderly and physically disabled populations through the ALTCS program are adequate and appropriate.

Please do not hesitate to contact us should you have additional questions.

Sincerely,

Gretchen Engquist

Gretchen Engquist, Ph.D., Corporate Director
EP&P Consulting, Inc.

c: Tom Betlach, Deputy Director, AHCCCS
Kari Price, Assistant Deputy Director, Division of Health Care Management, AHCCCS
Jim Cockerham, Assistant Director, Division of Business and Finance, AHCCCS
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September 4, 2003

Ms. Terri Green
Financial Manager
Arizona Health Care Cost Containment System
701 East Jefferson Street
Phoenix, AZ 85034

Subject:
Contract Year Ending 2004 (CYE04) Trends

Dear Ms. Green:

This letter provides an outline of the trend methodology that Mercer Government Human Services Consulting (Mercer) used in the development of capitation rate ranges for the October 1, 2003, through September 30, 2004, CYE04 time period.

The letter is an update to the July 31, 2003, correspondence concerning CYE04 trends. This revised trend letter includes additional sections regarding higher unit cost trends exhibited in outpatient and emergency room services, as well as an updated inpatient hospital unit cost trend.

Background

The Arizona Health Care Cost Containment System (AHCCCS) Acute Care Program is currently in RFP/procurement process for the first time in 6 years. As actuary to the AHCCCS program, Mercer has established rate ranges for each of the various geographic service areas (GSAs) that the health plans are bidding on. A key part of the process in establishing these ranges was the selection of appropriate utilization and unit cost trends for the various categories of service covered under the program. Two and a half years of base data, from October 1, 1999 through March 31, 2002, were generally used to develop the ranges. Therefore, to project forward to CYE04, approximately three years of trend was applied. Mercer's trend assumptions are summarized in the enclosed attachment.

During this same time period, the covered population grew enormously due to the implementation of Proposition 204, which created expansion populations such as the Title XIX waiver group (TWG). Many health plans have been facing new problems as they try to expand existing provider networks to serve the expanding AHCCCS population. One of the problems that health plans will have to face is the growing reluctance of the provider community to sign financial risk arrangements such as capitation. Faced with more consumer protection activity in the marketplace, providers are less willing to accept risk arrangements. Provider organizing activity has lessened competition in the marketplace and many health plans will find themselves competing more to contract with the same medical care providers than in the years past. As health plans compete for fewer providers, negotiating leverage tilts toward provider organizations.

Trend development based solely on the use of historical data is not likely to be the best predictor of future changes in medical cost. The national economic downturn has resulted in increased Medicaid enrollment. Rising unemployment and increasing employer health care premiums will generally drive more individuals onto welfare and health care coverage through Medicaid. In making financial projections for Medicaid, the Centers for Medicare & Medicaid Services (CMS), Office of the Actuary recognizes the rapid growth in the Medicaid population in its more recent projections. As stated above, the increase is attributable to higher health insurance premiums, and a softer labor market with higher unemployment.

Methodology

Mercer considered the following data sources to ensure a comprehensive review and development of reasonable trends used in the CYE04 rate setting process. These sources include:

- AHCCCS encounter data;
- Health plan financial reports;
- Bureau of Labor Statistics Consumer Price Index (CPI) information;
- Global Insight Incorporated, DRI-WEFA data;
- Mercer's Survey of Health Care Trends;
- Other State Medicaid Programs;
- Mercer/Foster Higgins Health Plan Survey;
- U.S. Department of Commerce, Bureau of Economic Analysis; and
- CMS National Health Expenditure Report estimates.

Inpatient Hospital

According to the CMS, Office of the Actuary, the per capita National Health Expenditures and the Medicaid program expenditures for hospital care will increase 5.1 percent and 6.4 percent, respectively, in 2004. This increase in Medicaid expenditures is expected to be $97.8 billion, with the majority paid to hospital inpatient services. In the last few years inpatient trends have increased at a much higher rate than during the latter half of the 1990's. Over the next year, trend changes are expected to be more moderate than in the past. Consistent with past years however, is that the primary factor driving inpatient trend is underlying cost inflation. Nationally, inpatient costs are expected to increase 5 to 7 percent annually in 2003. Factors that contribute to this trend include the following:

- nursing workforce shortages to staff hospital rooms;
- rising hospital expenditures for drugs, biologicals, and devices;
- wages, salaries, and benefits;
- hospital liability insurance; and
- new technology.

Using primarily the information from the databook as well as the audited financial reports for the AHCCCS Acute Care Program, Mercer assumed that inpatient utilization increased by 1 to 5 percent annually, depending upon rating group. Based on a review of the same sources, as well as the Global Insight, Incorporated inpatient hospital prospective reimbursement market basket trend, Mercer developed assumptions for unit cost trend. The inpatient hospital unit cost trend originally incorporated a 4.0 percent annual prospective trend provided by AHCCCS. In accordance with Arizona state statute, a revised trend of 3.8 percent was provided by AHCCCS and Mercer incorporated this adjustment into the annual inpatient hospital unit cost trend.

As a result unit costs have been trended at 3 to 8 percent annually. On a combined basis, the per member per month trend for inpatient hospital have been trended at 5 to 10 percent, depending upon rating group. These ranges are summarized in the attachments.

Outpatient/Emergency Room

Outpatient and emergency room (ER) services have continued to increase, as there is a significant demand for medical service in these settings. Utilization controls for ER services are typically more effective in managed care and as a result, utilization trends for ER services are lower than utilization trends for outpatient services. The underlying cost influences for these services are similar to those described above for inpatient services. However, the effects of these influences will vary between settings.

Over two-thirds of all surgeries are now performed on an outpatient basis. Further advances in medical technology will continue to increase the proportion of surgical procedures performed on an outpatient basis. Enhancements to laproscopic and endoscopic surgical procedures enable treatments previously performed on an inpatient basis to be performed in outpatient settings. Growth in outpatient procedures continues as evidenced by shifting procedures like uncomplicated hysterectomies and gastroesophageal reflux disorder treatment from inpatient to outpatient settings. Alternate payment strategies for outpatient care have been growing as this shifting of service continues.

CMS continues to transition Medicare payment for outpatient hospital setting services from a cost based approach to a prospective payment (OPPS) basis. Initially mandated by the Balanced Budget Act of 1997, Medicare initiated OPPS in August 2000. In calendar year 2003 (CY03) Medicare's payment approach, based on Ambulatory Payment Classification Groups (APCs), has been refined to package more costs related to drugs, hemophilia related clotting factors, blood products, biologicals, and devices into new or existing APCs. Pass-through status payments will be significantly lower as many expenditure classes are being valued in a prospective pricing package, including many new technology procedures. As a result, CMS anticipates total payments to increase 3.7 percent in 2003. In 2004, CMS is required to reduce the limit of Medicare pass-through payments from the current 2.5 to 2.0 percent which will have a downward pressure on cost change for the program. Also in 2004, CMS will likely adopt more changes to review emergency room services and diagnostic visit services to help differentiate the relative resource consumption for low, middle, and high service levels within these settings. Developing consistency in the way outpatient services are defined will also be aided by new HIPAA billing requirements.

How hospitals adapt to Medicare changes may also influence hospital financial outcomes for health plans. Hospitals will likely shift costs due to the more restrictive actions by CMS. Health plans with good utilization review processes already in place will find it more difficult to hold down unit costs, while less effective health plans will show increases in both unit costs and utilization levels.

Medicare's hospital market basket projected the increase for fiscal year 2003 (FY03) at 3.5 percent, and was the primary factor in deriving the Medicare OPPS increase of 3.7 percent. The projected increase for hospital and related services as measured by DRI-WEFA for the same period is 5.9 percent. Though this projection measures more than hospital cost, it is the primary component of the measure. Both the CMS hospital market basket and DRI-WEFA measures are fixed weighted measurements, and a certain amount of the difference is assumed attributable to the cost-shifting phenomenon. The DRI-WEFA statistical measure is sensitive to higher costs as it measures consumer expenditures or the amount hospitals are reimbursed, while the projected figure used by CMS is not sensitive to this phenomenon. Health plans usually do not develop reimbursement pricing structures to isolate this influence on payments to hospitals and how their cost for Medicaid business may be affected. More health plans are developing outpatient reimbursement capability that minimizes the impact that cost shifting has on their payments to providers. Health plans will be financially exposed, to a varying degree, under charge based reimbursement.

As we have stated, outpatient trends will generally be higher because of technology improvement and continued emphasis on shifting of services from an inpatient setting to an outpatient setting. Many hospitals are still expanding their outpatient capabilities and the demand for outpatient services continues to be very strong nationally and within Arizona.

Using primarily the information from the databook, as well as the audited financial reports for the AHCCCS Acute Care Program, outpatient and emergency room utilization increased by 0 to 12 percent annually, depending upon rating group. Based on a review of the same sources, unit costs were trended at –5 to 6 percent annually. These initial unit cost trend assumptions were updated due to release of a timely study developed by EP&P Consulting on behalf of AHCCCS. The study indicated that sharp upward trends were experienced after the databook time period in both outpatient and emergency room unit costs. This experience was not captured in the data sources used to develop the original unit cost trends.

