STATE OF ARIZONA

Joint Legislative Budget Committee

STATE
SENATE

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HOUSE OF
REPRESENTATIVES

JOINT LEGISLATIVE BUDGET COMMITTEE
Tuesday, October 24, 2006
9:30 a.m.
Senate Appropriations Room 109

MEETING NOTICE

- Call to Order

- Approval of Minutes of September 21, 2006.

- DIRECTOR'S REPORT (if necessary).

- EXECUTIVE SESSION - Arizona Department of Administration - Review of Request for Proposal.

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

2. DEPARTMENT OF REVENUE
   A. Review of Business Reengineering/Integrated Tax System Contract Amendment.
   B. Review of General Fund Revenue Enforcement Goals for FY 2007.

3. ARIZONA DEPARTMENT OF ADMINISTRATION - Review of Emergency Telecommunication Services Revolving Fund Expenditure Plan.

4. AHCCCS - Review of Capitation Rate Change.

5. ARIZONA COMMISSION ON THE ARTS - Review of the Arizona Arts Endowment Fund and Private Contributions.

The Chairman reserves the right to set the order of the agenda.
10/18/06

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HOUSE OF REPRESENTATIVES

MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

September 21, 2006

The Chairman called the meeting to order at 9:45 a.m., Thursday, September 21, 2006, in Senate Appropriations Room 109. The following were present:

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

APPROVAL OF MINUTES

Hearing no objections from the members of the Committee to the minutes of August 24, 2006, Senator Burns stated the minutes would stand approved.

DIRECTOR'S REPORT

Mr. Richard Stavneak, Director, JLBC Staff, said that the Chairman will be appointing a subcommittee to review the results of our actuarial audits. Funds were budgeted last year to contract with several actuarial firms to review retirement, health insurance, risk management, and Title XIX rates.

ARIZONA DEPARTMENT OF TRANSPORTATION (ADOT) – Review of Motor Vehicle Division Counter Clerk Funding Shift Report.

Mr. Bob Hull, JLBC Staff, said that last session, the Legislature was very concerned about the increase in Motor Vehicle Division (MVD) customer wait times, which increased from 14 to 28 minutes over the past 3 years. The customer wait time was accompanied by a decrease of 168 counter clerks (19.4%). To address the problem, the Legislature added $1.1 million (25 counter clerk positions), and required Committee review before any funds were transferred into or out of MVD, quarterly progress reports on MVD wait times, and a report due by the end of July 2006, reflecting where funding for counter clerks had been shifted. That is the report presented here today. ADOT reports that $2 million of funding was shifted primarily from license plates and tags, shown in the table on page 2 of the memo.

The Committee has at least 2 options, shown on page 1 of the memo: A favorable review, since the report was submitted, or an unfavorable review, since no reasons were given for the funding shift and the $2 million does not appear to account for the whole funding shift. An unfavorable review would also express the Committee's disagreement with ADOT's funding reallocations. Under either option, JLBC Staff recommends that ADOT provide the additional information shown on page 1 of the memo.

Representative Burton Cahill asked for a description of the relationship between the additional funding appropriated to MVD and the population demand increase.

Mr. Hull responded that the number of customers in MVD field offices has decreased 10.6% over the last 4-5 years, as noted on page 2 of the memo due to greater use of on-line transactions.

Representative Burton Cahill asked where funds are categorized from internet transactions and commercial licenses. She also asked whether the transactions require more data to be collected, and if that is perhaps the reason that wait times are now longer.

Mr. Hull stated he did not have the detailed information being requested. The information would need to be obtained from ADOT. ADOT has reported that with increased security and document review, there has been some increase in work, but this has not been reflected in transaction time at the counter.

<u>Mr. George Delgado, MVD Assistant Director</u>, introduced himself and stated he was present to testify on behalf of the division.

Representative Pearce observed that wait times should include the wait time in line, before receiving a ticket.

Mr. Delgado responded that the measurement being implemented for FY 2007 is an average customer wait time based on arrival at the point where the customer receives a ticket. A pilot program is currently in place at 4 offices with palm pilots, which provides customers a ticket upon arrival. The division feels that this will alleviate the wait time problem.

Representative Pearce alluded to an incident where a customer waited 7-½ hours for one transaction. He stated that MVD ought to be the premier example of government service, because it is most people's first contact when they come to the state. Representative Pearce recounted that a few years ago the division was facing the challenge of addressing wait times of 2 to 3 hours, without requesting additional resources from the Legislature. Over 3 million annual transactions were eliminated, Service Arizona was developed, multi-year and lifetime registrations were introduced. He questioned why 168 positions were eliminated, but there was no reduction in funding.

Mr. Delgado responded that in FY 2003, MVD experienced a high turnover rate. An effort was initiated to create and fill limited, unfunded positions, which brought the total filled positions to 866. In April 2002, the customer service representative positions were reclassified, resulting in a pay increase for existing employees, and a higher entry-level salary for new employees. That, in addition to the national recession during this period, dramatically reduced turnover. Consequently, the customer service program had a larger contingent of employees than was sustainable by the budget. In November 2002, ADOT imposed a hiring freeze, which resulted in 815 filled Customer Service Representative positions at the end of FY 2003. The program overspent its budget by $1.6 million as a result of the high staffing level. Other programs such as Competitive Government, Enforcement, Motor Carrier, and Division Operational Support Services were relied upon to fund the deficit. In 2004, the customer services budget was normalized, from $25.1 to $23.1 million for Personal Services, and has been consistent through FY 2005 and FY 2006.

Representative Pearce asked for a breakdown of the distribution of the $2 million saved due to the 168 eliminated positions.

Mr. Delgado replied that the funds were used for passenger license plates, postage, new equipment and furniture for the division. Division copiers and some computers were replaced within the division.

Representative Pearce expressed concern over using personnel funds for these purposes, without bringing it before the Committee for approval.

Mr. Delgado explained that it is common industry practice to store a 9-month supply of plates in case of a major disaster, with passenger plates accounting for 75% of all plates produced. He stated that in the time he has been with ADOT fund reallocations have taken place, but in retrospect these are issues that should have been brought before the Committee for approval.

Representative Tully asked what type of emergency would warrant the surplus, whether the plates were blank, and where they were stored. He also asked how the common practice of keeping a 9-month supply of plates was established.

Mr. Delgado cited the example of the Florence plate-producing facility being shut down due to an illness. He stated that 722,000 fully embossed plates, for a 6.8-month supply, are stored in an ADOT warehouse in the area of 19th Avenue and McDowell. A study was conducted in all states that identified an average 9-12 month supply as the benchmark.

Representative Pearce asked what MVD is doing to reduce the customer wait times.

Mr. Delgado responded that the target is to fill 825 FTE Positions. Currently, there are 751 FTE Positions filled. The goal is to decrease the wait time to 15 minutes, by the end of FY 2007.

Representative Pearce moved that the Committee give an unfavorable review of the MVD Counter Clerk Funding Shift Report, since the report does not give reasons for the funding shift.

In addition, ADOT is to provide:

1) *Further rationale as to the need to shift funding to license plates and tabs.*
2) *Clarification as to whether the MVD clerk positions were intentionally left vacant or could not be filled for other reasons.*
3) *Clarification of the total funding shift from FY 2003 to FY 2006, and the rationale for any additional funding shift above the $2 million already identified.*
4) *Estimated funding shift in FY 2007, if any, and the reasons for it.*

The motion carried.

ARIZONA BOARD OF REGENTS – Review of FY 2007 Tuition Revenue.

Ms. Leah Ruggieri, JLBC Staff, stated that the Arizona Board of Regents is requesting a favorable review from the Committee for their expenditure plan for tuition revenue amounts above the original FY 2007 budget, and all retained tuition and fee revenue expenditures for the current fiscal year. She referred to table 4 on page 3 of the memo, which shows where the $28.1 million increase in tuition revenue amounts will be expended. She explained that the increases will cover inflationary increases such as higher utility bills, hiring of faculty to improve student/faculty ratios, as well as academic and support planning priorities. No funds will go to alumni associations.

Ms. Ruggieri noted that locally retained tuitions are non-appropriated money that the universities can retain of the tuition collections. She directed the Committee's attention to table 5 on page 4 of the memo which lists, by university, the locally retained tuition and fees, and where the universities plan to expend those funds in FY 2007. She reported that locally retained tuition and fees will increase by $30.9 million above FY 2006 amounts. The majority of the increase will go toward financial aid, with $1.2 million used to pay the debt service, and $1 million to service existing facilities, with a small portion being used to pay for auxiliary services.

Mr. Michael Hunter, Assistant Executive Director for Government Affairs for the Arizona Board of Regents, introduced himself.

Representative Pearce asked whether retention rates of students who receive financial aid had improved.

Mr. Hunter responded that retention rates have improved, and offered to provide more detail, at a later date, of the successes on that subject. The Board of Regents staff is working with the universities on a financial aid report, which is provided annually to the Legislature. There have been statutory changes which require more detailed information on the breakdown of who is receiving financial aid, and what the success rate is.

Representative Pearce asked how much of the $77 million was due to tuition increases.

Mr. Hunter replied that he did not have a system-wide statement, but one for each university, broken down by the collection amount versus the locally retained amount. For example, locally retained tuition at ASU increased by $32.8 million, equal to a 22.4% increase. Of that, $10 million was attributed to higher enrollment, and $12.4 million to tuition increase.

Senator Martin mentioned that he had heard on the radio about a rally at one of the state universities regarding cost restrictions on financial aid to illegal immigrants. He inquired whether statistics were available on the growth attributed to students who are not U.S. citizens or legal residents.

Mr. Hunter stated that policy requires that, in order for students to receive in-state tuition, they must be legal residents of the state of Arizona. Students are required to check a box, on both State and Federal financial aid forms that states whether you are a legal resident or U.S. citizen. Mr. Hunter was unsure how well this information is being verified. He said the Arizona Board of Regents (ABOR) has been relying heavily on the Federal government regarding financial aid matters.

Representative Pearce said that it is against the law for illegal immigrants to receive tuition assistance or grants, and that he was concerned that people in positions of authority are not complying with the law, by checking the students' immigration status. He further stated that ABOR should ensure that compliance with both State and Federal eligibility laws are enforced.

Representative Pearce moved *that the Committee give a favorable review to the ABOR expenditure plan, with detailed information on retention rates to be provided to the Committee.* The motion carried.

DEPARTMENT OF EDUCATION - Review of Kinder Morgan Settlement.

Mr. Steve Schimpp, JLBC Staff, gave a brief background, stating that the settlement pertains to 5 counties. Yuma was the only county that had its paperwork in order to be on the agenda for the June meeting. Maricopa and Cochise Counties have submitted their paperwork, and are entitled to $1.6 million in aid, under state statute. The Committee provided a favorable review of the June request for approximately $1 million in funding for Yuma County school districts, and the Department of Education is now requesting a favorable review for Maricopa and Cochise Counties. Mr. Schimpp informed the Committee that Pima and Pinal Counties have yet to report their settlement data, and thus this topic will again be heard at a future meeting.

Representative Pearce moved *to accept the JLBC Staff recommendation to give a favorable review to provide school districts in Maricopa and Cochise Counties with $1,578,600 in corrected Basic State Aid funding.* The motion carried.

ADMINISTRATIVE OFFICE OF THE COURTS – Review of Reimbursement of Appropriated Funds.

Mr. Kevin Bates, JLBC Staff, stated that the Administrative Office of the Courts was requesting a favorable review of the expenditure of $3.6 million in reimbursements, as it complies with statutory requirements. Statute allows for reimbursements of expenditures if the agency directors finds that the reimbursements are necessary and that the reimbursements were not specifically considered and rejected by the Legislature during the agency's original appropriation. He referred to page 2 of the memo that includes a short description of each individual reimbursement and a table listing the amounts and the total.

Representative Pearce moved *to accept the JLBC Staff recommendation to give a favorable review to the Administrative Office of the Courts' request of $3.6 million in reimbursements.* The motion carried.

GOVERNMENT INFORMATION TECHNOLOGY AGENCY – Arizona Web Portal.

Mr. Tyler Palmer, JLBC Staff, reported that this item was for information only and no Committee action was required. He provided some background information, stating that the Government Information Technology Agency (GITA) manages a contract with IBM, who oversees the Arizona Web Portal, by developing web pages and manages the online transactions. He gave an example of an online transaction: The Motor Vehicle Records Request System, which is a service that allows insurance companies to purchase motor vehicle records. The payment for those records is held by IBM, who uses the money to cover their expenses, and maintenance and operation of the online portal. Any leftover funds are applied to projects approved by GITA.

In the past year, $3.2 million had accrued as excess revenue to be used for projects. GITA plans to use $2 million to purchase new servers and relocate them from the IBM warehouse in Texas to the ADOA warehouse in Phoenix. To increase legislative oversight over the expenditure of the excess revenue, the Legislature passed 2 laws during the last session. The first was a Web Portal Fund, intended to receive money from the revenues. However, since a contract already exists between GITA and IBM, the deposits will not be deposited into the Web Portal Fund until the signing of a new contract for October 2007. The remaining $1.2 million will be used for future e-government projects.

Mr. Palmer reiterated that this was for information only, and no Committee action is required. However, the JLBC Staff recommends continuing to fulfill the intent of the legislation that GITA submit a report for review on the use of the $1.2 million credit, when it is determined how it will be used.

Senator Martin asked whether the web portal was for the whole state or just the Executive Branch.

Mr. D.J. Harper, GITA, introduced himself, and responded to Senator Martin's question, saying that the web portal is available for use by the Executive, Legislative and the Judicial Branch.

Senator Martin pointed out that he regularly checks the web portal, and there is no link to the Judicial Branch.

Mr. Harper said he would ask the web master to proactively contact the chief information officers from the Legislature and Supreme Court, to make them aware that the web portal is available for postings.

Representative Pearce asked whether the credits will be deposited to the new State Web Portal Fund when the new contact is signed in 2007.

Mr. Harper answered by saying that all credits accrued under the new State Web Portal Fund will be deposited directly to the Web Portal Fund.

Representative Pearce inquired whether Mr. Harper envisioned ADOA bidding for the contract, or that it will stay in the hands of private vendors.

Mr. Harper said he could not speak for ADOA. However, on behalf of GITA, he stated that an open bid process will be available to any private sector company that wishes to participate.

Representative Pearce asked whether a Project Investment Justification (PIJ) was developed for this item.

Mr. Harper replied that no PIJ was submitted for this process, but that it was submitted to the Information Technology Committee as an agenda item. The reason for a PIJ not being submitted for this project was that it was part of an ongoing contract for services within the state. The Committee reviewed the planned expenditures and the transition plan, and gave a favorable review.

Mr. Stavneak stated that JLBC would forward a request to GITA to inform the Committee about how the $1.2 million credit will be used.

EXECUTIVE SESSION

Representative Pearce moved that the Committee go into Executive Session. The motion carried.

At 10:55 the Joint Legislative Budget Committee went into Executive Session.

Representative Pearce moved that the Committee reconvene into open session. The motion carried.

At 11:30 the Committee reconvened into open session.

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

At 11:35 the Joint Legislative Budget Committee went into Executive Session.

Representative Pearce moved that the Committee reconvene into open session. The motion carried.

At 11:40 the Committee reconvened into open session.

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

Representative Boone moved that the Committee approve the recommended settlement proposal by the Attorney General's Office and the Risk Management Department in the case of Dement v. State of Arizona, et.al.

Senator Harper requested a roll call vote on the motion.

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

The meeting adjourned at 11:43 a.m.

Respectfully submitted:

Diana Torres, Secretary

Richard Stavneak, Director

Senator Robert Burns, Chairman

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

JOINT LEGISLATIVE BUDGET COMMITTEE

Meeting Date: Sept. 21, 2006

ITEM # 2 (Executive Session)

	PRESENT	ABSENT	PASS	AYE	NAY	PRESENT	ABSENT
SEN. ARZBERGER		✓					X
SEN. BEE		✓					X
REP. BIGGS		✓					X
REP. BURTON CAHILL	✓			X			
SEN. CANNELL	✓			X			
SEN. GARCIA		✓					X
REP. GORMAN	✓				X		
SEN. HARPER	✓				X		
REP. HUFFMAN		✓					X
REP. LOPEZ	✓						X
SEN. MARTIN	✓		X	X			
REP. PEARCE	✓				X		
REP. TULLY	✓			X			
SEN. WARING		✓					X
REP. BOONE	✓			X			
SEN. BURNS	✓			X			
TOTALS	10	6		6	3		7

ITEM # ____

	PASS	AYE	NAY	PRESENT	ABSENT
SEN. ARZBERGER					
SEN. BEE					
REP. BIGGS					
REP. BURTON CAHILL					
SEN. CANNELL					
SEN. GARCIA					
REP. GORMAN					
SEN. HARPER					
REP. HUFFMAN					
REP. LOPEZ					
SEN. MARTIN					
REP. PEARCE					
REP. TULLY					
SEN. WARING					
REP. BOONE					
SEN. BURNS					
TOTALS					

Attachment 1

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2/20/2006

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

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PHOENIX, ARIZONA 85007

HOUSE OF REPRESENTATIVES

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DATE: October 17, 2006

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

THRU: Richard Stavneak, Director

FROM: Leatta McLaughlin, Fiscal Analyst

SUBJECT: JLBC Staff – Consider Approval of Index for School Facilities Board 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 (JLBC) as necessary but not less than once each year."

The SFB Staff recommends that the Committee approve an adjustment for FY 2007 based on an average of 2 Phoenix Metropolitan marketplace indices developed by a project management firm and a construction-consulting group. The SFB staff also asks the Committee to consider revisiting the inflation level again in January 2007.

Recommendation

The Committee has at least 2 options to consider:

1. Approve a 6.9% increase in the cost-per-square-foot factors based on the Committee's 2005 methodology, which was an average of national and Phoenix data. Approving this adjustment may generate $22.0 million through FY 2011 for new construction authorized in the next year. About 5% of these additional costs would be incurred in FY 2007. The adjustment would increase Building Renewal costs by $6.0 million to $11.1 million in FY 2008.

2. Approve a 12.2% increase in the cost-per-square-foot factors as requested by SFB Staff. This adjustment is based on an average of Phoenix construction costs indices developed by a project management firm and an international construction-consulting group. Approving this adjustment may generate $38.9 million through FY 2011 for new construction authorized in the next year. The adjustment would increase Building Renewal costs by $10.5 million to $19.7 million in FY 2008.

(Continued)

Table 1 lists the dollar per square foot amounts for each of the 2 options.

Table 1

Dollars per Square Foot Amounts for Each Option

	K-6	7-8	9-12
Current Amount	$116.87	$123.37	$142.85
Option 1- BEA/MVS average	$124.93	$131.88	$152.71
Option 2- PinnacleOne/Rider average	$131.13	$138.42	$160.28

SFB has the statutory authority to fund projects about these square foot amounts if a district cannot build a school within the New School Facilities (NSF) formula amount. In FY 2006, SFB funded 38% of their projects over the formula amount for a total additional funding of $20.4 million. So far in FY 2007, SFB has funded 82% of their projects over the funding amount for a total additional funding of $9.2 million, which translates into about $1 million additional funding per project.

Analysis

This section includes background information regarding the SFB inflation index, details on rising construction costs, an explanation of the options available for the current adjustment, and discussion on the SFB's guidelines for funding new school construction projects.

Background Information

The original Students FIRST legislation (Laws 1998, Chapter 1, 5^{th} 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. 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 JLBC as necessary but not less than once each year." (A.R.S. § 15-2041D.3c). 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.

Prior to 2002, the Committee used the Marshall Valuation Service (MVS) construction cost index for Class C structures (masonry bearing walls) for Phoenix. At the August 2002 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 that year, 5 school districts brought suit against the Committee, claiming the Committee had failed to perform its statutory duty under A.R.S. § 15-2041D.3c to adjust the index not less than once per year. The following year, at the September 2003 meeting, the Committee approved a 2-year adjustment. The adjustment made was based on the Bureau of Economic Analysis (BEA) index for "State and Local Government Investment - Structures." The Committee again approved the BEA index at the September 2004 meeting. At the October 2005 meeting, the Committee approved an adjustment based on a midpoint between the BEA and MVS indices, which was higher than actual prior year inflation under either index, to account for the high rate of growth in construction costs over the past few years.

For building renewal, the inflation adjustment is applied to the *formula* amount. In FY 2007 the state funded $86.3 million of the $161.5 million building renewal formula amount. An inflationary adjustment, therefore, would increase the full formula amount to at least $172.6 million (based on the average of the BEA and MVS indices) in FY 2008 prior to any other possible formula adjustments. Adjusting for inflation would not change the existing FY 2007 appropriation.

Construction Costs

The prices of aluminum, steel, and other construction commodities have risen by about 25% over the past year. Increasing costs of construction inputs are due to the surge in China's infrastructure building, the Gulf Coast hurricane season of 2005, the real estate boom, and the war in Iraq. According to the U.S.

(Continued)

Bureau of Labor Statistics, ready-mix concrete, cement, iron ore, pre-stressed concrete, plastic construction products, gypsum products, diesel fuel, copper ores, iron and steel scrap, copper base scrap, and non-ferrous pipe and lube all had average price increases of 13-116% from June 2005 to June 2006. As a result of these inflationary pressures, school districts in Arizona have been experiencing higher costs.

Even though there have been high levels of construction inflation over the last year, a recent Wall Street Journal article reports that there might be relief forthcoming in the form of falling commodity prices and slowing housing sales. Oil prices are already on the decline. For example, the Energy Information Administration reports the price of gasoline decreasing from $2.67/gallon in September 2006 to $2.27/gallon in October 2006. Petroleum, or crude oil, is a key component in asphalt and plastic, which are used to make and transport items such as cement and steel. Gypsum prices are also expected to decrease due to less residential construction.

<u>Options for the Current Adjustment</u>
The JLBC Staff has identified at least 2 possible adjustments that could be considered.

Average of BEA and MVS Indices
The BEA index for "State and Local Government Investment - Structures" for FY 2006 was 7.9%. 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.

The MVS index for "Class C - Masonry Bearing Walls" structures for Phoenix for FY 2006 was 5.9%. 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 3 stories or less. The MVS Class C index has a greater likelihood, as a single construction measurement, of year-to-year fluctuation.

The average of the BEA and MVS indices for FY 2006 is 6.9%. The total estimated new construction impact would be $22.0 million through FY 2011. This estimate is based on SFB Staff projections of $319.0 million in new construction approvals in the FY 2007 cycle.

The FY 2008 building renewal impact would be $6.0 million-$11.1 million. The low-end estimate is based on the appropriated FY 2007 revised formula amount of $86.3 million, and the high-end estimate is based on the FY 2007 existing formula amount of $161.5 million.

Average of PinnacleOne and Rider et al Indices
The SFB staff has requested the Committee approve an adjustment based on an average of 2 Phoenix market indices developed by PinnacleOne, a project management firm, and Rider Hunt Levett & Bailey, an international construction-consulting group.

The PinnacleOne index reports inflation of 13.1% for FY 2006 and is based on the cost of an elementary school in the Phoenix area. Beginning in January 2006, this index is only developed for Phoenix and is based on the cost to build a 70,000 square foot K-6 school. Input prices are updated each quarter based on conversations with their subcontractors and suppliers. Even though it measures inflation for Phoenix area elementary schools, it does not measure inflation for high schools or schools outside of the Phoenix metropolitan area.

The Rider index reports inflation of 11.27% and includes all types of Phoenix area construction. This index tracks the bid cost of construction including labor, materials, general contractor and subcontractor overhead costs and fees, and applicable sales and use taxes. Rider develops a construction costs index for 11 major U.S. cities, including Phoenix. This index also does not measure inflation outside of Phoenix.

(Continued)

The average of these 2 indices is 12.2%. The total estimated new construction and building renewal impacts would be $38.9 million and $10.5 million-$19.7 million, respectively.

See *Table 2* for an example on the differences between the current costs per square foot amount versus other options.

Table 2

K-6 Cost per Square Foot FY 2007 Options

	Cost/Sq. Foot Amount	**Difference from Current Amount**	**FY 2008 New Construction Cost ($ in M)** [1/]	**FY 2008 – FY 2011 New Construction Cost ($ in M)** [1/]	**FY 2008 Building Renewal Cost ($ in M)** [1/]
Current Amount	$116.87				
Option 1- BEA/MVS avg.	$124.93	6.9 %	$1.1	$ 22.0	$ 6.0 - 11.1
Option 2- PinnacleOne/ Rider avg.	$131.13	12.2%	1.9	38.9	10.5 - 19.7

1/ Represents costs for K-6, 7-8, and 9-12 schools.

New School Construction Funding Guidelines

SFB provides new construction funding based on the product of the following statutory NSF formula:

No. of pupils x Sq. foot per pupil x Cost per sq. foot = Allocation amount

SFB has the authority to provide additional funding above and beyond the statutory allocation amount to a district if it cannot build a school within the NSF formula amount. A district can prove they cannot build a minimum guidelines school by demonstrating they are building the least expensive school they possibly can but are still over the formula amount.

Since the enactment of Students FIRST, some of these projects have been funded above the formula with SFB monies. In FY 2006, SFB funded 38% of their projects over the formula amount for a total additional funding of $20.4 million. So far in FY 2007, SFB has funded 82% of their projects over the funding amount for a total additional funding of $9.2 million, which translates into about $1 million additional funding per project.

SFB has applied the JLBC adopted inflationary adjustment to projects that are approved subsequent to the Committee's action. As a result, projects that are approved at different times but began construction at the same time might receive different funding amounts from SFB.

Minimum School Facility Guidelines

Minimum guidelines for school facilities were developed by SFB, adopted by JCCR, and became effective in 1999. *Attachment 1* provides a summary of the individual rules for the minimum guidelines as adopted by the Committee in 1999. No significant changes related to new school construction standards have been made to the guidelines since their adoption.

Since the minimum guidelines do not provide guidance on all aspects of a new school project, the SFB Staff is developing guidelines on such issues and will bring their recommendations before their Board within the next month.

RS/LMc:ym
Attachment

Attachment 1

STATE OF ARIZONA

Joint Committee on Capital Review

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 542-5491

FAX (602) 542-1616

DATE: June 17, 1999

TO: Randall Gnant, Chairman
Members, Joint Committee on Capital Review

THRU: Richard Stavneak, Director RS

FROM: Steve Schimpp, Senior Fiscal Analyst SS

SUBJECT: PROGRESS REPORT REGARDING THE DEVELOPMENT OF SCHOOL FACILITY ADEQUACY GUIDELINES BY THE SCHOOL FACILITIES BOARD

Request

The School Facilities Board requests an opportunity to report progress in the development of school facility adequacy guidelines, as is required under A.R.S. § 15-2011.F.

Recommendation

No committee action is required.

Analysis

Our analysis will consist of an Overview and a Review of Individual Rules.

<u>Overview</u>

On June 14, 1999, the School Facilities Board adopted its final draft of rules for establishing school facility adequacy guidelines pursuant to A.R.S. § 15-2011.F. Before seeking JCCR review of those rules, however (as is required prior to their final adoption), the Board will be soliciting public input on them. After that input is received, it then will seek JCCR review of the guidelines–probably at the JCCR meeting on August 5th. Therefore at this meeting the Board seeks only to report progress in the development of the guideline rules.

A copy of the draft rules is attached. Since this is the first time that they are available in near-final form, this memo will summarize them briefly "rule by rule." We also will attempt to point out key issues that were debated during their development.

Also attached is the adopted draft list that shows "fixtures" and "equipment" that would be required under the guidelines. That list was the focus of contentious debate, with some members believing that Students FIRST did not require minimum adequacy guidelines to be developed for "soft capital" items such as science laboratory equipment. They also believed that the increased formula funding for soft capital in Students FIRST (approximately $36.5 million for FY 1999) was intended to fully address this area. The majority of Board members, however, voted

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to establish minimum guidelines for soft capital. Not including soft capital guidelines would have reduced the potential cost of the Students FIRST program, since the state would not have been required to ensure that schools have all of the items on the minimum equipment and fixture lists.

Please note that we do not have an estimate of what it would cost to implement these guidelines. This cost will depend largely upon the results of the statewide school facility inventory survey that is required by A.R.S. § 15-2002, Subsection E. That survey will determine the extent to which existing schools do not comply with the guidelines, which, in turn, will determine the long-term cost of correcting deficiencies with monies from the Deficiencies Correction Fund (A.R.S. § 15-2021). Under Students FIRST, that fund received a total appropriation of $35 million for FY 1999, and $50 million per year for FY 2000 and FY 2001.

While we do not have data with which to estimate the total cost of correcting deficiencies under the draft guidelines, anecdotal evidence suggests that key high-cost areas will include computers, libraries, lighting and air conditioning. At the last JCCR meeting, for example, it was reported that the Tucson Unified School District (TUSD) estimates that it would cost about $55 million to replace its evaporative coolers with air conditioning units–as probably would be required in order to meet the adopted classroom temperature guideline. Likewise at one of the guideline development meetings, a TUSD staff member indicated that his district currently has about 1 computer for every 16 students–half as many as would be required under the guidelines. If this ratio held true statewide, there would be a shortfall of at least 50,000 computers. At a quick assumed cost of $500 apiece, this would cost $25 million.

The guidelines also could possibly affect funding requirements from the New School Facilities Fund (A.R.S.§ 15-2041), which funds the construction of new schools. This would only be true, however, if it was determined that the funding formula for new schools in A.R.S.§ 15-2041 did not provide enough money to build schools that comply with the guidelines, and the formula was modified accordingly. Our understanding, however, is that the funding formula in A.R.S.§ 15-2041 is expected to adequately fund the construction of new, standards-compliant school buildings.

Review of Individual Rules

R7-6-101. Definitions (pages 1 & 2 of attachment)

Defines terms that require precise legal meanings elsewhere in the guidelines. Most of the definitions in this section are non-controversial, since they are defined elsewhere in statute or have a scientific basis (e.g., "foot candle"). The terms "equipment" and "fixture," however, were the focus of much discussion because they determine whether capital items are considered "soft" versus "hard" capital, since those two types of capital items are funded differently under Students FIRST.

R-7-102. Application (page 2)

Simply indicates that the rules discussed in this memo apply to the Students FIRST program.

R7-6-201. School Site (page 3)

Indicates that a school site shall have safe parking, drainage, security and an area to accommodate facilities that comply with minimum standards. Much discussion focused around how difficult it was to precisely identify minimum adequacy requirements for school sites, particularly for components such as parking and security.

R7-6-301. Academic Classroom Space (pages 3 & 4)

Sets separate standards for classroom space for various age ranges. Note that these square footage requirements pertain to *classroom* space only, affect existing schools, and are for gauging whether a school has a square footage deficiency. In contrast, the square footage allotments that appear in A.R.S. § 15-2011.C pertain to *gross* square footage (not just classroom space). Likewise they differ from the square footage requirements in A.R.S. § 15-2041.D3(b), which are simply part of the funding formula for new construction and are not minimum adequacy guidelines.

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R7-6-302. Classroom Fixtures and Equipment (page 4)

Requires a work surface and seat for each pupil in a classroom, and that the work surface and seat be appropriate for the normal activity in the classroom. Also requires an erasable surface, projection surface, group instruction surface and display surface (one surface may serve multiple purposes). Requires adequate storage for classroom materials or access to conveniently located storage. Requires work surface and seat for each teacher and aide and secure storage for student records.