Using the results of the EP&P Consulting study, a specific adjustment to the unit cost trends was applied to both outpatient and emergency room services. Mercer supplemented the initial trend assumptions with an additional 10 percent per year for two years in both categories of service to account for the changing experience. The additional 10 percent per year was applied only to the time periods where sharp upward trends were experienced, and are projected to continue. This adjustment was not applied to the entire trend time period. The final assumptions reflecting the new data resulted in unit costs being trended at 2 to 14 percent annually, depending on the rating group.

On a combined basis, the per member per month costs for outpatient hospital and emergency room have been trended at 2 to 26 percent annually, depending upon rating group. These ranges are summarized in the attachments.

Physician, Other Professional, and Other Services

According to the CMS, Office of the Actuary, National Health Expenditures for physician and related services is projected to increase 10.1 percent to $47 billion. Projected per capita expenditure for physician and related services is projected to increase 6 percent for the same time period. One contributing factor to the 10.1 percent increase is the expected growth in Medicaid eligibility. However, this population change does not impact the per capita increase of 6 percent. The range of projected unit cost change for physician and other services is 3 to 5 percent for CYE04.

Nationally, projected cost change for physician and other services is better aligned with the change in other CPI indices, rather than the change for hospital services. This is attributed to the tendency for more physician and other service cost to be related to wage/salary base driven cost change than in the hospital setting where technological cost becomes more of a factor.

CMS has recently announced that physician reimbursement will increase by 1.6 percent for the remainder of 2003 for the Medicare program. Without this special regulation, physician fees would have been reduced 4.4 percent from 2002 levels and reduced by approximately 10 percent since 2001. This change should help alleviate some of the concern for inducing physicians to shift practice costs in the form of higher charges to other insurers. Even with this change in Medicare, physician and other service cost for other payors will likely be higher in CYE04, and was a factor in preparing the trend assumptions.

Using primarily the information from the databook as well as the audited financial reports for the AHCCCS Acute Care Program, Mercer assumed that utilization of physician and other profession al services increased by 2 to 13 percent annually, depending upon rating group. Based on a review of the same sources, unit costs have been trended at -5 to 4 percent annually. On a combined basis, the per member per month costs for physicians have been trended at 1 to 15 percent annually, depending upon rating group. These ranges are summarized in the attachments.

Using primarily the information from the databook as well as the audited financial reports for the AHCCCS Acute Care Program, Mercer assumed that utilization for the miscellaneous, or other services, increased by –25 to 20 percent annually, depending upon rating group and type of miscellaneous service. Based on a review of the same sources, unit costs have been trended at 0 to 5 percent annually. On a combined basis, the per member per month costs for the miscellaneous, or other services, have been trended at –25 to 25 percent, depending upon rating group and type of miscellaneous service. These ranges are summarized in the attachments.

Pharmacy

Pharmacy trends have outpaced other medical trends over the past several years and are expected to continue in 2004. This is largely due to the continual rise in pharmaceutical utilization driven by many factors, including:

- the introduction of new, innovative, biotechnology drugs offering therapy options for previously untreated conditions;
- common medications with improved dosing schedules, delivery methods, and additional indications;
- direct-to-consumer advertising resulting in greater consumer knowledge and patient demand for advertised treatments;
- greater reliance on drug therapy by prescribing physicians;
- an aging population;
- modified clinical treatment guidelines resulting in early diagnosis and preventative prescribing for certain chronic disease states;
- efforts to delay generic introduction and extend patent protection for brand name drugs;
- improved techniques and technologies to detect and diagnose diseases; and
- general manufacturing price increases.

As we look to future years, an ever increasing component of the pharmacy trend will be attributed to costly biotechnology oral and injectable medications that are demonstrating promising results, particularly in the treatment of cancer, AIDS, and various central nervous system diseases such as epilepsy and Alzheimer's. These drugs, while costly, will continue to move drug therapy into the outpatient arena and will likely provide some immediate medical cost offset.

One such drug that Mercer has built into the CYE04 rates is a new class of medications called fusion inhibitors used for the treatment of HIV/AIDS. Fuzeon®, also known as T-20, is the first of these fusion inhibitors and was approved by the FDA in March 2003. Fusion inhibitors are intended for use as salvage therapy in HIV infected individuals who have developed drug resistance to available medications or in treating patients who have been newly infected with drug-resistant virus strains. Therefore, fusion inhibitors will likely be used for only those patients whose severity of illness has increased and thus current therapies do not adequately control viral load. Although fusion inhibitors are widely anticipated and celebrated, they carry a high price tag – with annual therapy reaching $20,570 per patient per year. Additionally, fusion inhibitors must also be combined with other antiretrovirals to minimize the development of resistance, therefore, therapy costs for these patients may soar as high as $35–38,000 annually. However, due to complex manufacturing process, the pharmaceutical company will only be able to produce enough Fuzeon during 2003 to treat approximately 15,000 worldwide, increasing this number to approximately 32,000 by the end of calendar year 2004. Additionally, Fuzeon will be under a controlled distribution model in which only those patients described above will be eligible. Mercer has developed cost estimates for the impact that Fuzeon may have on the AHCCCS program in CYE04, however at this juncture, it is very difficult to foresee exactly how many AHCCCS recipients might be eligible to receive Fuzeon.

Using our national research, the information from the databook as well as the audited financial reports for the AHCCCS Acute Care Program, Mercer assumed that pharmacy utilization increased by 4 to 13 percent, depending upon rating group. Based on a review of the same sources, unit costs have been trended at 5 to 13 percent. On a combined basis, the per member per month costs for pharmacy have been trended at 9 to 27 percent, depending upon rating group. These ranges are summarized in the attachments.

MERCER

Government Human Services Consulting

If you have any questions regarding the above information on trends, feel free to contact me at 602 522 6535.

Sincerely,

Mark S. Hoyt

Mark S. Hoyt, FSA

MSH/kmj

Copy:
Emil Kalinowski, Mercer
Shannon Landwehr, Mercer
Kevin Lurito, Mercer
J Carmelina Rivera, Mercer

Attachments

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Appendix A

All TANF Rate Cells Combined

Category of Service	Utilization per 1,000	Unit Cost	PMPM
Hospital Inpatient	1.5%	5.5%	7.1%
Outpatient *	2.8%	10.0%	13.1%
Emergency Room *	9.7%	11.1%	21.9%
Physician and Other Professional	5.4 to 11.1%	-0.7 to 2.1%	4.7 to 13.4%
Miscellaneous	1.2 to 15.9%	0 to 3.8%	1.3 to 18.5%
Pharmacy	9.3%	10.7%	21.1%

All SSI Rate Cells Combined

Category of Service	Utilization per 1,000	Unit Cost	PMPM
Hospital Inpatient	4.6%	4.4%	9.1%
Outpatient *	1.2%	11.5%	12.8%
Emergency Room *	2.0%	11.2%	13.4%
Physician and Other Professional	8.8 to 10.4%	-4.1 to 0.6%	5.9 to 9.5%
Miscellaneous	0 to 7.3%	0 to 3.3%	0 to 13.6%
Pharmacy	7.1%	5.8%	13.4%

* Outpatient and Emergency Room categories of service reflect unit cost adjustment of an additional 10% per year.

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Delivery Supplemental Payment *			
Category of Service	**Utilization per 1,000**	**Unit Cost**	**PMPD**
Hospital Inpatient	-0.1%	-0.9%	-1.0%
OB/GYN and Nurse/Midwife	-0.4%	-1.1%	-1.5%
Specialist/Anesthesia	-2.3%	0.21%	-2.1%
Pharmacy	-0.1%	-0.24%	-0.3%
Miscellaneous	-6.3 to -1.2%	-1.6 to –1.0%	-7.5% to -2.8%

* The delivery supplemental payment reflects negative trends, however this may be misleading. In fact the average health plan rate increase in this risk category was 10% when compared to CYE03. The disconnect lies in the base data, which suggested a high PMPD but did not reconcile with the AHCCCS experience or the health plan financials. Mercer recommended applying credibility to the base data and financials in order to reflect both sources of information in the final rate. The outcome of this decision produced trends that were negative when compared to the base data but a supplemental payment that increased over the previous year.

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August 12, 2003

PROPRIETARY & CONFIDENTIAL

Ms. Kari Price
Assistant Deputy Director
Arizona Health Care Cost Containment System
701 East Jefferson Street
Phoenix, AZ 85034

Subject:
Arizona Long Term Care System - Contract Year Ending 2004 Capitation Rate Methodology Letter

Dear Ms. Price:

1 The Contract Year Ending September 30, 2004 (CYE04) capitation rates for the Arizona Long Term Care System (ALTCS) were renewed for all counties. At the request of the Arizona Health Care Cost Containment System (AHCCCS), Mercer Government Human Services Consulting (Mercer) performed a rate update for the CYE04 ALTCS capitation rates. This rate update is based upon the previously approved CYE03 capitation rates.