Some board members wanted to define minimum size requirements for instructional surfaces (e.g., "dry erase boards"), but others indicated that this should be a local decision.

R7-6-303. Classroom Lighting (page 4)

Requires at least 50 foot-candles of light in general, science and art classrooms. This standard underwent considerable debate on numerous occasions, with some members believing that current schools with much lower lighting levels are adequate. Based on these discussions it would appear that this standard would require extensive lighting modifications in the state if adopted, and will have substantial cost implications.

R7-6-304. Classroom Temperature (page 4)

Requires that each general, science and art classroom be able to maintain a temperature between 68 and 82 degrees Fahrenheit during 95% of classroom time. This standard likewise was the subject of much debate, with members realizing that this standard could be one of the most costly to comply with due to the extensive use of evaporative coolers in Tucson. It is anticipated that most Tucson schools will have to convert to air conditioning in order to meet this standard.

R7-6-305. Classroom Acoustics (page 5)

Requires that each general, science and art classroom be able to maintain a sustained background sound level of less than 55 decibels.

R7-6-306. Classroom Air Quality (page 5)

Requires that each classroom have a HVAC system capable of maintaining a CO_2 level of not more than 800 PPM above the ambient CO_2 level.

R7-6-321. Facilities for Disabled Students (page 6)

Simply requires that a school facility have space or access to space capable of being used for the education programs of disabled students attending the school facility.

R7-6-401. Libraries and Media Centers/Research Area (page 6)

Establishes minimum library space square footage requirements for schools that have at least 150 pupils. The minimum for elementary schools is the greater of 1,000 square feet or 20 square feet per pupil for 10% of the student population. The minimum for high schools is the greater of 1,200 square feet or 20 square feet per pupil for 10% of the student population. Also requires fixtures, equipment and materials in accordance with a list adopted by the Board (attached).

There was considerable discussion regarding the changing nature of libraries because of computers. The minimum square footage requirements listed above were increased from originally proposed levels after Board members concluded that the original levels were inadequate.

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R7-6-501. Cafeterias (page 6)

Requires a school facility to have an area or space to permit students to eat within the site, outside of general classrooms.

R7-6-511. Food Service (page 6)

Requires a school facility to have space, appropriate fixtures and equipment for the preparation, receipt, storage, and service of food to students that is accessible to the serving area. Requires food service facilities and equipment to comply with county health codes. Considerable discussion occurred regarding the fact that many schools contract out their food preparation and therefore do not need food preparation resources.

R7-6-601. Auditoriums, Multipurpose Rooms, or Other Multi-Use Space (p.7)

Requires a school facility to have a space capable of being used for student assembly sufficient to accommodate at least 1/3 of the student body.

R7-6-701. Technology (page 7)

Requires the following: 1) at least 1 multimedia computer for every 8 students, 2) an Internet connection (at least by modem) for each classroom, and 3) a local area network [LAN] in each school. Also requires technology equipment to meet generic assessment criteria defined in R7-6-1201 (discussed below).

This standard generated much debate and was developed in consultation with technology specialists. Much of the discussion revolved around whether to require "rewiring" of older facilities for Internet connectivity, and whether that cost would be worthwhile. It should be noted requiring a LAN at each school has implications for operating budgets, since personnel will be needed at each school in order to maintain the LAN on a day-to-day basis.

R7-6-801. Transportation (page 7)

Requires replacement of all buses manufactured before 1978 (after which higher federal safety standards applied). Requires replacement of diesel buses with more than 400,000 miles and gas buses with more than 200,000 miles. These mileage thresholds are reduced by 1/3rd if at least ½ of the miles were on unimproved roads.

No standard is provided for providing buses due to enrollment increases, and one Board member indicated that this was a key area for further public input.

R7-6-901. Science Facilities (page 8)

For Grades 5 through 12, requires classroom space for practical science instruction or for an alternate science delivery method. For practical science instruction, requires science fixtures and equipment that are on the attached Board-adopted list (e.g., one compound microscope for every 25 students).

R7-6-911. Arts Facilities (page 8)

For Grades 7 through 12, requires space to deliver art education programs including visual, music and performing arts or have access to an alternate delivery method.

R7-6-921. Vocational Education Facilities (page 8)

For Grades 7 through 12, requires space to deliver vocational education programs or have access to an alternative delivery method.

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R7-6-931. Physical Education and Comprehensive Health Program Facilities (page 8)

For Physical Education, requires area, space and fixtures that are on the attached Board-adopted list (e.g., "basketball–one court size surfaced area and 2 goals per 300 students). For Comprehensive Health Programs, requires space only.

R7-6-941. Alternate Delivery Method (page 8)

Requires the local school board to approve any alternate delivery method for art, science or vocational education instruction. Also requires that the alternative method be capable of meeting requirements established in state academic standards for that subject area.

R7-6-1001. Parent WorkSpace (page 9)

Requires a workspace capable of being used by parents if parents are invited to assist with school activities.

R7-6-1002. 2-Way Internal Communication System (page 9)

Requires each school to have a network and 2-way internal communication system between a central location and each classroom and the cafeteria. (During debate, some members opined that the wiring needed to meet this standard also could be used to provide each classroom with access to the Internet, as is required under R-6-701. This seems to assume that phone lines would be used for 2-way internal communication, rather than wiring for simple public address systems.)

R7-6-1003. Fire Alarm (page 9)

Requires a fire alarm system in each school.

R7-6-1004. Administrative Space (page 9)

Requires each school to have space capable of being used for 1) administration, 2) isolation of sick students, and 3) faculty work space.

R7-6-1101. Building Codes (page 9)

Requires school buildings to be in compliance with federal, state and local building and fire codes. Does not require that older buildings be brought up to current standards unless mandated by other laws. Sets the 1997 Uniform Building Code (UBC) as the minimum standard for new school construction.

R7-6-1201. Building Systems (pages 9 &10)

Sets the following adequacy guidelines for building systems:
- capable of being operated as intended and maintained
- newly manufactured or refurbished replacement parts are available
- remaining life expectancy of at least 3 years at time of assessment
- capable of supporting gross square footage and minimum facility standards
- components present no imminent danger of personal injury

States that buildings must include a roof, plumbing, telephone, electrical and heating and cooling systems as well as fire alarm, 2-way internal communication, computer cabling, and existing security systems.

Note that some of the bulleted guidelines above also apply to areas such as technology and food service.

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R7-6-1301. Building Structural Soundness (page 10)

Sets the following adequacy guidelines for building structural soundness:
- remaining life expectancy of at least 3 years at time of initial assessment
- capable of supporting the required building systems
- components present no imminent danger of personal injury

R7-6-1302. Exterior Enveloped, Interior Surfaces and Interior Finishes (page 10)

Requires that the exterior envelope, interior surfaces and interior finishes be safe and capable of being maintained.

R7-6-1401. Minimum Gross Square Footage (pages 10 and 11)

Each school shall meet gross square footage requirements established in A.R.S. § 15-2011.C.

(Note that these are *gross* square footage requirements and not *classroom* square footage requirements as defined in R7-6-301. Likewise they are different from the square footage amounts referred to in A.R.S. § 15-2041.D3(b), which pertain only to the funding formula for new school construction.)

R7-6-1402. Assessment of Minimum Gross Square Footage (page 11)

Sets parameters for assessing whether a school has a minimum gross square footage deficiency.

R7-6-1501. Notice of Interim Health of Safety Issues During Assessment Period (page 11)

Allows a school district to apply for emergency deficiencies correction funding to correct a critical health or safety problem prior to completion of the initial statewide assessment of school facilities.

R7-6-1601. Guidelines Exception (page 11)

Allows the Board to grant an exception from guidelines upon agreement between the Board and a school district, but only if the Board determines that the guideline can be met in an alternate manner.

RS/SS:ag
Attachments

STATE OF ARIZONA
SCHOOL FACILITIES BOARD

Governor of Arizona
Janet Napolitano

Executive Director
William Bell

RECEIVED
SEP 12 2006
JOINT BUDGET COMMITTEE

September 8, 2006

The Honorable Russell Pearce
Chairman
Joint Legislative Budget Committee
1716 West Adams
Phoenix, Arizona 85007

Dear Representative Pearce,

A.R.S. 15-2041, section 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."

For FY 2007, SFB staff is requesting the committee adjust the formula by 12.18 percent. This number was derived from two indexes developed specifically for the Phoenix market. The project management firm PinnacleOne developed the first index. This index is based on the cost of an elementary school in the Phoenix metropolitan market and reports FY 2006 inflation at 13.1 percent. The second index was developed by Rider Hunt Levett & Bailey an international construction-consulting group. This index includes all types of construction and sets inflation at 11.27 percent. The recommended number of 12.18 percent is the average of these two indexes.

In recent years, SFB staff has recommended relying on the Marshall Swift index. However, for FY 2006 the Swift index is dramatically out of line with other indexes and SFB staff's experience. Swift sets inflation for the July 2005 to July 2006 period at only 5.9 percent including one quarter that shows *deflation*. SFB staff does not believe that an adjustment based on this index will provide the resources necessary to build a minimum guidelines school in the future Arizona marketplace. Based on these factors, SFB staff recommends the committee no longer use the Marshall Swift index.

Table one shows the impact on the cost per square foot of the recommended increase.

Table One

Grade Level	Current Amount	Adjusted Amount
K-6	116.87	$131.10
7-8	123.37	$138.40
9-12	142.85	$160.25

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In addition to the current increase, SFB staff also recommends that the Committee review the inflation levels in January 2007. The current action before the committee will update the costs per square foot to July 2006 levels. However, the SFB will award the majority of the projects subject to this cost per square foot after January 2007. Therefore the new construction projects are subject to at least six months of inflation that is unaccounted for in the established cost per square foot. In seasons of extreme inflation, this will dramatically impact the buying power of the formula.

Fiscal Impacts

The increase will affect both the building renewal and new construction programs. The new construction impact is calculated by multiplying the projected FY 2007 awards by the recommended rate. The conceptual plan adopted in FY 2006 suggests that the SFB will award approximately $425 million in new construction in FY 2007. However, this projection was made before the current slow down in the housing market. Based on this more current information, SFB staff would recommend reducing the conceptual number by 25% to $319 million.

Based on $319 million in projected awards, the total fiscal impact of the inflation adjustment would be $38.9 million. This impact will be spread across fiscal years 2007 through 2011. The FY 2007 impact would be 5 percent of the total amount or $1.9 million.

For building renewal, there is no FY 2007 impact. However the estimated FY 2008 impact to the building renewal formula is approximately $25.6 million.

If you or your staff have any questions regarding this letter, please contact me.

Sincerely,

John Arnold

CC
Richard Stavneak
Gary Yaquinto
Becky Hill
George Cunningham

DATE: October 18, 2006

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

THRU: Richard Stavneak, Director

FROM: Bob Hull, Principal Research/Fiscal Analyst

SUBJECT: Department of Revenue – Review of Business Reengineering/Integrated Tax System Contract Amendment

Request

The Department of Revenue (DOR) requests review of its Business Reengineering/Integrated Tax System (BRITS) proposed contract amendment. Laws 2006, Chapter 350, requires DOR to submit for Committee review any BRITS contract extensions or modifications that change the dollar value of the contract.

Summary

DOR hired a contractor (Accenture) in September 2002 to enhance the automation of its revenue collection process. The contractor is paid through a gain-sharing arrangement. Under gain-sharing, the contractor receives 85% of the increased enforcement revenue attributed to BRITS, and 15% goes to the state. The current cost of BRITS is $136.7 million, including $129.7 million for the original contract and $7 million for 2 previous contract amendments. The project is 2 years behind schedule. Due to a misunderstanding, DOR had thought that the project would be completed for a firm fixed price, since it had been described as a fixed price contract during the contracting process. The Arizona Department of Administration (ADOA) has clarified that fixed price contracts can increase in cost under certain circumstances.

Due to delays in the earlier part of the project, DOR is now seeking a $14.8 million contract amendment to finish converting individual income tax collections to BRITS. The $14.8 million cost would result in foregone revenue of $12.6 million to the General Fund, $1.7 million to cities and counties, and $500,000 to Proposition 301 education programs. In addition to the $14.8 million, the contractor will pay $4.25 million to finish the contract.

DOR and the contractor reached an agreement on their respective share of the costs after a series of negotiations. While DOR has provided an outline of their cost sharing agreement, there has been no

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independent assessment of responsibility between DOR and the contractor for the earlier project delays. DOR did not ask the Government Information Technology Agency (GITA) to participate in the contractor negotiations.

The $14.8 million amendment will not cover all of the original components of the BRITS project, which included document imaging and "customer relationship management". These components have not been started, and may cost at least another $10 million. The "customer relationship management" component has not been well defined, which leads to further uncertainty about future costs.

DOR has rejected the option of stopping the project at this point. Given that 2 main tax categories have already been converted, the department believes that there are potential gains to both customer service and enforcement from having the individual income tax on the system as well.

Overall, the project could eventually cost at least $161.5 million, or 24.6% more than originally projected. To date, DOR says that BRITS has generated more additional revenue than was projected, or $182.3 million. It is difficult to confirm the amount of enforcement revenues generated by BRITS versus other causes. Only $37.1 million of the $182.3 million can be traced to specific taxpayers who were discovered by BRITS. The remaining $145.2 million attributed to BRITS is enforcement revenue which exceeds baseline amounts agreed to by DOR and the contractor. It is also unclear to what extent the improved economy may have contributed to the revenue increases which have been attributed to BRITS.

In general, DOR and GITA do not appear to have sufficiently communicated on this project. GITA does not have sufficient information to comment on the reasonableness of the $14.8 million contract amendment's revised timeline and cost. GITA has no basis to evaluate the division of cost between DOR and the contractor for the transaction privilege tax delays. In its "green-yellow-red" project status report, GITA continues to show BRITS with a "green" status. We have asked GITA for their perspective on this ranking, given the project's problems.

Beyond the cost of the contract amendment, DOR has begun to identify costs of taking over the project from the contractor in 2008 and beyond. The department estimates that they will need $6.2 million in FY 2008, and $2.2 million in FY 2009.

Recommendation

The Committee has at least the following 2 options:

1) A favorable review, since as required, the submittal provides information on the proposed contract amendment. The project has generated more revenue than anticipated.

2) An unfavorable review, since the BRITS project is over both budget and time. There is no independent basis to determine whether the vendor is being held appropriately accountable.

Under either option, the JLBC Staff suggests that the Committee consider adopting the following recommendations:

1) DOR/GITA provide joint monthly status reports to JLBC and Office of Strategic Planning and Budgeting (OSPB) Staff on the project until its conclusion, including reports from the project's outside oversight consultant.

2) DOR not pursue contract amendments for the document imaging and "customer relationship management" components until the individual income tax is implemented. This delay would give the Legislature time to consider in the 2007 session the value of these components. To assist in this

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evaluation, DOR should submit detailed rationale for these last 2 components to the JLBC by January 31, 2007.

3) ITAC report by December 31, 2006 to the JLBC as to improving general procedures for ensuring that all agencies keep them apprised of high dollar value contract changes to automation projects, and GITA's efforts to ensure that they provide sufficient monitoring.

4) JLBC Staff with DOR and OSPB jointly convene an outside panel to evaluate the BRITS baseline calculation and provide feedback regarding the effects of automation versus an improving economy on the increased level of collections. We would report on the results by November 30, 2006.

5) The Arizona Department of Administration (ADOA) report to the JLBC by November 30, 2006 as to steps to improve agencies' understanding of contract provisions.

Analysis

<u>Background</u>

A.R.S. § 41-2559 allows an agency to contract with a vendor to finance technology projects without receiving a legislative appropriation for the project. The vendor is paid based on a gain-sharing agreement from a portion of the increased revenues, which are computed according to established performance standards and attributed to the project above agreed upon baseline revenues. Before awarding the contract, the agency must consult the Joint Legislative Budget Committee (JLBC) Staff regarding the contract's potential fiscal impact on the state. If JLBC Staff finds a significant negative impact to the state, the Staff must report its findings to the Committee.

BRITS is the computer system being implemented by the DOR to further automate and integrate their separate tax systems, including the transaction privilege tax, and corporate and individual income taxes. BRITS was designed to improve enforcement and ultimately increase revenues to the state.

BRITS is being paid for through a gain-sharing arrangement, which pays the vendor 85% of tax enforcement revenues above an established baseline amount until the project is paid for. The state receives the remaining 15%. Enforcement revenue represents collections received through the tax audit and collection processes. The actual baselines were negotiated between DOR and the vendor, with input from consultants, and are subject to modification to account for legislative changes which would affect the baselines.

Delays have increased both the cost and completion timeline of BRITS. The cost has increased from $129.7 million for the original contract to $136.7 million due to project delays and previous contract amendments, as shown in *Table 1*. In February 2006, DOR belatedly signed a $6,586,000 contract amendment for the contractor to operate the BRITS data center for 4 years from October 1, 2003 through September 30, 2007. Operating the BRITS data center had been an additional cost option in the original contract, which DOR chose on its own to implement. The contract amendment allowed DOR to use additional General Fund resources on this project without a legislative appropriation.

The BRITS project is running behind its original schedule of taking 4 years to complete, from September 2002 through August 2006. This is due to problems and ensuing delays following the conversion of the transaction privilege tax to BRITS. The project was 2 years behind schedule in converting corporate income tax, as shown in *Table 2*. The individual income tax conversion has been delayed from September 2006 to February 2008. DOR has postponed implementing 2 other key deliverables, "customer relationship management" and document imaging, and expects to report on their estimated additional costs and timeframes sometime before February 2008.

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Table 1

Current Estimate of BRITS Costs

	Timeframe	**Cost**
Base contract	9/02 - 8/06	$122,664,700
Estimated Interest	9/02 - 8/06	7,000,000
Subtotal Original Contract		$129,664,700
Previous Amendments		
Operate BRITS Data Center	10/03 - 9/07	$6,586,000
Corporate Scope Changes		422,300
Subtotal Previous Amendments		$7,008,300
Current Total [1/]		**$136,673,000**
Proposed Amendment		
Contractor Support (one-time)	9/06 - 2/08	$8,412,200
Temporary DOR Staff (one-time)	9/06 - 2/08	2,080,000
Operation and Support (ongoing)	9/06 - 8/07	4,365,000
Subtotal Proposed Amendment		$14,857,200
Total With Proposed Amendment [1/]		**$151,530,200**
Document Imaging/Customer Mgmt [2/]		$10,000,000
Total With Future Amendment [1/]		**$161,530,200**

1/ In addition, Laws 2006, Chapter 350, provides $1,200,000 from the General Fund in FY 2007 to DOR for operational support of BRITS. The $1,200,000 includes $800,000 for disk storage and equipment costs and $400,000 for server and printer replacement costs.

2/ Our estimate for the cost of project support is at least $10 million. The cost of a contract amendment for these 2 key deliverables is yet to be determined.

Table 2

BRITS Completion Timeline

	Original Projection	**Revised Projection**	**Conversion**
Transaction Privilege Tax	1/04		1/04
Withholding	1/04		10/04
Corporate Income Tax	9/04	7/06	9/06
Customer Relationship Management	9/05	To Be Determined	
Document Imaging	3/06	To Be Determined	
Individual Income Tax	9/06	2/08	

(Continued)

The proposed $14.8 million contract amendment to finish converting individual income tax collections would raise the current total cost to $151.5 million. This future contract amendment for document imaging and "customer relationship management" could raise the cost to at least $161.5 million, or 24.6% more than originally projected.

Auditor General Report and Legislative Action

An Auditor General performance audit issued in October 2005 concluded that DOR needed to better manage the BRITS project, including hiring an outside expert oversight advisor to monitor the project as called for in the original contract and involving more DOR information technology staff with the project. DOR reports that they hired an outside oversight consultant in March 2006. In June 2006, the Auditor General reported in their 6-month follow-up that their recommendations are in the process of being implemented. The Auditor General expects that their 12-month follow-up will be issued sometime after October 2006.

Due to the project's delays, Laws 2006, Chapter 346, included session law requiring legislative authorization prior to executing any future BRITS contract extensions or modifications that increase the contractor's share of gain-sharing proceeds from state revenues. However, Laws 2006, Chapter 350, also enacted session law authorizing DOR to execute extensions or modifications of the current BRITS contract in FY 2007, if DOR submits for JLBC review any contract extensions or modifications that change the dollar value of the contract. This is the basis for the Committee review of DOR's proposed $14,857,200 contract amendment.

Revised Project Scope

DOR wants the contract amendment since they used more resources than planned for both transaction privilege tax delays and corporate income tax scope changes. The contract amendment includes $8,412,200 for contractor support for implementation delays, $2,080,000 for temporary DOR backfill staff, and $4,365,000 for contractor operation and support of BRITS. These items are described as follows:

- The $8,412,200 is the cost to finish converting individual income tax collections to BRITS. This amount is due to overspending original contract monies on previous conversions and increased testing for the individual income tax conversion. The $8,412,200 includes $3,382,000 for DOR's 44% share of transaction privilege tax delays, $250,000 for DOR's 2-month corporate income tax acceptance testing delay, and $4,780,200 for 6 additional months of testing for the individual income tax conversion. DOR and the contractor reached a negotiated agreement that DOR was 44% responsible and the contractor was 56% responsible for problems with the transaction privilege tax conversion. The $3,382,000 represents the cost for DOR's 44% of responsibility for transaction privilege tax delays. In addition, the vendor will absorb $4,252,000 of costs for their 56% of responsibility. Please see *Attachment A* for DOR's response to JLBC Staff questions, including their description of how they and the contractor arrived at the 44%/56% split of responsibility. It is difficult to assess the percentage shares, due to a lack of information. GITA has not evaluated the reasonableness of the 44%/56% split.

- The $2,080,000 is the cost of DOR's temporary staff used to check the quality of legacy system data and resolve data problems before converting individual income tax to BRITS.

- The $4,365,000 represents the 1-year cost for the contractor to support the new software used by BRITS. Before BRITS, DOR had mainly legacy mainframe systems. The BRITS project has introduced new technologies and software. DOR states that they will need to train their information technology personnel and hire additional staff to support BRITS in the future, including database

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administrators, system designers, programmers, technical architects, and server administrators. DOR is now beginning an assessment to identify the number of staff and skill levels needed to operate and maintain BRITS. DOR has not yet requested funding for this issue in their FY 2008 budget request. The department states that they expect to submit the budget issue before the Committee meeting.

DOR reports that if the BRITS project were stopped now, they would have the cost of continuing to run and maintain both the legacy and BRITS computer systems. Currently the transactions privilege tax and corporate income tax have been converted to BRITS, and the individual income tax is still running on the legacy system. In addition, DOR would not receive the full benefit of increased enforcement revenue and customer service from having all 3 taxes running on the BRITS database.

From the beginning of the BRITS project, DOR has reported that the BRITS contract was a firm, fixed price contract, which the contractor was obliged to complete for the stated price regardless of the timeframe. DOR now reports that they misunderstood the meaning of a fixed price contract. The Arizona Department of Administration (ADOA) has provided an explanation that a fixed price contract may be adjusted for changes in the work or conditions under which the contract was awarded. BRITS is a task order-based contract which will cost more to extend the timeline. Please see *Attachment B* for ADOA's complete response.

In addition to the proposed $14,857,200 contract amendment to finish converting individual income tax collections, DOR has also delayed implementing 2 additional key deliverables of the original BRITS contract, "customer relationship management" and document imaging. BRITS' "customer relationship management" component is intended to provide customers with a good experience when interacting with DOR, including accurate and timely processing and a single point of contact. Document imaging is intended to improve DOR's processing of paper documents by such means as capturing and viewing images from BRITS, automating data capture, automated fax receipt, and remittance processing. The cost of project support for these 2 key deliverables could be at least $10 million. DOR reports that they do not yet have either a cost or timeframe for implementing these 2 key deliverables. DOR states that they will develop and provide this information while working on the individual income tax conversion.

GITA's Perspective

We asked the Government Information Technology Agency (GITA) for their perspective on the status of BRITS. Please see *Attachment C* for GITA's complete response. GITA reports that the DOR director met with the GITA director on September 6, 2006 to discuss BRITS issues. The GITA director recommended that DOR get the BRITS Oversight Committee more involved. The BRITS Oversight Committee includes mostly DOR staff, an Information Technology Authorization Committee (ITAC) representative, a GITA representative, and some county and city representatives.

In general, GITA and DOR do not appear to have sufficiently communicated on this project. GITA does not have enough information to comment on the reasonableness of the $14.8 million contract amendment's revised timeline and cost. GITA has no basis to evaluate the 44%/56% division of cost between DOR and the contractor for the transaction privilege tax delays. GITA is also concerned that DOR has not provided GITA with their staffing plan for ongoing BRITS support upon completion of the project, which could contribute to future cost overruns and implementation delays. GITA has asked DOR to provide monthly updates to ITAC to improve DOR's communication regarding BRITS.

GITA cites the success of BRITS in producing $182 million of revenue, and reports that the BRITS project has a "green" status. GITA defines a green status project as being on schedule, within budget and having clear deliverables, a project plan and status report.

(Continued)

BRITS Revenue

DOR reports that $182,289,000 of total increased revenue through August 2006 has been attributed to the BRITS project, including $37,061,500 from discovery and $145,227,500 from efficiency. Discovery revenue is money from nonfilers and unlicensed businesses or collections identified by BRITS' automated taxpayer identification programs. Discovery revenue can be traced to specific taxpayers. Efficiency revenue is all enforcement revenue which results from BRITS process or program changes other than discovery revenue. Efficiency revenue is measured against baseline dollar amounts which are based on complex baseline calculations, and were negotiated between DOR and the vendor. The baselines are subject to modification to account for legislative changes which would affect the baselines. It is unclear to what extent the improved economy may have contributed to the revenue increases which have been attributed to BRITS.

BRITS' $182,289,000 of total revenue includes $154,945,600, or 85% of the total, which is available to pay the vendor. The $154,945,600 available to pay the vendor exceeds the $151,530,200 total cost of the original contract, prior amendments, and the proposed $14,857,200 amendment by $3,415,400.

RS/BH:ym
Attachments (3)

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

Janet Napolitano
Governor

Gale Garriott
Director

RECEIVED
OCT 06 2006
JOINT BUDGET COMMITTEE

October 5, 2006

Richard Stavneak, Director
Joint Legislative Budget Committee
1716 West Adams
Phoenix, Arizona 85007

Dear Mr. Stavneak:

Thank you for your letter on September 22, 2006, wherein you asked ten questions in preparation for the upcoming JLBC meeting on the Department's Business Reengineering/Integrated Tax System (BRITS). Attached to this letter are the Department's responses to your questions.

We greatly appreciate receiving these questions in advance of the committee meeting. The Department continues to welcome the opportunity to communicate the advancements of BRITS and having these questions in advance enhances the Department's ability to accurately address JLBC's and the Legislature's questions.

After reviewing these responses, if you have any further or follow-up questions, please contact Kristine Ward (716-6934).

Sincerely,

Gale Garriott

Gale Garriott
Director – Arizona Department of Revenue

Responses to JLBC Questions – BRITS Amendment

JLBC Question #1

DOR has reported from the beginning of the BRITS project that the contract was a firm, fixed price contract and the vendor would complete the project for that price. Now DOR reports that the cost of the BRITS contract will have to be increased in order to complete the BRITS project. How did this misunderstanding come about and how can it be avoided in the future? As part of your explanation, we would like to understand the role of the state procurement office relative to DOR in the initial contract negotiation.

Question # 1 Response

DOR understood the BRITS contract to be fixed price, but did not fully understand all the conditions under which the contract cost could change. DOR had assumed that regardless of the timeframe of the project (i.e. if the project exceeded the originally proposed 4 years), the cost would remain fixed as long as there were no additional requirements over and above those in the RFP. However, during the EPS-led negotiations with Accenture, EPS clarified the nature of the contract. The explanation below, provided by EPS, further explains the nature of the contract:

Contract AD010133-003 for the BRITS project was negotiated by the State Procurement Office as a Firm-Fixed-Price contract for $122.65 million plus contingencies for additional support, data center and interest. The Contract provided for award of tasks or releases at the discretion of DOR.

The Federal Acquisition Regulation (FAR) is often consulted by state and local government for procurement guidance. A Firm-Fixed-Price (FFP) contract is defined in the FAR as "A type of contract providing for a price that is not subject to adjustment on the basis of the contractor's cost experience in performing the contract." A contract that is subject to change based on the contractor's cost is called a Cost-Plus Contract. According to the FAR, FFP contracts are generally subject to adjustment in accordance with contract clauses providing for equitable adjustments or price adjustments. This means that FFP contracts may be adjusted for changes in the work or conditions under which the contract was awarded.

It is not practical or even possible to award a contract for something as complex as the BRITS project without allowance for change. Like construction contracts, complex business projects seldom are completed for the exact price that was awarded. The process for changing government contracts is supported in laws and regulations. A.R.S. 41-2552 permits contract change orders and the BRITS contract contains a clause that permits contract modifications. The BRITS Contract changes are necessary, allowable under the law and contract and were negotiated for a fair and reasonable price.

As stated above, work on the BRITS contract is authorized by execution of task orders that are a fixed price agreement to provide a fixed scope of work. The scope of Accenture's originally proposed BRITS Project Support Activities (Application Support, Technical Support, Change Management, and Project Management) was to provide services for a 4-year period for a fixed price. Now that the project duration has exceeded the 4-year period, additional costs will be incurred.

JLBC Question #2

The $3,382,000 for the proposed one-year extension assumes that DOR was 44% responsible for the problems and the vendor was 56% responsible. We understand that DOR and the vendor jointly arrived at these percentages shares, but we would like a better understanding of the derivation of the percentages.

Question # 2 Response

During the negotiations with Accenture, each of the project support activities (Application Support, Technical Support, Change Management, and Project Management) was classified as to the amount each party (DOR or Accenture) should bear for the one-year extension. The final percentages were a result of the aggregate costs for each party. The starting point for the negotiations was an estimate supplied by Accenture, which were adjusted down during the negotiations, before the following cost sharing calculation was applied.

The cost sharing was determined as follows:

- *75% DOR, 25% Accenture.* Responsibility for the additional cost is shared, but the majority of the cost falls to DOR. This classification was applied to Application Support, because DOR did receive value from the services provided by Accenture to operate the production BRITS systems after implementation. Despite the problems with Release 1, the Application Support Team did work to keep the system operating for DOR. The magnitude of activies was related to the quality of Release 1, so Accenture was asked to bear 25% of the costs of an additional year of Application Support activities.
- *75% Accenture, 25% DOR.* Responsibility for the additional cost is shared, but the majority of the cost falls to Accenture. This classification was applied to Change Management and Technical Support. The majority of activities in both Change Management and Technical Support after Release 1 should have been Release 2 training, documentation, and technical setup. Due to the issues with Release 1, activities on Release 2 were delayed, and therefore DOR did not receive significant value from the costs generated from Change Management and Technical Support following Release 1. Accenture was asked to bear 75% of the costs of an additional year of both Change Management and Technical Support activities.
- *50% DOR, 50% Accenture.* Responsibility for the additional cost is shared equally between DOR and Accenture. This classification was applied to Project Management. Project Management issues leading up to, and following Release 1 led DOR to request that Accenture bear 50% of the cost of an additional year of Project Management. DOR and Accenture both share responsibility for the Project Management issues, and steps have been taken by both organizations to address the Project Management issues.