Overview of Rate-Setting Methodology

2 Mercer has developed risk-based capitation rates in accordance with the Centers for Medicare and Medicaid Services (CMS) requirements and regulations under the Balanced Budget Act of 1997 (BBA). In the rate-setting methodology checklist and managed care regulations (42 CFR 438.6) effective August 13, 2002, CMS requires that capitation rates be set in an actuarially sound manner. CMS defines actuarially sound rates as meeting the following criteria:

- have been developed in accordance with generally accepted actuarial principles and practices;
- are appropriate for the populations to be covered and the services to be furnished under the contract; and
- have been certified by actuaries who meet the qualification standards established by the American Academy of Actuaries and the Actuarial Standards Board.

3 Actuarially sound capitation rates that meet the criteria listed above were developed for the CYE04 time period. Mercer has utilized actuarially sound principles and practices in the development of these capitation rates.

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4 As part of the capitation rate update process for CYE04, Mercer reviewed various data sources in the development of trend, programmatic changes, increased placement in Home- and Community-Based Settings (HCBS), and actual cost and utilization experience as reported by program contractors. Overall rate increases for program contractors in Maricopa County range from 3.0 percent to 13.8 percent, with a weighted average of 4.6 percent. The rate changes for program contractors in non-Maricopa counties range from a 1.5 percent decrease to a 19.0 percent increase, with a weighted average of 6.0 percent increase. The statewide weighted rate increase is 5.2 percent.

5 The following sections describe the methodology and data sources used in the development of the various CYE04 rates and rate components.

Non-Ventilator Dependent Clients

Statewide County Rate Update Development

Nursing Facility

6 In determining the increase to the Institutional component, Mercer reviewed contract language, DRI trends, encounter data trends, liability insurance, and changes to the State's fee-for-service (FFS) schedule. Changes to the Institutional mix percent by program contractor were also reviewed, and adjustments were made to the Institutional rate component where appropriate. A review of the DRI and fee schedule changes for CYE04 resulted in the Institutional rate increasing 4.0 percent. Also, audited financial data from CYE01 and CYE02, as well as six months of un-audited CYE03 financial data were used when reviewing each contractor's financial experience. These factors contributed to the Institutional component increases of the capitation rate by county ranging from 0.0 percent to 11.0 percent, with a weighted statewide average of 4.1 percent.

Share of Cost (SOC)

7 The SOC component of the capitation rate was developed utilizing the change in Institutional placement percentages by county, and comparing these trended SOC values to actual assignments and member months for the first six months of CYE03. The rate change to this component varies by county and ranges from 10.0 percent decrease to 77.5 percent increase, with

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a statewide average decrease of 7.3 percent. This rate component is fully reconciled with each contractor.

HCBS Mix

8 Several factors were considered in the determination of the CYE04 HCBS placement percentages for each county and program contractor. Current placement percentages, program growth, and the number of ALTCS members were reviewed by contractor and by county. Over two years of placement data was reviewed, and the percent of individuals in the home was calculated separately from the percent of individuals in alternative community settings.

9 Historically, HCBS placement has consistently increased statewide. The overall projected HCBS placement percentage for CYE04 is 60.4 percent compared to an HCBS placement of 24.4 percent in October 1992. Every county has seen historical increases in their HCBS placement, but it appears that some counties may have plateaued. Where appropriate, certain counties CYE04 HCBS placement percentage have decreased or are being held relatively flat compared to the CYE03 HCBS placement. This resulted in the HCBS placement percentages by county to range from a 7.4 percent decrease to a 9.5 percent increase. Statewide, the average HCBS placement percentage increased 1.8 percent over the CYE03 projected placement percentage.

HCBS Cost

10 Similar to CYE03, the HCBS component was divided into two separate components based upon the setting of the individual: HCBS – In-Home, and HCBS – Alternative Community. A review of the DRI, liability insurance, and fee schedule changes for CYE04 resulted in the In-Home rate change being held flat and the Alternative Community rate increasing 3.0 percent. A review of program contractor financial experience and HCBS placement percentages adjusted the final HCBS rate component increases. The In-Home rate is held flat across all counties. The Alternative Community rate changes range from being held flat, to a 3.0 percent increase, with a statewide weighted increase of 2.9 percent.

11 Similar to the CYE03 rates, the reinsurance offset for high cost behavioral health clients were deducted from the HCBS – Alternative Community rate component. The CYE04 offset was assumed to trend at the same percentage as the HCBS – Alternative Community rate component.

Case Management

The case management component was developed using the case management model that has been in effect for several years. Program contractor audited CYE02 financial data, and six
12 months of un-audited CYE03 financial data was also reviewed. The case management model was updated to reflect new HCBS placement percentages, updated enrollment numbers, and case manager and case management supervisor salaries.

The blended CYE02 and CYE03 financial data by program contractor was trended at 3.5 percent per year, and the results were compared to those from the case management model. Case management rates were then developed by reviewing and adjusting the trended financial
13 experience based upon its cost relative to the current CYE03 rates and the projected CYE04 rates developed by the model. These adjustments resulted in a statewide increase to the case management component of 4.2 percent.

Acute Care

The acute care rate component was trended forward from the CYE03 rate to take into account
14 inflationary increases, changes in the HCBS placement percentages, changes in the percent of members with Medicare, financial experience, and program changes.

As part of the acute care rate development, a reinsurance offset was calculated to account for the reinsurance payments AHCCCS is expected to make to the program contractors. This offset
15 varies by county based on the percent of clients with Medicare. Reinsurance deductibles and offsets also vary for program contractors with 2,000 members or more and program contractors with under 2,000 members. No changes were made to the current reinsurance offsets or deductible levels for CYE04.

16 Overall, the acute care rate changes vary by county, ranging from a 24.0 percent decrease to an 18.0 percent increase. The statewide weighted average increase is 5.8 percent.

Administration/Risk/Contingency

The administration component of the ALTCS rate was developed by taking a percentage of the
17 Institutional, HCBS, acute care, and case management components for each county. The administration percentage varies by program contractor and by county. Audited CYE02 financial

data and six months of un-audited CYE03 financial data was reviewed to determine the appropriateness of the administration load for each county. Mercer also utilized its professional experience in working with other state Medicaid programs to review if the administration loads were reasonable. For CYE04, administration loads were increased approximately 2.0 percent to account for additional State requirements to the program contractors. This increase was also applied to the prior period coverage, ventilator dependent, and acute care only rates. The CYE03 to CYE04 per member per month (PMPM) cost change of the administration component of the ALTCS rate varies by county, and results in an overall statewide increase of 4.0 percent for this rate component.

18 The risk/contingency component of the ALTCS rate was developed by taking 2.0 percent of the CYE04 ALTCS rate, excluding SOC. After a review of the program contractor's financial experience, Mercer and ALTCS deemed a 2.0 percent load appropriate.

Summary

19 The Maricopa County and non-Maricopa county CYE03 rate components were updated taking into account recent data including trends, financial experience, changes in placement, program changes, fee schedule changes, and changes in eligibles with Medicare coverage. The overall statewide increase from the previously approved CYE03 rates to the CYE04 rates is 5.2 percent. Rate changes vary by county and range from a 1.5 percent rate decrease to a 19.0 percent rate increase.

Prior Period Coverage (PPC) Rates

20 PPC rates were developed to cover the time period from the first day of the month of application through the date of enrollment. Actual PPC reconciled experience and current financial experience by program contractor was reviewed and used to develop the CYE03 PPC rates. This analysis resulted in no change to the current CYE03 PPC rates for all program contractors. The CYE04 rates are held flat from the CYE03 rates.

Ventilator Dependent Clients

21 HCBS and Institutional rates were developed for ventilator dependent clients, based upon their setting. In addition to reviewing current HCBS and Institutional placement data and Institutional

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Government Human Services Consulting

PROPRIETARY & CONFIDENTIAL

per diem rates by program contractor, Mercer also reviewed two and a half years of financial experience to develop the CYE04 Institutional and HCBS rate increases.

This analysis resulted in no rate increases for the HCBS component of the Ventilator Dependent
rate (Vent rate) for all program contractors. Rate increases for the Institutional component of the
Vent rate were provided to the three Maricopa County program contractors and to Pinal County.
22 MLTCP received a 14.0 percent rate increase; Mercy Care received a 23.1 percent rate increase;
Evercare Select – Maricopa received a 16.1 percent rate increase; and Pinal County received a
1.4 percent rate increase. All other program contractors received no rate increases for the
Institutional component of the Vent rate.

Acute Care Only Clients

As in prior years, clients who are only eligible for the acute care services in the ALTCS program
23 will be paid the acute care component plus the case management component. Since the
reinsurance policy is the same for these clients as for other ALTCS clients, the same reinsurance
offset is appropriate.

Certification of Final Rates

Mercer certifies that the CYE04 ALTCS rates were developed in accordance with generally
accepted actuarial principles and practices by actuaries meeting the qualification standards of the
American Academy of Actuaries for the populations and services covered under the managed
24 care contract. Rates developed by Mercer are actuarial projections of future contingent events.
Actual ALTCS program contractor costs will differ from these projections. Mercer has
developed these rates on behalf of AHCCCS to demonstrate compliance with CMS requirements
under 42 CFR 438.6(c) and are in accordance with applicable law and regulations. These rates
may not be suitable for other purposes.