JLBC Question #3

Is the vendor solely responsible for their 56% share, or is that cost borne by the state in some fashion?

Question # 3 Response

Accenture is solely responsible for their 56% share of the cost of the 12-month extension. The State's share of the 12-month extension for Project Support Activities is the 44% share ($3,382,000) identified in the BRITS Contract Amendment Summary document.

JLBC Question #4

Is the proposed 6-month extension (costing $4,780,200) the result of more testing than was envisioned in the original contract?

Question # 4 Response

The original contract did not identify a specific amount of testing to be performed by DOR. However, yes, the lack of sufficient User Acceptance testing during Release 1 was identified by both DOR and the Auditor General's office as a key contributing factor to the problems experienced after the implementation of Release 1. As part of Release 2, additional testing was scheduled, but DOR resource constraints led to the need to delay implementation from July 1, 2006 to September 5, 2006. Resource constraints were experienced by each of DOR's divisions involved with the BRITS project because of the limited number of qualified resources who were asked to participate in (1) executing Release 2 User Testing, (2) providing Release 2 training to DOR staff,

(3) providing requirements definition for Release 3, while still maintaining responsibilities for day-to-day operation of DOR.

Completing an adequate level of testing using qualified resources was one of the key factors of the success of BRITS Release 2. DOR has now factored in resource constraints to set a more realistic schedule for BRITS Release 3 where the highest volume tax type – individual income tax – will be implemented.

JLBC Question #5

The proposed extension assumes $2,080,000 will be used to backfill DOR's operating budget. How much, if any, does any other part of the proposed extension backfill DOR costs? How much of the original BRITS contract by year has been used to backfill the operating budget?

Question # 5 Response

The amendment for the $2,080,000 portion of the contract amendment is not to backfill DOR's operating budget. The backfill dollars are to pay for resources necessary to implement BRITS. If the Department was not implementing BRITS, these dollars would not be necessary. Key project related activities to be performed by these temporary resources include purification of data in legacy systems and resolution of rejected legacy system transactions (e.g. tax returns) to prepare the data for conversion into BRITS. Without these temporary resources, these mandatory activities would fall to existing, already constrained, DOR resources. No funding has ever been used to supplant DOR's annual appropriations (operating budgets).

JLBC Question #6

The proposed extension includes $4,365,000 for the vendor's programming support through August 2007 until DOR can provide the appropriate technical support. How much will it cost DOR to provide this support in FY 2008 and subsequent years and is any of that funding available in the current budget?

Question # 6 Response

There are a number of possible approaches to meeting the Department's technical support needs. The approach that the Department is currently finalizing as a budget request is a mix of internal support and consultant support. In FY2008, the Department anticipates needing a vendor to provide 95% of its technical support needs. Current estimates are that total costs for that level of support for both consultants and internal staff will be between $7 million - $8 million, of which the Department's current budget provides $1.3 million. In FY2009, the Department's goal is to provide 70% of the technical support needs internally and 30% through consultant services. Current cost estimates for FY2009 are estimated to be between $3 million - $4 million, of which $1.3 million is currently in the Department's FY2007 budget. The Department anticipates having the analysis complete and the budget issue submitted prior to the JLBC meeting.

JLBC Question #7

How much, if any, of the $2,189,300 requested for BRITS software licenses in FY 2007 is included in the proposed extension?

Question # 7 Response

There are no software license costs included in this contract amendment.

JLBC Question #8

How much of the total $14,857,200 proposed cost would come from General Fund revenue and how much would come from revenue distributed to political subdivisions?

Question # 8 Response

Since the payments to Accenture total $14,857,200 (at 85%), there will need to be $17,479,059 in benefits (at 100%).

- General Fund portion is $14,783,788, with $2,217,568 staying with the general fund and $12,566,220 going to Accenture
- Counties/Cities portion is $2,071,268 with $310,690 staying with the cities/counties and $1,760,578 going to Accenture.
- Education portion is $624,002 with $93,600 staying with Education and $530,402 going to Accenture.

JLBC Question #9

What is the cost of the original contract for each of the following individual components (transaction privilege tax, withholding tax, corporate income tax, individual income tax, customer relationship management, and document imaging)? What are your estimates now?

Question # 9 Response

The costs for the individual components are as follows (does not include Project Support Activities as they apply to the whole BRITS project, not to an individual component):

Component	Original Cost	Current Estimate	Notes
Transaction Privilege Tax	$14,619,846	$13,833,676	Release 1 completed. No additional implementation costs.
Withholding Tax	Costs combined with Transaction Privilege Tax – BRITS Release 1		
Corporate Income Tax	$6,916,092	$6,916,092 + $449,350[1] - $37,000[2] $7,328,442	[1] Design, development, testing, and implementation of 13 additional requirements approved by DOR Steering Committee and executed through contract change orders for a total cost of $449,350. [2] Credit for design, development, testing, and implementation of four (4) removed requirements approved by DOR Steering Committee and executed through contract change orders for a total credit of $37,000. Since Release 2 has completed, there will be no additional Corporate Tax implementation costs.
Individual Income Tax	$6,974,293	$6,974,293 + TBD TBD	Additional requirements for Release 3 will result in additional costs. Additional requirements are typically 10-20% of the project budget, although with the Corporate Tax release the additional requirements were less than 10% (see previous row in this table).
Customer	$1,940,224	TBD	Costs estimates will depend upon CRM solution

Relationship Management (CRM)			chosen by DOR.
Document Imaging	$4,870,861	TBD	Costs estimates will depend upon Imaging solution chosen by DOR.

JLBC Question #10

The letter indicates that Phase 2 activities were delayed because of resource constraints. Is this the result of Phase 1 exceeding its budget so that these activities could not be funded under the original contract?

Question # 10 Response

No, the delay of BRITS Release 2 from July 1, 2006 to September 5, 2006 was due to DOR resource constraints experienced during User Acceptance Testing. Knowledgeable, qualified resources were needed to successfully complete testing, and competing operational responsibilities led to the need for additional time for DOR to successfully complete the testing. Release 1 of BRITS had no bearing on this delay.

On October 3, 2006, Bob Hull asked:

"Why didn't DOR understand the BRITS contract was a firm, fixed price contract?"

Contract AD010133-003 for the BRITS project was negotiated by the State Procurement Office as a Firm-Fixed-Price contract for $122.65 million plus contingencies for additional support, data center and interest. The Contract provided for award of tasks or releases at the discretion of DOR.

The Federal Acquisition Regulation (FAR) is often consulted by state and local government for procurement guidance. A Firm-Fixed-Price (FFP) contract is defined in the FAR as "A type of contract providing for a price that is not subject to adjustment on the basis of the contractor's cost experience in performing the contract." A contract that is subject to change based on the contractor's cost is called a Cost-Plus Contract. According to the FAR, FFP contracts are generally subject to adjustment in accordance with contract clauses providing for equitable adjustments or price adjustments. This means that FFP contracts may be adjusted for changes in the work or conditions under which the contract was awarded.

This Contract may sometimes be referred to as a "task-order" contract. The term "task-order" refers to how the contract is used. The BRITS contract requires that portions or phases of the work are authorized when DOR issues a written task order for each "release".

It is not practical or even possible to award a contract for something as complex as the BRITS project without allowance for change. Like construction contracts, complex business projects seldom are completed for the exact price that was awarded. The process for changing government contracts is supported in laws and regulations. A.R.S. 41-2552 permits contract change orders and the BRITS contract contains a clause that permits contract modifications. The BRITS Contract changes are necessary, allowable under the law and contract and were negotiated for a fair and reasonable price.

Attachment C

JANET NAPOLITANO
GOVERNOR

CHRIS CUMMISKEY
DIRECTOR

STATE OF ARIZONA
GOVERNMENT INFORMATION TECHNOLOGY AGENCY
100 North 15th Avenue, Suite 440
Phoenix, AZ 85007

RECEIVED
OCT 04 2006
JOINT BUDGET COMMITTEE

October 3, 2006

Richard Stavneak, Director
Joint Legislative Budget Committee
1716 West Adams
Phoenix, AZ 85007

Dear Richard:

This letter is in response to your inquiry dated September 22, 2006 regarding the Business Reengineering/Integrated Tax System (BRITS) managed by the Department of Revenue (DOR).

The BRITS project has been quite successful in many ways and has provided numerous benefits to the State. Since the start of the project four years ago, revenue generated from the implementation of the project is over $182M and has resulted in a net benefit to the State of $16.3M. The benefits to date far exceed forecast totals for a 10 year payout for the system and have proven that a revenue sharing funding model can work in Arizona.

On September 6th, DOR Director Garriott contacted me to discuss several issues with the BRITS project. At that meeting, I recommended they get the BRITS Oversight Committee more involved in this process. I also asked DOR to provide a report at the ITAC meeting on September 27th. Unfortunately, there was insufficient time for the agency to prepare for the September meeting, so they have been scheduled for the ITAC meeting on October 25th.

GITA has a number of concerns with the BRITS project as it stands today. First and foremost, DOR has not shared with GITA their staffing plan to address the ongoing support of the tax systems once the contractor has completed development and implementation. We believe that a lack of certainty around future staffing could contribute to future cost overruns and delays with implementation. We have requested a staffing plan to ensure a successful transition of responsibilities from the contractor to DOR personnel.

We are also concerned because two of the key deliverables of the contract, Customer Relationship Management and Document Imaging, are to be delayed and therefore are excluded from being implemented within the proposed timeframe for the project. Since both of these deliverables were included in the original contract, cost implications for this delay are not addressed in their proposed amendment.

Phone: (602) 364-GITA ❖ Fax: (602) 364-4799
Web: www.azgita.gov

In addition, we believe that DOR needs to strengthen their communications efforts regarding this project. We have asked DOR to involve the project oversight committee on a more frequent basis and we are requesting monthly updates to ITAC.

In response to your specific questions:

1. We understand that DOR and Accenture have been analyzing the problems associated with implementing the Phase 1 deliverables of the project and they have come to an agreement on an equitable solution for sharing responsibility. We have no reason to believe that their statements are inaccurate or that the negotiated settlement is unreasonable.

2. At this time, GITA has not reviewed the Accenture Task Orders which detail the revised timelines, costs and staffing projections for their proposed timetable. Once the task orders are finalized and approved by both parties, GITA will have an opportunity to review. These project task orders serve as the basis for monitoring project performance and are reported to GITA on a monthly basis.

3. The BRITS project and gain sharing funding model is very unique so it is difficult to compare with other State projects. GITA understands that the revenue required for this amendment has already been realized and will only be paid out to the contractor once services are rendered.

4. ITAC will review and take action on the amended PIJ. In addition, we are recommending that DOR present monthly status updates to the Committee.

Please contact me if you have any further questions regarding this project.

Best wishes,

Chris Cummiskey
Director, State CIO

DH:mm

cc: Gary Yaquinto, OSPB
Gale Garriott, DOR

STATE OF ARIZONA

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

GREAT SEAL OF THE STATE OF ARIZONA DITAT DEUS 1912

Janet Napolitan
Governor

Gale Garriott
Director

September 14, 2006

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

Dear Senator Burns:

In compliance with Laws 2006, Chapter 350, Section 41, this letter is to request placement on the Joint Legislative Budget Committee's October 24, 2006 meeting agenda for review of the Department's modification of the current business reengineering/integrated tax system contract (BRITS). The contract modification does not provide for an increase in the contractor's share of gain-sharing proceeds and therefore legislative authorization is not being sought per Laws 2006, Chapter 346, Section 3.

Attached is a copy of the Department's "BRITS Contract Amendment Summary". The amendment is needed because, as explained in the summary, the implementation schedule for the project has been extended and, therefore, contractually established support activities must also be extended. The table below illustrates the summary of costs related to the amendment.

BRITS Contract Amendment Summary of Costs

Cost Components	Timeframe	Cost
BRITS Project Related One-Time Costs		
1. Accenture Services for Project Support Activities	Sep 2006 - Feb 2008	$8,412,200
2. Temporary Staff for Project Related Activities	Sep 2006 - Feb 2008	$2,080,000
Sub-Total One-Time Costs		**$10,492,200**
DOR Ongoing System Operation and Support Costs		
3. Accenture Application Development & Support Services	Sep 2006 - Aug 2007	$4,365,000
Sub-Total Ongoing Costs		**$4,365,000**
Total Contract Amendment		**$14,857,200**

If you have any questions regarding this request, please contact Deputy Director Kristine Ward at 716-6090.

Sincerely,

Gale Garriott

Gale Garriott
Director

cc: Representative Russell Pearce
Richard Stavneak – Director JLBC
Gary Yaquinto – Director OSPB
Bob Hull – JLBC
Matthew Kennedy – OSPB

Department of Revenue
BRITS Contract Amendment Summary

Contract Amendment Introduction

The implementation of the Department of Revenue's BRITS project, which consists of three primary software releases, was originally scheduled to take four years to complete, from September 2002 through August 2006. The first release occurred in January 2004 and converted transaction privilege tax (TPT) and withholding tax processing from the Department's legacy systems to the new BRITS system. The second release of the BRITS project will convert corporate income tax processing with a scheduled go-live date of September of this year, subject to the final approval of the Department's users. The third release of the BRITS project, conversion of personal income tax processing, will go-live approximately 14–18 months after the second release.

The Department experienced a number of problems with the first BRITS release. Both the Department and Accenture share in the responsibility for the problems that occurred. Working together the Department and Accenture applied lessons learned from the first release to the subsequent releases by instituting improved requirements gathering, improved project management, improved quality control, including a greater number of Department resources in the project, and by taking an adequate amount of time to complete user testing based upon the availability of the Department's resources. These actions are mandatory for the success of the project, but result in the project schedule being extended from its original August 31, 2006 end date to February 28, 2008.

From the beginning of the BRITS Project, the Department believed that the BRITS contract was a firm, fixed price contract, and that Accenture would complete all contracted project activities for the proposed price, regardless of the timeframe of the project. During the contract amendment negotiations with Accenture (led by the State's Enterprise Procurement Services - EPS), the Department learned that the contract is not a firm, fixed price contract. The BRITS contract is in fact a Task Order-based contract, and some of the Task Orders are established to provide a defined scope of work for a specified period at a fixed price. Therefore, the Department incurs additional project costs if the BRITS project timeline is extended.

The Department adhered to the "Partner Approach" defined in the contract to determine who should absorb the additional costs relating to the schedule extension. Instead of seeking a legal remedy that would have jeopardized the project, the Department chose to work cooperatively with Accenture through an EPS-led negotiation process. It is the Department's belief that pursuing a legal course of action would have been more costly than the negotiated solution, would not have resulted in a materially different outcome, and would have significantly damaged the on-going contractual relationship between Accenture and the Department.

As presented in **Table 1**, the amendment total is $14,857,200 consisting of one-time project related costs of $10,492,200 and on-going operational costs of $4,365,000. This contract amendment is funded through the continued generation of benefits from the

BRITS project and, therefore, does not require an appropriation of funds. As of August 2006 the benefits generated from BRITS total approximately $182 million, 76% above original projections.

Table 1 - BRITS Contract Amendment Summary of Costs

Cost Components	Timeframe	Cost
BRITS Project Related One-Time Costs		
1. Accenture Services for Project Support Activities	Sep 2006 - Feb 2008	$8,412,200
2. Temporary Staff for Project Related Activities	Sep 2006 - Feb 2008	$2,080,000
Sub-Total One-Time Costs		***$10,492,200***
DOR Ongoing System Operation and Support Costs		
3. Accenture Application Development & Support Services	Sep 2006 - Aug 2007	$4,365,000
Sub-Total Ongoing Costs		***$4,365,000***
Total Contract Amendment		**$14,857,200**

1. *Accenture Services for Project Support Activities*

Table 2 outlines the project support activities required for the BRITS project. These project support activities are one-time costs charged by Accenture for the second and third releases of the BRITS project. Without funding for these support activities, the third phase of the BRITS project could not be completed, and the Department would be forced to continue processing personal income tax on the legacy system, falling short of the primary objective of the BRITS Project: a fully integrated tax administration system.

Table 2 - BRITS Project Support Activities

Task Order Name	Cost
Application Support - Provides resources to operate the production system and all related processes while the software is being developed.	$1,185,000
Technical Support - Provides resources for the setup, monitoring, and maintenance of the computer system environments required for developing, testing, and deploying the third release of BRITS.	$491,000
Change Management - Provides resources to manage the human aspect of a major system implementation, including providing training, preparing system documentation, and providing communication.	$338,000
Project Management - Provides resources to manage, track, measure, control, and report on project activities.	$1,368,000
Sub-Total Core Support Task Orders through August, 2007	***$3,382,000***
Delay of Release 2 Implementation from July 1, 2006 to September 5, 2006	$250,000
Additional Extension September 2007 through February 2008	$4,780,200
CONTRACT AMENDMENT AMOUNT FOR PROJECT SUPPORT ACTIVITIES	***$8,412,200***

The costs associated with the project support activities extension are made up of three components:

- **Negotiated One-Year Extension -** The Department and EPS spent considerable time meeting with Accenture to discuss the degree of responsibility that each party held for the problems encountered with the first BRITS release. The results of these negotiations are the basis of the calculation of each party's share of the additional project support activity costs. For the additional costs associated with the first release of BRITS the State will be responsible for $3,382,000 or 44%, and Accenture will be responsible for $4,252,000 or 56%.

· **Delay of BRITS Release 2 Implementation** – DOR experienced resource constraints during the User Acceptance Testing for BRITS Release 2 (corporate income tax) that delayed the implementation date from July 1, 2006 to September 5, 2006. This delay resulted in an additional $250,000 cost for two additional months of Change Management and Project Management support.

· **Additional 6 Month Extension -** DOR experienced resource constraints during the User Acceptance Testing for BRITS Release 2 (Corporate Income Tax) that made it clear that the Department would need to factor in a greater amount of time to successfully test BRITS Release 3, which involves the Department's highest volume tax type – personal income tax. The Department must also factor in sufficient time for thorough performance testing, due to the high volume of personal income tax returns. DOR has established a high-level plan that extends Release 3 through February 28, 2008. The cost of adding an additional 6 months (September 2007 – February 2008) is $4,780,200. This additional amount may not be fully used if the project is completed ahead of the revised target timeline. However, this additional amount provides project support for a reasonable amount of time.

2. *Temporary Backfill Staff for Project Related Activities* **_$2,080,000_**

The Department continues to need temporary or "backfill" staff to perform a variety of project related activities. A one-time cost of $2,080,000 is necessary to provide the Department with temporary staff to (1) conduct data purification activities to ensure the quality of the data in the Department's legacy systems prior to conversion, and (2) provide temporary staff resources to backfill existing Department staff to ensure key DOR resources are available to participate in the project. During the first release, the quality of the converted data and the lack of vital resources were key contributing factors to the problems encountered. Without funding for these costs, DOR will not be able to commit necessary resources to the project, thereby risking project failure.

3. *Accenture Application Development and Support Services* **_$4,365,000_**

In addition to the above project-related costs, the Department continues to require Accenture's assistance in the on-going development and operational support of the new system. The BRITS project has introduced a large number of technologies into the Department. Before the BRITS project, the Department's systems were mainly legacy mainframe systems. In order to operate and maintain the BRITS system when software development is complete, the Department must have the appropriate number of technical staff (e.g., Oracle database administrators, system designers, Oracle programmers, technical architects, and server administrators) who possess the appropriate skill levels for these technologies. Until the Department can successfully transition current technical staff and hire additional skilled staff, the Department must rely on Accenture to provide support. The cost for this support for the period of September 2006 – August 2007 is $4,365,000.

Maintenance and support of the BRITS system has on-going costs for the Department; however, it is the Department's goal to build system expertise within our own staff in order to eliminate the current dependency on outside vendors. Toward this goal, the Department is currently undertaking a work-force assessment to identify the staffing level and skill levels needed to successfully operate and maintain the system. This assessment will identify staffing needs, skills, and experience necessary to support the BRITS system. Going forward, the on-going costs of operation and maintenance of the BRITS system will shift from outside vendors to internal Department staff. Without sufficient resources that possess the appropriate skills, the Department will be unable to process TPT, withholding, corporate income, or personal income taxes for the State of Arizona.

Delay of Implementation: Customer Relationship Management and Document Imaging

In addition to the contract amendment described in this document, the Department has decided to delay implementation of two components included in the BRITS project – Customer Relationship Management (CRM), and Document Imaging. Executing these two complex implementations simultaneously with the implementation of the corporate income tax or personal income tax releases puts all of the project activities at risk. In addition, before introduction of CRM and Document Imaging technologies into the Department, appropriate Department resources must be in place to operate and maintain them. The Department has not yet established timeframes for implementation of CRM and Document Imaging, but during work on the third release of BRITS, the Department will develop and communicate an implementation plan.

DATE: October 16, 2006

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

THRU: Richard Stavneak, Director

FROM: Bob Hull, Principal Research/Fiscal Analyst

SUBJECT: Department of Revenue – Review of General Fund Revenue Enforcement Goals for FY 2007

Request

Pursuant to a General Appropriation Act footnote, the Department of Revenue (DOR) requests review of its General Fund revenue enforcement goals for FY 2007. DOR is required to report by July 31, 2006 on their goals, and to provide quarterly progress reports to the Committee as to the effectiveness of the department's overall enforcement and collections program within 30 days after the end of each calendar quarter.

Summary

DOR's overall General Fund revenue enforcement goal for FY 2007 is $333.4 million, which is $12.1 million, or 3.8% above their FY 2006 goal of $321.3 million. However, the $333.4 million goal for FY 2007 is $(57.6) million or (14.7)% below their FY 2006 actual General Fund revenue enforcement collections of $391.1 million.

DOR's revenue enforcement goal consists of audit revenue, collections revenue, and accounts receivable.

- DOR's attributes projected <u>audit</u> revenue decreases in FY 2007 to an audit division hiring freeze to pay for $1.7 million of annual software licensing fees for their new Business Reengineering/ Integrated Tax System (BRITS) computer system.

- DOR's <u>collections</u> revenue decreases in FY 2007 with the passing of a temporary spike in FY 2006 in transaction privilege tax collections, which was caused by BRITS billing problems that are now fixed.

- DOR has provided no explanation for the increase in <u>accounts receivable</u> collections. We have asked DOR for their comments.

(Continued)

Recommendation

The Committee has at least the following 2 options:

1) A favorable review since, as required, the report provides information on DOR's General Fund revenue enforcement goals for FY 2007. DOR's overall General Fund revenue enforcement goal of $333.4 million for FY 2007 is $12.1 million, or 3.8% above their FY 2006 goal of $321.3 million.

2) An unfavorable review, since DOR's overall General Fund revenue enforcement goal of $333.4 million for FY 2007 is $(57.6) million, or (14.7)% below their FY 2006 actual General Fund revenue enforcement collections of $391.1 million.

Analysis

A footnote in this year's General Appropriation Act requires DOR to provide the department's General Fund revenue enforcement goals for FY 2007 for Committee review by July 31, 2006. In addition, DOR shall provide quarterly progress reports to the Committee as to the effectiveness of the department's overall Enforcement and Collections Program. The reports shall include a comparison of projected and actual General Fund revenue enforcement collections for FY 2007. The reports are due within 30 days after the end of each calendar quarter.

The table below compares DOR's General Fund revenue enforcement goals for FY 2007 to their goals and results for FY 2006. The 3 main categories of enforcement revenue are audit, collections, and accounts receivable. <u>Audit enforcement</u> revenue includes revenue due to DOR's auditing of taxpayer returns, and finding and licensing unlicensed businesses. <u>Accounts receivable</u> revenue includes taxpayer accounts paid before they would have been moved to collections, which allows DOR's collectors to work on other accounts. After certain periods of time, unpaid taxpayer accounts are moved from accounts receivable to DOR's <u>collections</u> section.

DOR's overall General Fund revenue enforcement goal for FY 2007 is $333.4 million, which is $12.1 million, or 3.8% above their FY 2006 goal of $321.3 million. However, the $333.4 million goal for FY 2007 is $(57.6) million, or (14.7)% below their FY 2006 actual General Fund revenue enforcement collections of $391.1 million. DOR's explains the major changes as follows:

Audit:

- DOR's FY 2007 goal for audit revenue is $(7.8) million, or (8.7)% below their FY 2006 goal, and $(38.2) million, or (31.9)% below their FY 2006 actual audit revenue. DOR attributes the decrease in audit revenue to their instituting a hiring freeze in the audit division to pay for $1.7 million for annual software licensing fees for their new BRITS computer system. We have asked DOR to explain how they calculated the amount of reduced audit revenue, including the large variances in corporate income tax and license compliance. DOR has not yet responded to this request. The $1.7 million for annual software licensing fees is not included in DOR's proposed $14.8 million BRITS contract amendment. The $14.8 million contract amendment would pay for increased costs to convert individual income tax to BRITS by February 2008, due to previous BRITS delays.

Collections:

- DOR's FY 2007 goal for collections revenue is $10.4 million, or 5.5% above their FY 2006 goal, but $(22.6) million, or (10.2)% below their FY 2006 actual collections revenue. DOR attributes a large part of the increase in FY 2006 collections revenue to a temporary spike in transaction privilege tax collections, which was caused by BRITS problems that delayed transaction privilege tax billings. DOR reports that the BRITS problems have been fixed, and the FY 2006 surge in transaction privilege tax collections is not expected to be repeated. We have asked DOR how much of the

(Continued)

collections' $187.8 million FY 2006 goal, $220.8 million FY 2006 actual, and $198.2 million FY 2007 goal is due to transaction privilege tax collections.

Accounts Receivable:

- DOR's FY 2007 goal for accounts receivable revenue is $9.6 million, or 21.8% above their FY 2006 goal, and $3.2 million, or 6.4% above their FY 2006 actual accounts receivable revenue.

DOR's General Fund Enforcement Revenue Goals in FY 2007 Compared to FY 2006 (Net of Duplications)

	FY 2006 Goals	FY 2006 Actual	FY 2007 Goals
Audit Division			
Corporate Tax	$53,474,200	$70,425,500	$39,129,100
Individual Tax	8,250,400	11,871,400	12,855,600
Transaction Privilege Tax	15,780,700	15,336,000	15,392,400
Luxury Tax [1/]	--	--	594,000
Discovery [2/]	--	--	1,782,000
License Compliance	12,100,400	22,351,000	12,015,000
Subtotal Audit	$89,605,700	$119,983,900	$81,768,100
Collections	187,837,900	220,835,800	198,206,200
Accounts Receivable [3/]	43,887,300	50,234,500	53,469,600
Total	**$321,320,900**	**$391,054,200**	**$333,443,900**

1/ DOR did not report separately on this item in FY 2006.
2/ DOR did not report separately on this item in FY 2006. Discovery revenue is DOR's term for additional revenue attributed to BRITS, which can be traced to specific taxpayers.
3/ Taxpayer accounts paid before they would have been moved to Collections, which allows collectors to work on other accounts.

RS/BH:ym

STATE OF ARIZONA

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

Janet Napolitano
Governor

Gale Garriott
Director

September 21, 2006

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

Dear Senator Burns:

The Department of Revenue's Enforcement Program, net of duplications, was projected to generate $438,853,076. After a very successful year the Enforcement Program brought in $530,000,447, or 120.8% of ($91.1 million above) the annual objective. The success can be attributed primarily to: the Collections Division exceeding their objective by $47.4 million; the Audit Division collecting over $34.6 million above targets; and Accounts Receivable generating an extra $9.1 million.

For fiscal year 2006-2007 the Department's Enforcement Objectives are (please see Attachment A for a General Fund breakdown of these numbers):

Audit Division		
Transaction Privilege Tax	$ 25,913,042	
License Compliance	$ 17,275,360	
Individual Income Tax	$ 12,855,631	
Corporate Income	$ 39,129,122	
Discovery	$ 3,000,000	
Luxury Tax	$ 1,000,000	
Audit Division Total		$ 99,173,155
Collections Division		$ 284,983,784
Accounts Receivable		$ 76,879,379
FY 2007 Revenue Enforcement Goals		**$ 461,036,318**

FY 2007's Revenue Enforcement Goals are $22.2 million or 5.1% above FY 06's Goals.

The Department does not anticipate being able to duplicate FY 06's actual enforcement revenues of $530.0 million for the following reasons:

- Of the $317.5 million brought in by the Collections Division in FY 06 approximately $25-$30 million was a direct result of catching up with existing inventories from the prior year. These inventories were temporarily inflated due to the transition to the BRITS system. The introduction of the BRITS system resulted in delayed TPT billings and directly resulted in an increased number of TPT accounts that could not be collected upon until issues with BRITS were resolved. During FY 06 these BRITS issues were resolved and the backlog of TPT accounts was quickly addressed and contributed significantly to the Collections Division exceeding their objectives by over $47 million.

- For FY 07, the Department requested funding for the BRITS software. The Department's FY 07 budget request to fund this issue ultimately went unfunded, and the Department has been forced to reallocate $1.7 million from its existing appropriation to pay for the BRITS software. This reallocation has necessitated a hiring freeze within the Audit Division; consequently, the Audit Division's targets are anticipated to be $41.1 million below the FY 06 enforcement levels.

If you have any questions regarding this response, please contact Reed Spangler at 716-6883.

Sincerely,

Gale Garriott
Director

Attachments

cc: Representative Russell Pearce
Richard Stavneak – Director JLBC
Gary Yaquinto – Director OSPB
Bob Hull – JLBC
Matthew Kennedy - OSPB

Attachment A

FY 07 Revenue Enforcement Goals – General Fund

Audit Division		
Transaction Privilege Tax	$ 15,392,347	
License Compliance	$ 12,015,013	
Individual Income Tax	$ 12,855,631	
Corporate Income	$ 39,129,122	
Discovery	$ 1,782,000	
Luxury Tax	$ 594,000	
Audit Division Total		$ 81,768,113
Collections Division		$198,206,222
Accounts Receivable		$ 53,469,607
FY 2007 Revenue Enforcement Goals		$333,443,942

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

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DATE: October 17, 2006

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

THRU: Richard Stavneak, Director

FROM: Tyler Palmer, Fiscal Analyst

SUBJECT: Arizona Department of Administration – Review of Emergency Telecommunication Services Revolving Fund Expenditure Plan

Request

Laws 1998, Chapter 6, 4th Special Session requires the Arizona Department of Administration (ADOA) to submit the wireless services portion of its Emergency Telecommunications Services Revolving Fund (ETSF) expenditure plan to the Committee for review. ADOA oversees and provides support to the communities of the state as they enhance their 911 emergency telecommunications systems. In practice, the department submits its complete expenditure plan annually, although expenditures on wire services are not subject to Committee review.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review to the $9.4 million wireless portion of the ETSF expenditure plan.

In FY 2007, ADOA expects to distribute $28.1 million from the ETSF. However, based on past expenditure patterns this estimate could be high, as over the past 4 years average expenditures were $17.7 million. Of the $28.1 million, $18.0 million is for wire services, $9.4 million is for wireless services, and $0.7 million is for administrative and management costs.