Please note that all information regarding the CYE04 ALTCS rates are labeled PROPRIETARY
25 AND CONFIDENTIAL. Disclosure of this information could significantly impact the State's
future ability to conduct efficient and effective contract renewals and procurements.

PROPRIETARY & CONFIDENTIAL

If you have any questions, please contact me at 602 522 6535 or Kevin Lurito at 602 522 6540.

Sincerely,

Mark S. Hoyt

Kevin M. Lurito

Mark S. Hoyt, FSA, MAAA

Kevin M. Lurito, ASA, MAAA

Copy:
Terri Greene – AHCCCS
Chris Coleman – ALTCS
Alan Schafer – ALTCS
Emil Kalinowski – Mercer

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Governor

Phyllis Biedess
Director

AHCCCS
ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM
Committed to Excellence in Health Care

July 18, 2003

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

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, the same meeting as the discussion of TXIX behavioral health capitation rates as requested by ADHS/DBHS, for the purpose of reviewing changes to the TXXI (KidsCare and HIFA II) behavioral health capitation rates for the contract year 2004. This review is required in the footnotes to the General Appropriation Act.

The TXXI membership was approximately 60,400 on June 1, 2003. Because membership is small, and the behavioral health penetration is only 3%, 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.

<u>TXXI behavioral health capitation rate changes</u>

Below please find a comparison of the CYE '03 actual rates and the CYE '04 proposed rates:

	CYE '03	CYE '04	% Change	$ Impact
Children	$11.33	$13.34	17.74%	$ 1,948,868
Adult (18-19 yrs)	$34.78	$26.54	-23.69%	$(68,918)
HIFA II SMI	$63.48	$27.13	-42.74%	$(1,857,048)
HIFA II GMH	$19.82	$11.02	-55.6%	$(157,487)
				$(134,585)
			State	$(30,955)
			Federal	$(103,630)

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

Kari Price
Assistant Deputy Director

c. Richard Stavneak, Director, Joint Legislative Budget Committee Staff
Tom Betlach, Deputy Director, AHCCCS
C. J. Hindman, M. D., Deputy Director, AHCCCS
Jim Cockerham, Assistant Director, Division of Business and Finance, AHCCCS
Lynn Dunton, Assistant Director, Office of Policy Analysis and Coordination, AHCCCS
Bonnie Marsh, Manager Behavioral Health Unit, DCHM, AHCCCS
Patrice Spencer, Financial Coordinator Behavioral Health Unit, DCHM, AHCCCS

STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: September 17, 2003

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

THRU: Richard Stavneak, Director

FROM: Timothy Sweeney, Fiscal Analyst

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

Request

A.R.S. § 11-292P requires the JLBC Staff to calculate an inflation adjustment for the counties' contribution for Proposition 204 administration costs. Beginning in FY 2004, the JLBC is also required to calculate an additional adjustment based on changes in the population as reported by the Department of Economic Security (DES).

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of a $5,324,600 county contribution for Proposition 204 administrative costs in FY 2004. This amount reflects a 4% increase above the FY 2003 contribution level and is consistent with the FY 2004 budget. Pursuant to A.R.S. § 11-292P, the calendar year 2002 Gross Domestic Product (GDP) price deflator and the total population growth from July 1, 2001 to July 1, 2002, as reported by DES, were used to adjust the county withholding amount.

Analysis

The passage of Proposition 204 expanded coverage in the Arizona Health Care Cost Containment System (AHCCCS) up to 100% of the Federal Poverty Level. Prior to this expansion, counties had responsibility for health care costs for some individuals who did not qualify for AHCCCS. This responsibility was eliminated as part of the Proposition 204 legislation, and in return the counties were required to pay for some of the costs of implementing the Proposition 204 expansion. A.R.S. § 11-292P requires the State Treasurer to withhold

$5,000,000 from the Transaction Privilege Tax (TPT) distribution to counties for these costs, beginning in FY 2003.

Beginning in FY 2003, A.R.S. § 11-292P requires this amount to be adjusted for inflation (using the GDP price deflator), as calculated by the JLBC Staff. This calculation was made last year, increasing the TPT withholding to $5,118,200 for FY 2003. Beginning in FY 2004, A.R.S. § 11-292P also requires the JLBC Staff to calculate an additional adjustment to this allocation based on population changes, as reported by DES.

The Economic and Business Research Program at the University of Arizona estimate for the GDP price deflator for calendar year 2002 is 1.1%. Statewide population growth from July 1, 2001 to July 1, 2002 as reported by DES is 2.9%. Applying first the inflation adjustment and then the population estimate, these rates increase the withholding amount by $56,300 and $150,100, respectively. Thus, the total amount to be withheld for the county contribution for FY 2004 is $5,324,600.

The TPT withholding calculated above is deposited into the Budget Neutrality Compliance Fund (BNCF). In FY 2004, $5,324,600 is appropriated from the BNCF for administration costs in the Proposition 204 program in the AHCCCS budget.

RS/TS:ck

STATE OF ARIZONA

Joint Legislative Budget Committee

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http://www.azleg.state.az.us/jlbc.htm

DATE: September 19, 2003

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

THRU: Richard Stavneak, Director

FROM: John Malloy, Fiscal Analyst

SUBJECT: DEPARTMENT OF ECONOMIC SECURITY - REVIEW OF EXPENDITURE PLAN FOR 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 federal Workforce Investment Act (WIA) funds received by the state in excess of $48,004,700. Unlike most federal funds, the WIA monies are subject to legislative appropriation due to federal requirements. The total increase in WIA appropriation authority requested by the agency for FY 2004 is $12.3 million. This amount consists of $5.5 million in new, ongoing base funding and $6.8 million in one-time funding. DES reports that it plans to allocate the $12.3 million as follows:

- $8.3 million for local areas
- $2.7 million for the Virtual One Stop (VOS) Program
- $1.3 million to be retained by the state - $456,000 in specified funding for displaced workers and $820,000 for discretionary spending

These $12.3 million in additional monies cannot be spent until an expenditure plan has been reviewed by the Joint Legislative Budget Committee

Recommendation

The Committee has at least the following choices:

1. A <u>favorable review</u> of DES' plan for the entire $12.3 million of additional WIA monies.

2. A <u>favorable review</u> of the expenditure plan, with the recommendation that the $1.8 million available for discretionary program expansions be held in reserve at this time. This deferral would permit us to determine if those monies are needed to solve FY 2004 budget problems within the agency. This deferral would also allow the funding decisions on new programs to be considered by the full Legislature during the next legislative session.

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.

Federal provisions require that 85% of the monies received by WDA must be allocated to local areas, with the state receiving the other 15%. In FY 2004, DES reports that WIA funds allocated to the state totaled $53.5 million. This exceeded the FY 2004 appropriation of $48 million by $5.5 million. DES is seeking appropriation authority for this increase. The agency is also requesting appropriation authority for unspent WIA allocations from prior years, totaling $6.8 million. Because the department has three years to spend WIA allocations, these monies must be spent in FY 2004. The total appropriation authority requested by the agency is $12.3 million.

The department's expenditure plan for the $12.3 million in WIA monies involve the following components: monies retained by the state for displaced workers as well as discretionary spending on various workforce development activities, aid to local areas, as well as funding for the Virtual One-Stop (VOS) Program.

Displaced Worker Program and Discretionary Spending

The state will retain $1.3 million in WIA monies for various workforce development activities. Of this total, $460,000 is for a one-time National Emergency Grant that will be spent on dislocated worker services. Dislocated worker services enable individuals who have lost their jobs through no fault of their own to obtain employment as rapidly as possible after the occurrence of dislocation.

Discretionary spending includes funding for programs established by the Governor's Council on Workforce Development. The Governor's Council has recommended changing set-aside funding levels for certain programs. Changes in funding levels would be partially funded through reallocating current resources and partially through the increased ongoing WIA revenues.

The Governor's Council on Workforce Policy has recommended using the 15% discretionary dollars (totaling $7.9 million) as indicated on the next page, contingent on the JLBC reviewing the additional WIA discretionary monies.

The Governor's Council has recommended the establishment of new programs in FY 2004, designed to address workforce development issues related to women and youth. These new programs reflect the priorities of the Council to develop programs for these targeted groups. These programs are partially funded through reallocating current funding and partially through the increased ongoing funding.

The Women's Issues Program, funded at $500,000, would grant approximately $435,000 to fund programs that focus on improving job skills for women on welfare and women exiting the corrections system. Grant monies would assist this group in entering and remaining in the workforce and to assist displaced homemakers and provide training for women in non-traditional employment. The additional $65,000 would be utilized to fund a staff person to oversee the grant process.