Analysis

ADOA works with county/city 911 administrators to distribute monies from ETSF for FCC-compliant telecommunications equipment, software, carrier services, and maintenance. The counties and cities are responsible for implementing the improvements to their 911 system. ADOA is responsible for providing centralized oversight, administration, management, and guidance in developing project schedules to consider the greatest needs, especially in rural areas, and for maximizing regional efficiencies and local readiness. While ADOA prefers that each county complete implementation phases as a whole, the department does make allowances for cities or areas that are behind or ahead of the county schedule. Localities must provide and

(Continued)

fully fund their own personnel, utilities, and facilities. ADOA also requires communities to submit Wireless 911 Service Plans to the agency for its approval.

Emergency 911 Wireless Service Status

Federal Communications Commission (FCC) Report and Order 96-204, issued in 1996, ordered the development and implementation of 911 services for wireless telecommunications systems in 2 phases. Phase I requires local public safety answering facilities to be able to identify the phone number of, and nearest cellular tower to the caller, as well as to relay calls to the nearest emergency response center. Phase II necessitates answering facilities to be able to identify the location of the caller. Mobile service carriers were required to upgrade their systems for Phase II capability by December 2005. *Table 1* highlights the status of Arizona's wireless 911 availability as of August 2006.

Table 1

Arizona Counties Emergency 911 Wireless Capability

Phase I	**Phase II**
Graham County	Maricopa County
Page-Lake Powell	Northern Yavapai County
Pinal County	Pima County
Santa Cruz County	
Winslow	

* Counties not shown have no wireless Phase I or II capabilities.

With Wireless Phase II being completed in Pima and Maricopa Counties, 80% of the state's population lives in areas where the location of a 911 caller can be identified. Completion of mapping in Phase I compliant regions is a major step in becoming Phase II ready. Graham, Pinal, and Santa Cruz Counties are conducting their mapping projects and will deploy Phase II during the spring of 2007. Southern-Yavapai, Cochise, and Mohave Counties will deploy Phases I and II during FY 2008. For a more comprehensive description of emergency 911 deployments see the *State 9-1-1 Program FY 06 Project Plan* attachment.

Funding Mechanism

A.R.S. § 42-5252 authorizes a tax on wire and wireless telecommunication service accounts with a two-step decrease in the rate during FY 2007 and FY 2008. The rate was established at $0.37 cents per month, and decreases to $0.28 cents during FY 2007 and further to $0.20 cents during FY 2008. ADOA estimates that the decrease in the tax rate will reduce revenues from $28.7 million in FY 2006 to $17.9 million in FY 2010. ADOA also foresees expenditures increasing from $18.3 million to $37.3 million during the same timeframe. Despite the decline in revenues and the increase in expenditures, ADOA projects that the fund will maintain a positive balance until FY 2010, due to the $45.0 million balance currently in the fund. Under the ADOA revenue and expenditure assumptions, the shortfall in FY 2010 is projected to be $(15.9) million.

FY 2007 ETSF Expenditure Plan

ADOA distributes funds to the localities upon receiving copies of their invoices for emergency telecommunications services and equipment. In FY 2007, ADOA expects to distribute $28.1 million from ETSF, including $4.0 million from the existing fund balance. Of the $28.1 million, $9.4 million is for Phase I and Phase II wireless services. *Table 2* summarizes the actual ETSF distribution during the past 2 fiscal year's and projected distribution during the current fiscal year.

(Continued)

Table 2

ADOA Emergency Telecommunications Services
Revolving Fund FY 2005 - 2007 Expenditure Plan

	Actual FY 2005	Actual FY 2006	Projected FY 2007
Wireless Services			
Phase I Wireless	$2,600,000	$1,400,000	$1,400,000
Phase II Wireless	4,300,000	6,000,000	8,000,000
Wireless Services Subtotal	**$6,900,000**	**$7,400,000**	**$9,400,000**
Wire Services	$12,900,000	$10,200,000	$18,000,000
Administration	$ 800,000	$ 800,000	$ 700,000
ETSF Expenditure Plan Total	**$20,600,000**	**$18,400,000**	**$28,100,000**

In August 2005, ADOA estimated that FY 2006 expenditures would be $34.7 million; however, actual expenditures over the course of the year were only $18.4 million. Some of this discrepancy may be attributed to lower levels of participation by rural counties than expected.

Table 3 includes the expenditure plans for FY 2007. Of the $9.4 million projected to be spent on wireless services in FY 2007, $5.2 million is for wireless carrier charges. Carrier charges are monthly per customer fees provided to phone companies for providing emergency 911 services to their customers. The remaining $4.2 million of the wireless expenditure plan is for Local Exchange Carrier (LEC) network and Equipment expenses.

Table 3

FY 2007 Wireless Expenditure Plan

	LEC Network	Equipment	Wireless Carrier	Total
Graham County	$ 106,394	$ 76,950	$ 107,606	$ 290,950
Maricopa Region	950,000	64,000	3,248,000	4,262,000
City of Page	253,320	-	-	253,320
Pima County	1,200,000	4,400	636,400	1,840,800
Pinal County	575,934	137,150	651,816	1,364,900
Santa Cruz County	212,400	102,200	70,805	385,405
City of Winslow	118,970	-	61,150	180,120
No. Yavapai County	398,380	5,000	452,370	855,750
	3,815,398	389,700	5,228,147	9,433,245

Future Outlook

Arizona statute only requires wire and wireless telecommunication service accounts to pay a tax. Statute is unclear whether more recent technologies such as prepaid wireless accounts, internet based phones, OnStar pay the 911 taxes. Future fund revenues could decline if phone usage shifts to Voice over Internet Protocol (VoIP) based phones. VoIP phones may be differentiated into two divisions, the broadband providers such as Comcast and Qwest and the nomadic providers such as Vonage. The broadband providers may already be collecting a tax because they view the service as similar to a wire line account, but the nomadic providers are not currently collecting any taxes for emergency 911 services.

Of the nomadic VoIP providers, Vonage has approached the ADOA 911 office regarding developing an agreement to collect the tax as long as it is used specifically for emergency 911 purposes.

(Continued)

New to this year's expenditure plan is the establishment of an Internet Protocol-enabled network beginning in FY 2008. The estimated FY 2008 cost is $10.0 million. The current 911 system is based on technology not intended to support modern communications devices. The plan to build an Internet Protocol-enabled network is in line with recommendations from NENA, the National Emergency Number Association, on the future of emergency telecommunications standards.

RS/TP:dt

JANET NAPOLITANO
GOVERNOR

WILLIAM BELL
DIRECTOR

ARIZONA DEPARTMENT OF ADMINISTRATION
DIRECTOR'S OFFICE
100 N. 15TH AVENUE, SUITE 4001
PHOENIX, ARIZONA 85007

RECEIVED
SEP 19 2006
JOINT BUDGET COMMITTEE

September 18, 2006

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

Dear Representative Pearce:

As stipulated in the Laws of 1998, 4th Special Session, Chapter 6, Section 5 – Emergency telecommunications fund: report of expenditure plans, the Department of Administration shall report its expenditure plans to the Joint Legislative Budget Committee for review. In fulfillment of this requirement, I am enclosing:

- The Wireless Program Report for fiscal year 2006.
- The 9-1-1 financial forecast for fiscal years 2006 through 2010 incorporating the Fund Balance transfers to the General Fund during FY2003 and FY2004.
- The Status of Arizona 9-1-1 and the Estimated Costs and Deployment Schedule to Implement Wireless Phase I and Phase II.
- The 9-1-1 Phase I & II Wireless Implementation Plan.
- State of Arizona 9-1-1 GIS Standards.

Please note that the financial forecast shows a program deficit in fiscal year 2010. With additional Wireless Phase II deployments and transitioning to an IP Enabled Network, costs will continue to increase. This anticipated deficit will prevent the full implementation of the critical wireless program and may require a revenue enhancement or increase.

Should you have any questions, please contact me at 602-542-1500 or Barbara Jaeger, the State 9-1-1 Administrator at 602-542-0911,

Sincerely,

William Bell
Director

c: The Honorable Robert Burns, Chairman, Joint Committee on Capital Review
The Honorable Ken Bennett, Senate President
The Honorable James P. Weiers, Speaker of the House of Representatives
Mr. Richard Stavneak, Staff Director, JLBC
Mr. Gary Yaquinto, OSPB

Enclosures (5)

Arizona Department of Administration
State 9-1-1 Office
Wireless Program Report
2006

The State 9-1-1 program was established, through legislation in 1985, to provide a funding mechanism for the deployment and on-going costs of providing 9-1-1 services in Arizona.

Under A.R.S.§ Title 43, Article 6, Telecommunications Services Excise Tax, a tax is levied for each activated wire line and wireless service account for the purpose of financing emergency telecommunications services. Current law reduced the tax from thirty-seven cents per month to twenty-eight cents per month in July 1, 2006. The tax will again be reduced to twenty cents per month on July 1, 2007.

The funds collected are administered by the Arizona Department of Administration under A.R.S. § 41-704 and rules have been established that govern the allowable expenditures and funding eligibility requirements by communities and political sub-divisions in the State.

Components eligible for funding include necessary and/or appropriate network, equipment and maintenance to handle the processing of 9-1-1 emergency calls. Of the revenue generated, the program distributes 98% of the fund for 9-1-1 call service delivery of wire line and wireless services. One percent of the revenue is allocated for local network management of contracts through the 9-1-1 system coordinators.

Accounting methodology is in effect to track all expenditures by community and/or 9-1-1 system. The revenue is also collected and reported separately between the wire line and wireless services. All Public Safety Answering Point (PSAP) equipment used to answer and handle 9-1-1 calls are budgeted under wire line expenditures, although it should be understood that the equipment is used to answer both wire line and wireless 9-1-1 calls.

The Arizona 9-1-1 Wireless Phase I & II Implementation Plan has been updated during FY06 to expand the program moving specified sites toward deployment of Phase II Wireless. Costs associated with legislative cost recovery and a copy of the plan is enclosed. The Statewide System Project plan covering each 9-1-1 System for FY07 has been updated and is also attached.

The wireless program criteria established for rollouts, stipulate that Enhanced 9-1-1 (voice, telephone number and address) has been completed for either and entire county or significant portions of a county. Each county or system must complete a Wireless 9-1-1 Service Plan, utilizing the format specified in the State guidelines and appoint a single point of contact for each county or area. The Geographic Information System (GIS) data must be completed and meet the same 95% accuracy rate as established for Enhanced Wire Line 9-1-1. Equipment mapping components will be installed prior to implementation of Wireless Phase II.

Wireless Deployment

Significant progress continues to be made in the deployment of Wireless Phase II. The two major regions in the state, Maricopa and Pima have completed their Phase II deployments constituting approximately 80% of the state's population. Additionally, the Northern Yavapai County area, which encompasses the City of Cottonwood, City of Sedona, Town of Camp Verde and surrounding Yavapai County was upgraded to Wireless Phase II.

During FY06, funds were expended from the $1 million dollar Public Safety Answering Point (PSAP) Readiness Fund grant to complete the Geographic Information Systems (GIS) work necessary to move three counties from Wireless Phase I to Wireless Phase II. GIS completion for Graham, Pinal and Santa Cruz Counties is scheduled for September 2006, with mapping equipment being order for eight Public Safety Answering Points (PSAPs) in the three counties. Carrier Phase II service requests will go out on October 1, 2006, with implementation scheduled spring of 2007.

The completion of these projects will provide wireless Phase II service from Nogales all the way to Phoenix. Recently, Pinal County was identified as the third fastest growing county in the nation and with this deployment, the citizens will have an added level of public safety protection.

The GIS work for Graham, Pinal and Santa Cruz counties was completed for significantly less then what was originally estimated under the Scope of Work. The PSAP Readiness Fund Board is already pleased that their grant dollars have been used for specifically what it was intended for. With the funds remaining, we have been authorized to submit a subsequent Scope of Work to include other regions and counties in Arizona. Preliminary planning has identified that the next areas for deployment include the southern portion of Yavapai County, Cochise County and Mohave County and GIS work will be scheduled during FY07.

During FY06, the southern portion of Yavapai County completed their Enhanced 9-1-1 project and with the northern portion of the county already Wireless Phase II, it is logical to implement the remainder of the county. Cochise County is scheduled to complete their Enhanced 9-1-1 project during FY07, with accurate GIS data being developed in conjunction with the addressing project. These projects will be scheduled to be deployed with wireless Phase I and Phase II service during FY08.

Wireless Expenditures

During FY06, the majority of one time charges were expended for completed Wireless Phase II projects. The Northern Yavapai County project completed late in FY06 and all one time charges have not been invoiced.

The FY06 expenditures for Wireless Phase I & II are outlined in the table below.

System	FY06 Expenditures	PI/PII
Maricopa Region	$ 4,271,456	PII
Pima County	$ 1,528,209	PII
No. Yavapai County	$ 308,775	PII
Pinal County	$ 640,817	PI
Santa Cruz County	$ 178,582	PI
Graham County	$ 118,060	PI
City of Page	$ 245,123	PI
City of Winslow	$ 118,970	PI
	$ 7,409,992	

It should be emphasized that the 9-1-1 answering equipment is fiscally allocated to wire line equipment although this equipment handles calls for both wire line and wireless 9-1-1. In future years, with the reduction of wire line services, an equitable division of equipment costs and maintenance may have to be explored.

The FY07 budget includes the following expenditures for those systems which are currently Wireless Phase I and/or Phase II. As noted some systems are scheduled for transition during the current fiscal year.

System	FY07 Budget	PI/PII
Maricopa Region	$ 4,262,000	PII
Pima County	$ 1,636,400	PII
No. Yavapai County	$ 926,750	PII
Pinal County	$ 1,364,900	PI to PII
Santa Cruz County	$ 385,405	PI to PII
Graham County	$ 290,150	PI to PII
City of Page	$ 253,200	PI
City of Winslow	$ 180,120	PI
	$ 9,298,925	

Additional expenditures under consideration and budgeted for fiscal year 2007 are a frame relay network for deployment of an Enterprise Mapping System. With significant county boundary issues recognized, this system will allow GIS data to be distributed to the 9-1-1 centers within their county or share the data with other counties. These costs are already being expended in the Maricopa Region and Pima County because of the number of 9-1-1 centers located within that system. When a new map data is available, information can be sent via the network and updated information can be published more efficiently.

With an emphasis on Homeland Security and network restoration, the Telecommunications Service Priority (TSP) provisioning will be added during FY2007. This federal program is designed to ensure elevated network restoration to anyone who registers and pays for the service. In the event of a national disaster and federal intervention is required for network continuity, the service will ensure that Arizona's 9-1-1 systems will be restored in a timely manner.

All network components including 9-1-1 circuits, Automatic Location Identification circuits, emergency back circuits and circuits that run to all selective routers will be included in the service package.

The State 9-1-1 Office strives to reduce costs for network and equipment components. Negotiations recently completed with Qwest, will reduce the wireless selective router charges significantly in fiscal year 2007.

Revenue – FY07 Projections

Effective July 1, 2006, the Wireless Tax and Wire line Excise Tax was reduced from $.37/mo. to $.28/mo. by statute. The reduction for FY07 in projected revenues is based on an overall 5% increase in carrier services and the twenty per cent reduction in the tax.

There is an additional statutory reduction to $.20/mo is scheduled for FY08 beginning in July 2007. The overall decrease reduces the revenue by almost 40% over a two year time period.

The wireless revenue for FY06 closed at $13,620,376, a 12% increase over FY05. With these figures available and the new tax rate taken into consideration, projections indicate that the program will generate approximately $11.5 million dollars from wireless providers in FY07.