The Governor's Council recommends an additional $800,000 in new monies in order to target the youth population in FY 2004, for a total funding level of $1 million. In FY 2003, $200,000 was spent on youth-related workforce development programs. The Council recommends eliminating the High Concentration of Youth Activities Program and establishing two new initiatives – the formation of a Youth Council and the establishment of Youth Programs. The Council would utilize $170,000 to establish and staff a State

Youth Council on Youth Workforce Development. Staff would provide technical assistance to local boards in addition to establishing a statewide conference on youth workforce development activities. An additional $330,000 would be granted to organizations involved in youth-related workforce development activities. An additional $500,000 would be used for various youth programs at the local level.

DES plans to allocate an additional $510,000 for discretionary set-aside programs as yet unallocated by the Governor's Council on Workforce Policy. This amount would be used at the Council's discretion throughout the year. The Arizona Board of Regents has recently petitioned the Governor's Council to establish a program on issues related to the nursing profession using WIA monies. These unallocated funds may be used for this purpose.

Recommendation #2 above (favorable review with stipulation) suggests that DES not use the additional $1.8 million in new discretionary spending ($500,000 on women's issues, $800,000 on new youth programs and $510,000 on unallocated expenses) and save it in reserve in order to determine whether these monies could be used to address FY 2004 shortfalls within the agency. This deferral would also permit the Legislature to participate in these funding decisions on new programs.

It is not known if WIA funds will be allocated by the federal government at the same level in FY 2005 as in FY 2004. As a result, the recommended expenditure authority requested by the agency in FY 2004 may not be able to be sustained in FY 2005 and onward. Rather than expend these monies on new programs that might need to be curtailed in the following year due to lack of funding, they may be better utilized as a reserve for budget shortfalls in the current fiscal year. These new monies could be used as an offset to the General Fund or Federal Temporary Assistance for Needy Families (TANF) Block Grant, which could then be freed up for other purposes.

Governor's Council Recommendation of 15% Set-Aside

Program Activities	Agency	FY 2003	FY 2004	Net Change
Eligible Training Provider List	ADE	$223,000	$214,325	$ (8,675)
Incentive Funds for LWIAs	LWIA	689,000	500,000	(189,000)
Technical Assistance	LWIA	521,726	125,000	(396,726)
System Building	LWIA	--	152,000	152,000
High Concentration of Youth Activities	LWIA	200,000	--	(200,000)
Formation of Youth Council	GOV	--	500,000	500,000
Apprenticeship	ADOC	$ 125,000	$ 130,000	$ 5,000
Women Issues	GOV	--	500,000	500,000
Business Research and Statistics	ADOC	250,000	--	(250,000)
AZ Workforce Connection/Marketing	ADOC	225,000	--	(225,000)
Virtual One Stop	DES/WDA	524,000	325,000	(199,000)
Youth Programs	LWIA	--	500,000	500,000
Unallocated	LWIA	--	510,395	510,395
DES JOBS Administration	DES/JOBS	2,000,000	2,000,000	--
Subtotal		*$4,757,726*	*$5,456,720*	*$698,994*
State Administration				
DES Administration WDA	DES/WDA	1,976,362	1,900,000	(76,362)
ADOC/State Council	ADOC	402,500	600,000	197,500
Subtotal		*2,378,862*	*2,500,000*	*121,138*
TOTAL 15% Set-Aside		**$7,136,588**	**$7,956,720**	**$820,132**

Legend

ADE	*Department of Education*	*LWIA*	*Local Workforce Investment Areas*
GOV	*Governor's Office*	*ADOC*	*Department of Commerce*
DES	*Department of Economic Security*	*WDA*	*Workforce Development Administration*
JOBS	*JOBS Special Line Item*		

Aid to Local Areas

The Department's expenditure plan would allocate $8.3 million of the total monies received to local areas based on a state formula. The funding formula is based on each area's unemployed population, excess number of unemployed people, and relative number of disadvantaged individuals compared to the state total. Industry statistics are also considered such as plant closings, layoffs and long term unemployment data.

Each local area has a Local Workforce Investment Board (LWIB) that establishes one-stop career centers, which contain employment workstations, job postings as well as training opportunities. The local areas supervise the one-stops, determine funding levels for trainees and establish who is authorized to provide training.

Of the $8.3 million that will be allocated to local areas, $4.1 million is from prior year WIA expenditure authority. Those monies will be allocated according to the following schedule:

Local WIA	Total	Local WIA	Total
Apache	$ 8,707	Navajo	$ 33,745
Cochise	89,360	Navajo Nation	281,691
Coconino	78,724	Phoenix	1,050,405
Gila/Pinal	160,587	Pima	499,838
Graham	23,849	Santa Cruz	90,314
Greenlee	12,452	Yavapai	55,384
Maricopa	741,136	Yuma	618,176
Mohave/La Paz	89,453	Tribal	219,178
Total		**$4,052,999**	

Virtual One Stop Program

Of the prior year appropriation authority being sought by DES, $2.7 million would be retained by the state for funding for the Virtual One-Stop (VOS) automation enhancement project. VOS will provide universal access to online information for individuals seeking jobs, training and services as well as employers looking to recruit talent and access the labor market. It will also determine eligibility for the program, enroll individuals in various programs, track progress of enrollees as well as provide for case management functions. The following delineates how DES plans to spend the $2.7 million for the VOS Program.

DES VOS One-Time Allocation	FY 2004
Personal Services	$ 142,000
ERE	41,500
In-State Travel	7,100
Other Operating Expenditures	1,370,200
Capital Equipment	631,000
Non-Capital Equipment	530,00
TOTAL	**$2,721,800**

RS/JM:ck

ARIZONA DEPARTMENT OF ECONOMIC SECURITY
1717 W. Jefferson • P.O. Box 6123 • Phoenix, AZ 85005

Janet Napolitano
Governor

David A. Berns
Director

SEP 11 2003

RECEIVED
SEP 11 2003
JOINT BUDGET COMMITTEE

The Honorable Robert Burns, Chairman
Joint Legislative Budget Committee
Arizona State Senate
1700 West Washington
Phoenix, AZ 85007

Dear Senator Burns:

The General Appropriation Act includes the following footnote: "All federal Workforce Investment Act funds that are received by the State in excess of $47,960,700 are appropriated to the Workforce Investment Act Programs 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."

Pursuant to this requirement, the Arizona Department of Economic Security requests to be placed on the agenda for the September Joint Legislative Budget Committee (JLBC) meeting. The purpose of the request is to review the proposed expenditure plan for the additional Workforce Investment Act (WIA) funds currently being received by the Department above the appropriated level. The WIA federal allocation is $53,501,086; therefore, the additional appropriation authority requested is $5,540,386.

In addition, the Department is requesting increased appropriation authority for unspent WIA allocations received in prior years. The Department has three years to spend WIA annual allocations. There is $6,250,800 of prior-year funding unexpended that must be spent in FY 2004. Of this amount, $1,952,513 is for funding of the Virtual One-Stop (VOS) automation enhancement project that will be spent in FY 2004. An additional $524,000 of prior-year funding originally budgeted in FY 2003 requires appropriation authority for VOS in FY 2004. Therefore, the total increase in WIA appropriation authority being requested for FY 2004 is $12,315,186. On August 29, JLBC staff requested responses to several questions related to this request. Those responses are attached.

Please contact Lynne Smith, Assistant Director, Division of Business and Finance, at (602) 542-7166 if you have any questions.

Sincerely,

David A. Berns
Director

DAB:JS:sl

Attachment

c.
The Honorable Russell K. Pearce, Vice-Chairman, Joint Legislative Budget Committee
Richard Stavneak, Director, Joint Legislative Budget Committee
Clark Partridge, State Comptroller, Arizona Department of Administration
David Jankofsky, Director, Governor's Office of Strategic Planning and Budgeting

Attachment A

Workforce Investment Administration Funding/Expenditure Plan
Joint Legislative Budget Committee Follow-up Questions
August 29, 2003

Question 1: We had asked for further detail on how additional ongoing discretionary WIA monies totaling $825K will be spent on the state side (i.e., 10% Gov Council, 5% Admin) and how that fits into the existing expenditure plan for these funds. For both the existing funds (totaling $7.2 M) and the additional funds ($825K), please provide a specific expenditure plan. This would include budget schedule detail including amounts expended on FTEs, Personal Services, ERE etc. Grants to outside organizations should be separately detailed. These grant allocations could be allocated by project/component/grant recipient.

Response: See Attachment B.

Question 2: Please provide the same level of detail referenced above on how the $6.8 million in prior year appropriations will be expended. Additionally, please indicate which projects/components are one-time and which are ongoing.

Response: These monies were previously allocated by DES to the Local Workforce Investment Administration (LWIA) entities, but have not yet been expended by the local entities. Please refer to Attachment C for a breakout by LWIA and expenditure category.

Question 3: Please provide an updated list of expenditures approved by the Governor's Council on Workforce Development for FY 2003 and FY 2004. Please clarify which numbers would change as a result of the proposed additional funding.

Response: Listed on Attachment B are the recommendations from the Governor's Council on Workforce Policy for the 15% Set-Aside distributions for FY 2003 (July 1, 2002 - June 30, 2003) and FY 2004 (July 1, 2003 - June 30, 2004).

The Governor's Council on Workforce Policy made the recommended distributions based on the federal DOL allocations published in the Federal Registers dated March 8, 2002 and April 1, 2003. Therefore, the numbers will not change based on the additional funding.

Question 4: Please provide the same level of detail on the costs associated with the Virtual One Stop (VOS) Program. Are the costs associated with this program for software or for staff? DES staff or local staff? Does VOS attempt to link to other online job databases (i.e. Monster.com)? What are the costs estimated to be for ongoing operations? Can future operating costs of VOS be absorbed with the current $48 million WIA appropriation?

Question 4a: Please provide the same level of detail on the costs associated with the Virtual One Stop (VOS) Program.

Response 4a: See Attachment C.

Question 4b: Are the costs associated with this program for software or for staff?

Response 4b: Costs associated with this program are for both software and staff, as listed in Attachment C.

Question 4c: DES staff or local staff?

Response 4c: DES staff.

Question 4d: Does VOS attempt to link to other online job databases (i.e., Monster.com)?

Response 4d: Yes, VOS will link to America's Job Bank, Monster.com, Hot Jobs and the State Job Bank. In addition, VOS provides features including an advanced resume and letter builder, information regarding current workforce trends and labor market information.

Question 4e: What are the costs estimated to be for ongoing operations?

Response 4e: The ongoing operational cost for VOS is $606,000 per year, starting in FY 2005.

Question 4f: Can future operating costs of VOS be absorbed with the current $48 million WIA appropriation?

Response 4f: Yes, future operating costs for VOS will be paid from the existing DES WIA operating budget.

Question 5: What is the difference between WIA and Job Service?

Response: The Job Service is funded under the federal Wagner-Peyser Act. The primary focus of the Job Service is to operate as the state labor exchange, obtaining employer job orders for job applicants with specific skill sets. Job Service staff members match applicants with the skills required in job orders and refer qualified job seekers to the employment opportunities. Federal Wagner-Peyser program funds are sent from the Department of Labor to the DES; labor exchange services are delivered by DES staff.

WIA is federal legislation authorizing the establishment and implementation of federal workforce development programs. The primary focus of the WIA programs is to provide training for Dislocated Workers, Adults and Youth. WIA program funds are provided from the Department of Labor to DES and passed through to local government entities and their Local Workforce Investment Boards. Local staff deliver training programs through One-Stop Employment Centers.

Question 6: The Appropriations chairmen are interested in finding unit cost data currently being collected in state programs. Please provide any unit cost data (e.g., cost per trainee) currently being collected for WIA programs, either by DES or by local boards.

Response: As an average, the overall cost per participant is approximately $1,940. WDA is comprised of three programs:

	Average
Adult Programs	$1,864
Dislocated Worker Programs	$1,405
Youth Programs	$2,548
Overall Average	$1,940

Workforce Investment Act

Governor's Council Recommendation of 15% Set-Aside Distribution 1/			
Required Activities		**FY 2003**	**FY 2004**
Eligible Training Provider List	ADOE	223,000	214,325
Incentive Funds for LWIAs	LWIA	689,000	500,000
Technical Assistance / Capacity Building	LWIA	521,726	125,000
System Building	LWIA	-	152,000
High Concentration of Youth Activities	LWIA	200,000	-
High Concentration of Youth Activities / Formation of Youth Council	GOV	-	500,000
Subtotal		1,633,726	1,491,325
Program Set-Asides			
Apprenticeship	ADOC	125,000	130,000
Women Issues	GOV	-	500,000
Business Research and Statistics	ADOC	250,000	-
Arizona Workforce Connection / Marketing	ADOC	225,000	-
Virtual One Stop	DES/WDA	524,000	325,000
Youth Programs	LWIA	-	500,000
Miscellaneous	LWIA	-	510,395
Subtotal		1,124,000	1,965,395
State Administration			
DES Administration WDA	DES/WDA	1,976,362	1,900,000
DES JOBS Administration	DES/JOBS	2,000,000	2,000,000
ADOC / State Council	ADOC	402,500	600,000
Subtotal		4,378,862	4,500,000
Total 15% Set-Aside		7,136,588	7,956,720

DES Budget Detail 2/		
DES Set-Aside	**FY 2003**	**Estimated FY 2004**
Personal Services	1,079,400	1,088,200
Employee-Related Expenditures	255,300	313,400
Professional & Outside Services	120,200	40,300
In-State Travel	52,800	70,300
Out of State Travel	6,200	-
Client Services (JOBS special line item)	1,190,900	2,000,000
Other Operating Expenditures	259,600	421,900
Capital Equipment	131,700	-
Non-Capital Equipment	8,400	-
Total DES Set-Aside	3,104,500	3,934,100

1/ The Governor's Council recommendation of the distribution of the 15% set-aside was based upon the USDOL allocation of WIA Title I funds to Arizona as presented in the Federal Register dated March 8, 2002 and April 1, 2003.

2/ The DES Budget Detail amounts represent actuals through the 13th month for FY 2003 and the approved appropriation amounts for FY 2004.

Workforce Investment Act

Distribution of Carryover

ON-GOING COSTS

Local WIA	Adult	Youth	Dislocated Worker	Totals
Apache	3,211	4,610	886	8,707
Cochise	36,073	40,149	13,138	89,360
Coconino	20,198	28,707	29,819	78,724
Gila/Pinal	43,580	45,265	71,742	160,587
Graham	10,229	10,668	2,952	23,849
Greenlee	3,830	4,341	4,281	12,452
Maricopa	162,830	173,690	404,616	741,136
Mohave/LaPaz	29,920	28,976	30,557	89,453
Navajo	13,060	16,995	3,690	33,745
Navajo Nation	112,881	127,920	40,890	281,691
Phoenix	281,342	304,809	464,254	1,050,405
Pima	136,617	144,748	218,473	499,838
Santa Cruz	40,380	36,649	13,285	90,314
Yavapai	12,322	14,572	28,490	55,384
Yuma	249,714	284,616	83,846	618,176
Tribal	74,464	79,467	65,247	219,178
Local WIA Distribution	1,230,651	1,346,182	1,476,166	4,052,999

ONE-TIME COSTS

DES Distribution (VOS)	Estimated FY 2004
Personal Services	142,000
Employee-Related Expenditures	41,500
In-State Travel	7,100
Other Operating Expenditures	1,370,200
Capital Equipment	631,000
Non-Capital Equipment	530,000
Total DES Distribution	2,721,800
Total Carryover Distribution	6,774,799

STATE OF ARIZONA

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DATE: September 25, 2003

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

THRU: Richard Stavneak, Director

FROM: Brian Schmitz, Senior Economist/Fiscal Analyst

SUBJECT: TOURISM AND SPORTS AUTHORITY – REPORT ON ACTIVITIES

Request

Pursuant to A.R.S. § 5-814, the Tourism and Sports Authority (TSA) is required to annually appear before the Joint Legislative Budget Committee at the request of the Chairman to report on its activities and financial performance during the previous year.

Recommendation

This item is for information only and no Committee action is required. In FY 2004, the TSA projects revenues of $23.7 million and expenses of $21.9 million.

Analysis

The TSA is charged with overseeing the design and construction of a new multipurpose football stadium. After the stadium is built, it will be owned and operated by the TSA. In addition, the agency also distributes monies for the promotion of tourism in Maricopa County, Cactus League baseball spring training, and youth and amateur sports.

The TSA currently estimates that the stadium will cost $355 million to construct, plus $61 million for support infrastructure (parking, roads, utilities, etc.) and another $18 million for land. The stadium is projected to be finished by August 2006.

The TSA's operating revenue comes from a hotel bed tax, a car rental surcharge, NFL income taxes, and the recapture of sales taxes generated at Sun Devil Stadium. In FY 2004, total revenue is projected to be $23.7 million. The TSA's expenses include debt service payments, a Tourism Fund distribution, Cactus League payments, youth and amateur sports, and the agency's

operating costs. In FY 2004, total expenses are projected to be $21.9 million. The Tourism Fund distribution began in FY 2002 at $4 million and is statutorily required to increase by 5% each year thereafter. The Cactus League payments include bond debt service for construction of a spring training baseball stadium in Surprise.

In accordance with the Chairman's request for an accounting of the TSA's expenditures, we have prepared the table below. This table displays the agency's revenues and expenditures since FY 2002.

	FY 2002 Actual	FY 2003 Actual	FY 2004 Budget
Revenues			
Hotel Bed Tax	$9,898,026	$10,228,577	$10,779,947
Car Rental Surcharge	6,505,495	7,668,222	7,699,364
NFL Income Tax	4,420,872	3,784,320	4,087,066
Sun Devil Stadium Sales Tax Recapture	946,394	959,610	1,145,360
Other Operating Revenue	494	6,500	0
Total Revenue	$21,771,281	$22,647,229	$23,711,737
Expenses			
Operating Expenses	4,105,253	2,172,343	2,124,213
Bond Debt Service	7,000,000	4,643,294	11,143,906
Wells Fargo/Bank One Stadium Loan	0	5,000,000	0
Tourism Fund	4,016,667	2,017,500	4,428,375
General Fund [1/]	0	2,200,000	0
Cactus League	3,000,000	3,000,000	3,000,000
Youth and Amateur Sports	1,008,330	1,108,333	1,208,333
Youth and Amateur Sports, Reserve	0	1,000,000	25,000
Total Expenses	$19,130,250	$21,141,470	$21,929,827
Non-Operating Revenue/(Expense)			
Interest Income	136,887	358,800	120,438
Interest Expense	(58,011)	(115,225)	0
Net Operating Source/(Use)	2,719,907	1,749,334	1,902,348

1/ In FY 2003, the Legislature suspended the statute that would have transferred $4.2 million to the Tourism Fund, and instead transferred $2.0 million to the Tourism Fund and $2.2 million to the General Fund.

As indicated by the table, the TSA's revenues have been sufficient to meet its expenses in recent years, despite the economic downturn. In the long run, the TSA believes that its revenues will continue to exceed its costs. By FY 2011, the debt service costs will have risen to $17.1 million, from $11.1 million in FY 2004. This represents a 6.3% average annual increase in debt service payments over this period. Since the TSA's current revenues of $23.7 million already exceed its future debt service costs and its revenues are expected to increase in future years, especially once the stadium opens, it appears likely that the TSA will be able to pay future debt service.

According to A.R.S. § 5-835, the TSA's funding priority is as follows:

1. Multipurpose Facility Bonds
2. Tourism Fund Transfer for Promotion of Tourism in Maricopa County
3. Cactus League Baseball
4. Youth and Amateur Sports
5. TSA Operating Account
6. Youth and Amateur Sports Reserve Account

If, in the worst case scenario, the tourism industry declines sometime in the future and the TSA's revenues are not sufficient to cover all of its expenses, the available revenues would first go toward the stadium bonds, then to the Tourism Fund, and so forth, according to the funding priority. To at least meet its debt service obligations and avoid defaulting on its bonds, the TSA would need enough revenue to cover priorities 1 through 3. A severe tourism recession does increase the probability that youth and amateur sports, along with the TSA operating account, could go underfunded.

RS/BS:ck

Tourism and Sports Authority
Status of Approved Projects
August 2003

Multipurpose Stadium Facility, Glendale

- 63,000 seat (expandable to 73,000) stadium with a retractable roof and field, that will be new home of the AZ Cardinals, the Tostitos Fiesta Bowl, future Superbowls and NCAA Final Four Championships, as well as soccer, motorsporting events, concerts, trade and consumer shows.
- Estimated Cost—$355M stadium; $61M support infrastructure, including parking, roads, utilities, etc.; $18M land
- Groundbreaking—April 12, 2003
- Start of Mass Excavation—July 30, 2003
- Start Foundation—Late August 2003
- Start Main Concourse Formwork—Late October 2003
- Start Assembly of Super Trusses in Bowl—August 2004
- Raise Super Trusses to Roof—February 2005
- Complete Metal Deck on Roof—June 2005
- Building Enclosure Complete (except at bridge)—September 2005
- Start Outboard Field Work—October 2005
- Completion of Construction—August 2006

Cactus League Facilities

Surprise Stadium

- New home of the Texas Rangers and Kansas City Royals, formerly of the Grapefruit League, with 20-year leases
- Completed in December 2002 at a cost of $48M of which $32M was financed by the TSA
- Completed inaugural Cactus League Season in March 2003

Phoenix Municipal Stadium

- Home of the Oakland Athletics with a lease that has been extended 10 more years
- $6.6M renovation project is underway of which $4.4M is funded by the TSA
- Improvements will be completed by December 2003 in advance of 2004 spring training

Scottsdale Giants and Tempe Diablo Stadiums

- Negotiations underway for improvements to commence within the next year
- Current leases expire in 2007 and 2008, respectively
- Both cities/clubs are seeking capital improvements that primarily focus on practice facilities

Youth and Amateur Sports Facilities

South Mountain YMCA

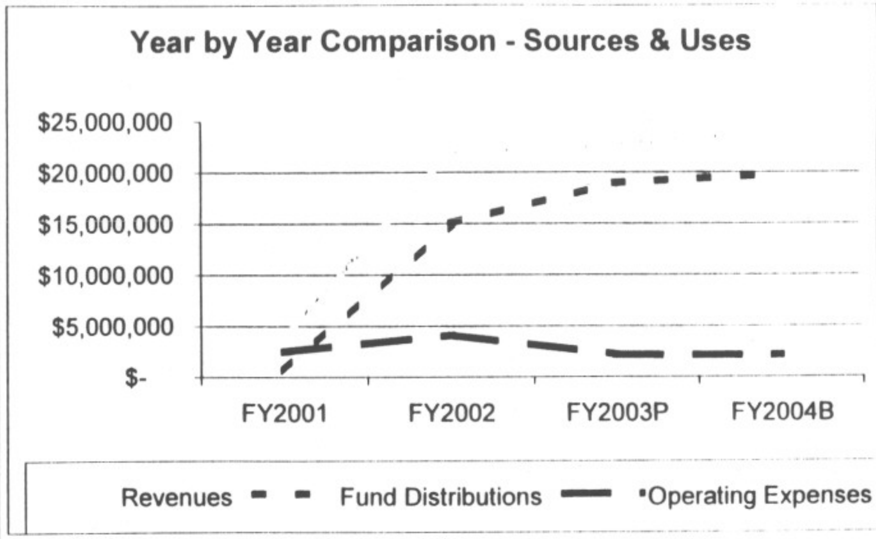
- Just completed a $750,000 project of which $150,000 was funded by the TSA
- Added a lighted baseball field and football/soccer field and support facilities on a 2.5 acre parcel adjacent to the Y's indoor facility

Avondale

- Construction underway for a large, regional complex at a cost of $5.5M of which $3.4M is being funded by the TSA.
- Will include 9 soccer/football fields, of which 6 will be lit, two baseball diamonds, two basketball courts, two tennis courts, open turf play areas, 600 parking spaces, restrooms, concessions, and a maintenance building.
- Completion of construction is set for early 2004.

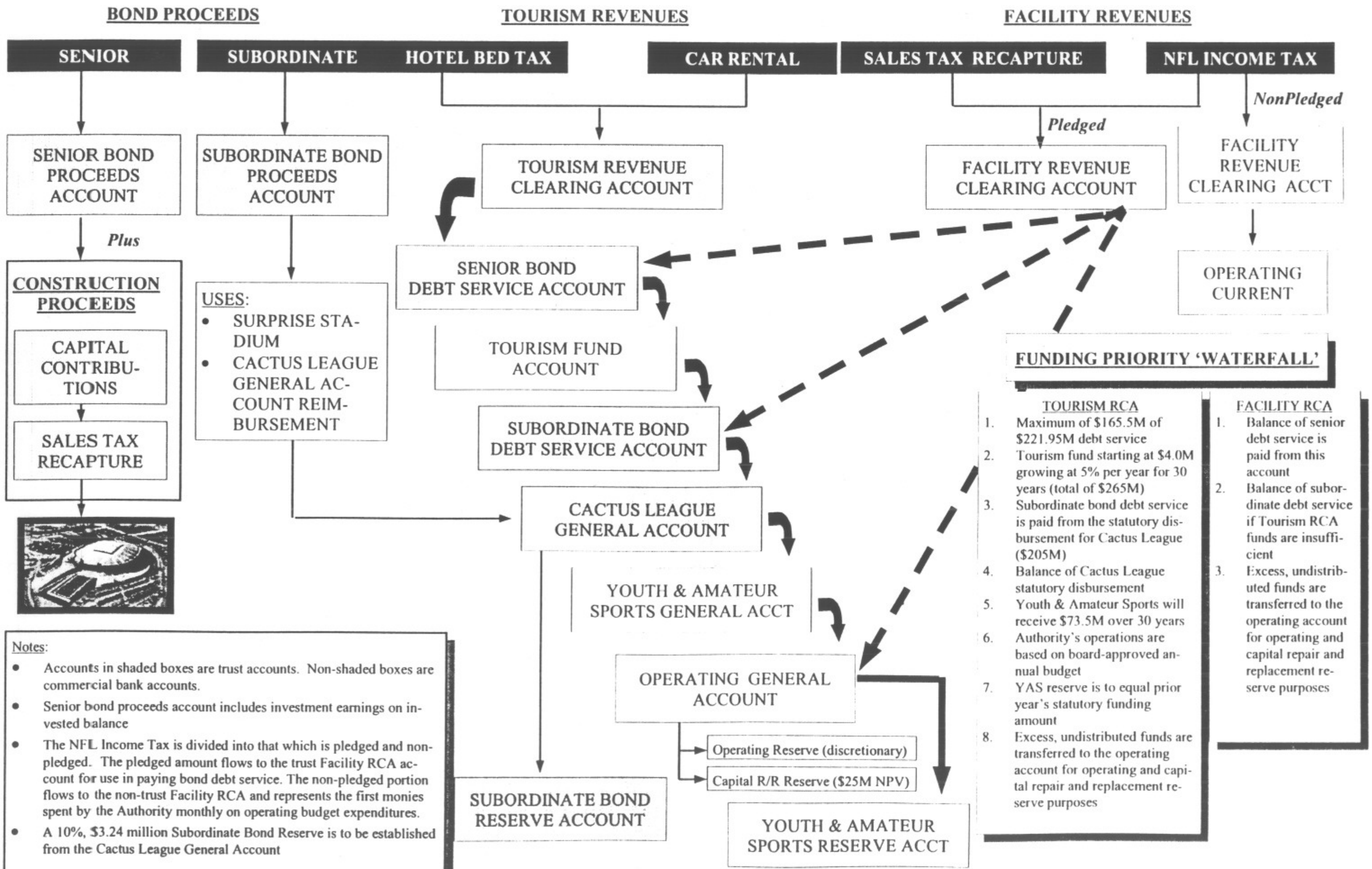
Sources and Uses Overview — Year by Year Comparison

Item	FY2001	FY2002	FY2003	FY2004B
OPERATING REVENUES				
Hotel bed tax	$ 2,750,976	$ 9,898,026	$ 10,228,577	$ 10,779,947
Car rental surcharge	1,534,416	6,505,495	7,668,222	7,699,364
NFL income tax	-	4,420,872	3,784,320	4,087,066
Sales tax recapture	-	946,394	959,610	1,145,360
Other operating revenues	-	494	6,500	-
Total Operating Revenues	$ 4,285,392	$ 21,771,281	$ 22,647,229	$ 23,711,737
OPERATING EXPENSES				
Marketing and Promotion	$ 16,008	$ 118,767	$ 100,244	$ 55,000
Payroll and Benefits	201,838	707,331	551,837	771,149
Office	69,772	288,607	311,216	430,176
Professional and consulting	1,009,471	1,332,116	272,732	313,160
Travel	12,561	25,678	11,104	17,280
All Other	266,192	242,441	109,096	162,000
Total Operating Expenses (non-legal)	$ 1,575,842	$ 2,714,940	$ 1,356,229	$ 1,748,765
Legal	938,584	1,390,313	816,114	375,448
Total Operating Expenses	$ 2,514,426	$ 4,105,253	$ 2,172,343	$ 2,124,213
OTHER FUND DISTRIBUTIONS			-	-
Bond Debt Service	$ -	$ 7,000,000	$ 4,643,294	$ 11,143,906
Wells Fargo/Bank One Stadium Loan	-	-	5,000,000	-
Arizona Office of Tourism	333,333	4,016,667	2,017,500	4,428,375
Arizona State General Fund			2,200,000	
Cactus League	250,000	3,000,000	3,000,000	3,000,000
Youth and Amateur Sports	83,333	1,008,330	1,108,333	1,208,333
Youth and Amateur Sports, Reserve	-	-	1,000,000	25,000
Total Other Fund Distributions	$ 666,666	$ 15,024,997	$ 18,969,128	$ 19,805,614
Operating Income	$ 1,104,300	$ 2,641,031	$ 1,505,758	$ 1,781,910
NONOPERATING REVENUE/(EXPENSE)				
Interest Income	$ 2,851	$ 136,887	$ 358,800	$ 120,438
Interest Expense	(14,470)	(58,011)	(115,225)	-
Total nonoperating revenue/(expense)	$ (11,619)	$ 78,876	$ 243,575	$ 120,438
Net Operating Source/(Use)	$ 1,092,681	$ 2,719,907	$ 1,749,333	$ 1,902,348



TSA TOURISM & SPORTS AUTHORITY

FLOWCHART OF ALL FUNDS SOURCE & USES



Notes:

- Accounts in shaded boxes are trust accounts. Non-shaded boxes are commercial bank accounts.
- Senior bond proceeds account includes investment earnings on in- vested balance
- The NFL Income Tax is divided into that which is pledged and non- pledged. The pledged amount flows to the trust Facility RCA ac- count for use in paying bond debt service. The non-pledged portion flows to the non-trust Facility RCA and represents the first monies spent by the Authority monthly on operating budget expenditures.
- A 10%, $3.24 million Subordinate Bond Reserve is to be established from the Cactus League General Account

TOURISM & SPORTS AUTHORITY

TSA/CARDINALS MULTIPURPOSE STADIUM
Construction Budget Summary
September 11, 2003

	Description	Cost
1	**Sitework and Concrete** Mass Excavation; Backfill; Concrete Foundations; Formwork; Concrete Structure	58,000,000
2	**Masonry and Metals** Reinforced Block; Handrails; Stairs	15,000,000
3	**Wood and Plastics** Rough Carpentry; Architectural Woodwork	2,000,000
4	**Thermal and Moisture Protection** Waterproofing; Fireproofing; Joint Sealants	1,000,000
5	**Enclosure** Exterior Metal Wall; Doors; Secondary Support Steel; Louvers; Windows; Roof Gutters	23,000,000
6	**Finishes** Acoustical Ceilings; Carpet; Floors; Paint	8,500,000
7	**Specialties** Flagpoles; Lockers; Partitions	2,000,000
8	**Equipment** Food Service; Commissary; Concession; Bars; Buffets	17,000,000
9	**Furnishings** Furniture; Seating; Field Benches	8,000,000
10	**Roof Steel** Primary and Secondary Trusses; Shop Fabrication and Field Erection; Metal Decking; Moveable Field; Scoreboards	65,000,000
11	**Conveying Systems** Escalators and Elevators	3,600,000
12	**Mechanical Systems** HVAC; Plumbing; Cooling Towers; Air Handling Units; Control Systems	28,000,000
13	**Electrical Systems** Power Distribution; Lighting; Audio Visual; Communication; Switchgear	25,000,000
14	**General Requirements** Jobsite Administration; Staffing and Facilities	15,000,000
15	**Design Consultant Fees; Preconstruction; Permitting**	22,000,000
16	**Design Builder's Fee**	15,000,000
17	**Project Errors and Omissions Policy; Liability Insurance; Builder's Risk Insurance; Payment & Performance Bond**	12,000,000
18	**Design Builder's Contingency** Subcontractor Pricing; Change Orders	9,000,000
		329,100,000
19	**Taxes**	17,200,000
		346,300,000
20	**Owner's Contingency** Change Orders; Owner Scope Changes	9,000,000
	TOTAL PROJECT BUDGET	**355,300,000**

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DATE: September 17, 2003

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 – REPORT ON LADEWIG EXPENDITURES

Request

This is a status report on the Department of Revenue's (DOR) monthly expenditure reports for their Ladewig administrative costs.

Recommendation

This report is for information only and no Committee action is required.

Analysis

The Legislature allocated $15,000,000 in FY 2003 to DOR for Ladewig administrative costs, with any unused amount to be held in reserve for future payments related to the case. Last year's Public Finance Omnibus Reconciliation Bill made any unused amount of the $15,000,000 available to DOR in FY 2004 for Ladewig administrative costs. In addition, the Governor vetoed the section of last year's Public Finance Omnibus Reconciliation Bill, which would have allocated an additional $75,000,000 in FY 2004 to DOR for Ladewig payments and costs with up to $7,300,000 allowed to be used for Ladewig administrative costs.

In November 2002, the Committee approved $27,607,100 for DOR's total estimated 5-year administrative requirement expenditure plan, including $13,497,000 (of the total $15,000,000 allocation) to fully fund DOR's estimated administrative costs in FY 2003. DOR reports that they spent $10,587,100 of the total $15,000,000 allocation in FY 2003, including $8,587,100 for DOR administration and $2,000,000 for attorney fees. This would leave $4,412,900 available for the department's Ladewig administrative costs in FY 2004. A $2,000,000 payment for attorney fees is due in September 2003. DOR estimates that the $4,412,900 should last until November 2003.

DOR has stated that the $7,300,000 which was vetoed by the Governor will need to be restored in FY 2004. DOR reports that they are reviewing whether the $7,300,000 figure could be reduced, especially in view of the $4,412,900 carry forward from FY 2003.

DOR reports that in August they tested and corrected the taxpayer data recovered from microfiche and filled in gaps in their data files. DOR's monthly status report shows expenditures of $22,700 for Ladewig in August, making total expenditures of $61,300 for the first 2 months of FY 2004. This would leave a balance of $4,351,600 still available for the department's Ladewig administrative costs in FY 2004. The following table summarizes these items.

DOR's Ladewig Administrative Costs

	FY 2003	**FY 2004 Through August 2003**
Beginning Balance	$ 0	$4,412,900
Allocation	15,000,000 1/	0 2/
DOR Expenditures	10,587,100 3/	61,300
Ending Balance	$4,412,900	$4,351,600

1/ JLBC approved $13,497,000 to fully fund DOR's estimated administrative costs in FY 2003.
2/ The Governor vetoed the allocation of up to $7,300,000 for Ladewig administrative costs in FY 2004.
3/ Includes $8,587,100 for DOR administration and $2,000,000 for attorney fees.

RS/BH:jb