Whereas the wireless customer base is increasing, the wire line customer base is decreasing. The original projections for FY06 estimated that the wire line base would be reduced by 3%. In reality, the base only reduced by 1%. The wire line (Excise Tax) revenue for FY06 closed at $ $14,116,318. Again, we offset the wire line revenue with the wireless revenue to come up with an overall 5% increase when preparing the projections.

	FY05 Actual	FY06 Actual	F07 Projected	% of Difference
	@$.37	@$.37	@$.28	FY05-FY06
Wireless Tax	12,927,897	14,620,376	11,522,436	12%
Excise Tax	14,317,661	14,116,318	11,125,184	-1%
	27,245,558	28,736,694	22,647,620	5%

	FY06 Budget	FY06 Actual	% of Difference
	@$.37	@$.37	FY05-FY06
Wireless Tax	13,186,455	14,620,376	10%
Excise Tax	14,604,015	14,116,318	-3%
	27,790,470	28,736,694	3%

In preparing the 911 Project Plan through FY11, the tax decrease and customer base has been taken into consideration indicating that the program will reach a deficit in FY10.

In addressing the Voice over the Internet, or Internet based telephone services issues, two distinct classes of service have been identified. The broadband providers may be collecting the tax, as they view the service as similar to wire line. These carriers upload location data into the 9-1-1 data base and already have connectivity to the 911 selective routers.

The taxation issue arises with the nomadic VoIP customers, such as Vonage, who can purchase this service at a local retail store. These companies rely on the customer to make changes to the location data base in order for the call to be correctly delivered to the right PSAP. Currently, these providers do not collect the Excise Tax, because they are of the opinion that they fall outside the tax language established in Arizona Statutes. There are several such companies operating in Arizona that are not remitting taxes under existing law.

Vonage has approached the ADOA 9-1-1 Office regarding developing an MOU to collect the tax as long as the tax is specifically used for 9-1-1 purposes. Acceptable language is being reviewed at this time. None of the other nomadic vendors has made any offer and are of the opinion they fall outside Arizona's statute. It should also be noted that taxes for emergency telecommunications are not being collected today on prepaid wireless service.

Several other states have modified their legislation to include any telecommunications services that have access to 911. The ADOA 911 Office is collecting samples of these changes in order to develop legislative language that will include all types of technology services.

The Future of 9-1-1

The 911 Project Plan addresses the need to transition to a more robust and technology forward network in coming years. The IP enabled network or Next Generation 9-1-1 designs are on the drawing board today. Once industry standards are developed, costs can be determined. The move toward a single network that provides ubiquitous service will ensure that calls can be routed anywhere without current boundary restrictions.

Beginning in fiscal year 2008, funds have been allocated to begin transitioning to an IP enabled network. It must be noted that this project may take several years to come to fruition and during this time all legacy network components will require continued support.

The 9-1-1 system was designed to ensure that in an emergency, citizens have one reliable number to call for public safety assistance. The State 9-1-1 program strives to ensure that this goal is met in the most efficient and cost effective manner.

9-1-1 PROJECT PLAN (w/ $15,000,000 Fund Transfers)

Includes Capital Cost Recovery for Wireless Phase I and Phase II

Assumes Change in Tax Rates

As of July 31, 2006

Includes Wireless & Excise Taxes at a Flat Rate of $.37 through FY 2006, a Flat Rate of $.28 for FY 2007 and a Flat Rate of $.20 for FY 2008-2011

					***ANNUAL INCREASE ASSUMPTIONS**: 5% Operations Cost; Wireless Tax and Excise Tax based on tax rate reduction*				
	Actual FY03	**Actual FY04**	**Actual FY05**	**Actual FY06**	**Budgeted FY07**	**Budgeted FY08**	**Budgeted FY09**	**Budgeted FY10**	**Budgeted FY11**
Administration	$ 253,532	$ 296,513	$ 469,822	$ 431,290	$ 481,824	$ 360,052	$ 370,261	$ 381,340	$ 393,012
PSAP Network Management	$ 237,059	$ 258,625	$ 277,526	$ 339,232	$ 240,912	$ 180,026	$ 185,130	$ 190,670	$ 196,506
Sub-Total	$ 490,591	$ 555,138	$ 747,348	$ 770,522	$ 722,735	$ 540,078	$ 555,391	$ 572,010	$ 589,519
Wireline - (Existing Network Technology)	$ 13,001,668	$ 11,087,417	$ 12,925,882	$ 10,162,966	$ 18,024,700	$ 18,925,935	$ 19,872,232	$20,865,843	$21,909,136
Wireline - (Proposed transition to IP enabled network)**						$ 10,000,000	$ 5,000,000	$5,000,000	$0
Phase I Wireless - (Includes Cost Recovery)	$ 1,566,822	$ 1,948,627	$ 2,581,835	$ 1,392,829	$ 1,400,000	$ 1,470,000	$ 1,543,500	$ 1,620,675	$ 1,701,709
Phase II Wireless - (Includes Cost Recovery)	$ -	$ 3,338,435	$ 4,341,115	$ 5,985,541	$ 7,989,485	$ 8,388,959	$ 8,808,407	$ 9,248,828	$ 9,711,269
TOTAL PROGRAM COSTS	$ 15,059,080	$ 16,929,617	$ 20,596,180	$ 18,311,858	$ 28,136,920	$ 39,324,972	$ 35,779,530	$ 37,307,356	$ 33,911,632
FUNDS FROM PRIOR	$ 22,503,370	$ 19,497,150	$ 25,736,153	$ 33,122,221	$ 44,996,452	$ 40,950,709	$ 19,628,322	$ 2,361,825	$ -
WIRELESS TAX	$ 9,596,186	$ 11,972,954	$ 12,927,897	$ 14,620,376	$ 11,522,436	$ 8,483,496	$ 8,797,252	$ 9,122,612	$ 9,460,005
EXCISE TAX	$ 13,914,520	$ 13,748,484	$ 14,317,661	$ 14,116,318	$ 11,125,184	$ 8,191,015	$ 8,493,954	$ 8,808,097	$ 9,133,858
INTEREST INCOME	$ 539,577	$ 447,181	$ 736,690	$ 1,449,395	$ 1,443,558	$ 1,328,073	$ 1,221,828	$ 1,136,300	$ 1,056,759
Total Collections	$ 24,050,284	$ 26,168,620	$ 27,982,249	$ 30,186,088	$ 24,091,178	$ 18,002,584	$ 18,513,033	$ 19,067,009	$ 19,650,622
TOTAL FUNDS	$ 46,553,654	$ 45,665,770	$ 53,718,402	$ 63,308,310	$ 69,087,630	$ 58,953,293	$ 38,141,355	$ 21,428,834	$ 19,650,622
PRIOR PERIOD ADJ OR PROJECT CARRY-FORWARD	$ 2,576	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
TRANSFER TO GENERAL FUND	$ 12,000,000	$ 3,000,000	$ -	$ -	$ -				
EXPENDITURES	$ 15,059,080	$ 16,929,617	$ 20,596,180	$ 18,311,858	$ 28,136,920	$ 39,324,972	$ 35,779,530	$ 37,307,356	$ 33,911,632
FUNDS FORWARD	$ 19,497,150	$ 25,736,153	$ 33,122,221	$ 44,996,452	$ 40,950,709	$ 19,628,322	$ 2,361,825	$ (15,878,523)	$ (14,261,010)
Wireless Tax Rate	$ 0.37	$ 0.37	$ 0.37	$ 0.37	$ 0.28	$ 0.20	$ 0.20	$ 0.20	$ 0.20

** Transition to robust IP enabled network in FY08 is pending approved standards development.

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE
SENATE

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PHOENIX, ARIZONA 85007

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HOUSE OF
REPRESENTATIVES

DATE: October 17, 2006

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

THRU: Richard Stavneak, Director

FROM: Jenna Seplow, Fiscal Analyst
Russell Frandsen, Fiscal Analyst

SUBJECT: AHCCCS – Review of Capitation Rate Change

Request

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

AHCCCS is proposing rate increases for the Traditional Medicaid, Proposition 204 (previously the MN/MI population), KidsCare and KidsCare Parents populations as well as the Arizona Long-Term Care System (ALTCS) Elderly and Physically Disabled population.

Summary/Recommendation

The JLBC Staff recommends that the Committee give a favorable review to the capitation rates proposed by AHCCCS.

The proposed rates would cost $6.4 million less from the General Fund than budgeted in FY 2007. The County requirement would be $2.5M less than budgeted. The actual surplus will also depend on enrollment growth. Current Acute and ALTCS caseloads are below forecast.

AHCCCS' actuaries use encounter data, financial information and projected enrollment to determine the actual cost of services and, thereby, recommend increases or decreases in capitation and Fee-For-Service (FFS) rates.

(Continued)

Analysis

Acute Care
This population represents members who participate in the Traditional Medicaid, Proposition 204, and KidsCare and KidsCare Parents programs.

In FY 2007, the approved Acute Care budget estimated capitation rate growth at 6.5%. AHCCCS states that the increase in FY will be only 5.9%. Based on enrollment projections used in developing the FY 2007 appropriation, this would cost $3.9 million less than budgeted from the General Fund. *Table 1* shows the proposed capitation rates for each patient group.

Increases in the cost and the utilization of pharmacy, physician, and inpatient benefits are responsible for 69% of the 5.9% rate growth above FY 2006.

- Pharmacy – Costs are predicted to increase between 3.7% and 15.2% as a result of increased utilization and treatment costs. The pharmacy component accounts for 10% of the rate increase above FY 2006.
- Physician – Costs are predicted to increase between 1.2% and 10.1% as a result of increased utilization and treatment costs. The physician component accounts for 20% of the rate increase above FY 2006.
- Inpatient – Costs are predicted to increase between 5.4% and 13.9% as a result of increased utilization and treatment costs. The inpatient component accounts for 39% of the rate increase above FY 2006.

The remainder is primarily adjustments for administrative and outpatient/emergency room increases. While these changes represent increases above FY 2006 levels they are below what was initially budgeted for FY 2007.

In FY 2007 acute care caseloads have been below forecast. As a result, additional savings may be generated by lower-than-expected enrollment.

Policy Changes
Laws 2006, Chapter 331 added statutory language that limits capitation rate adjustments to utilization and inflation unless those changes are approved by the Legislature or are specifically required by federal law or court mandate. For AHCCCS Acute Care, 1 program change is projected to impact rates in FY 2007:

Incontinence Supplies
In June 2005, a statewide class action lawsuit (*Ekloff v. Rodgers*) was filed seeking to change Arizona's Medicaid policy which only permitted coverage for incontinence briefs (i.e. diapers) for children with disabilities when a child had experienced skin breakdown, sores or infection, but not to prevent disease or injury. As a result of the court's ruling in *Ekloff v. Rodgers*, AHCCCS is now mandated by the court to provide incontinence supplies to members aged 3 through 20 who are incontinent as a result of a disabling condition. The impact on the Acute Care program is estimated to be $3.2 million for CY 2007. This cost has been incorporated into the $3.9 million projected savings for Acute Care.

Long-Term Care (ALTCS)
ALTCS services are provided to the elderly and physically disabled in need of long-term care either in nursing care facilities or in home and community-based settings (HCBS).

The approved FY 2007 budget provided for a 7.0% capitation rate increase; however, the proposed ALTCS monthly capitation rate (averaging approximately $3,120 for CY 2007) represents an increase of 4.8%. Based on enrollment projections used in developing the FY 2007 appropriation, the capitation rate

(Continued)

change will result in state match savings of $5 million. Of the additional state match savings, approximately half would be realized by the state, and half by the counties.

The 2 main reasons for the lower-than-anticipated levels of spending include: (1) 5-year rebidding of the provider contracts resulted in lower capitation rates and (2) a higher than anticipated utilization of home and community based services instead of nursing facilities. Contracts by county for long-term care are bid out every 5 years. In non-bid years, contracts are renewed annually with rate adjustments for utilization and inflation. The rebid process did not add to the number of service providers except for replacing the third Maricopa County option made vacant October 1, 2005 when the Maricopa County Long Term Care Plan terminated its contract.

In FY 2007 enrollment in the ALTCS program has been below forecast. As a result, additional savings may be generated by lower-than-expected enrollment.

Table 1

Monthly Regular Capitation Rates

Populations	Current CYE 06 Rate	Budgeted CYE 07 Rate	Proposed CYE 07 Rate	CYE 06 - CYE 07 % Change
Traditional Medicaid/KidsCare				
Age<1	$427.50	$455.80	$481.79	12.70%
Age 1 - 13	104.82	111.57	108.48	3.49%
Age 14 - 44 (Female only)	185.58	197.79	191.93	3.42%
Age 14 - 44 (Male only)	126.76	135.52	134.70	6.26%
Age 45+	359.82	383.38	367.93	2.25%
SSI with Medicare	185.82	197.75	184.60	-0.66%
SSI without Medicare	577.65	615.19	636.86	10.25%
Family Planning	16.39	17.41	17.37	5.98%
Deliveries	6,061.26	6,452.17	6,305.03	4.02%
Prop 204				
Prop 204 - Conversions	$425.94	$453.34	$438.44	2.93%
Prop 204 - Medically Eligible	827.68	880.91	974.27	17.71%
Prop 204 - Newly Eligible	425.94	453.34	438.44	2.93%
Hospital "Kick" Payment	10,136.52	10,840.88	10,491.29	3.50%
ALTCS				
Statewide Average Rate	$2,976.56	3,184.92	$3,120.34	4.8%

RS/JS/RF:ym

Janet Napolitano, Governor
Anthony D. Rodgers, Director

AHCCCS

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

RECEIVED
SEP 12 2006
JOINT BUDGET COMMITTEE

September 12, 2006

The Honorable Bob Burns, Chairman
Joint Legislative Budget Committee
1700 West Washington
Phoenix, AZ 85007

Dear Senator Burns:

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.

- Long Term Care Capitation Rates for Contract Year Ending 2007
- Acute Care Capitation Rates for Contract Year Ending 2007

As required by the Federal Balanced Budget Act of 1997, Title XIX and Title XXI Managed Care Programs must have actuarially sound capitation rates. The following proposed rate adjustments are in the process of being reviewed by the Centers for Medicare and Medicaid Services for an October 1, 2006 implementation.

Long Term Care Capitation Rates
For State Fiscal Year 2007 AHCCCS was appropriated an increase of 7.0% for ALTCS rates. In March 2006 AHCCCS estimated that the ALTCS increase would be in the range of 6.5-7.5%. This estimate was developed based on two specific caveats. The first was that the program was in the midst of a competitive Request for Proposal process and the agency had not yet received the bids from prospective contractors. The continued success of the ALTCS program generated strong competition in several areas of the state helping to keep overall cost growth down. The second caveat assumed that the same mix ratio of nursing facility to home and community based placements would exist for the Contract Year Ending 2007. With regard to both of these issues the rates were positively impacted to reduce the overall capitation rate increase required for the ALTCS program. The actual increase in capitation rates for Long Term Care is 4.8% (attachment 1).

These rate adjustments reflect the Elderly and Physically Disabled population and do not include the Developmentally Disabled population, which is administered through the Arizona Department of Economic Security.

ALTCS Budget Impact
As detailed in Attachment 1 the estimated cost of the new rates is $46.0 million, of which approximately $15.4 million is state match.

<u>Acute Care Capitation Rates</u>

When using the FY 2007 Appropriation Report projected member months, the overall weighted acute care rate increase is 5.9% for Contract Year Ending 2007 (Attachment 1). This rate increase is very close to the budgeted rate of 6.0% and the March estimate made by AHCCCS of 6.0-7.0%.

The major components accounting for approximately 69% of the overall increase are depicted in Attachment 2.

1. Inpatient Hospital costs account for 39% of the overall increase.
2. Physician costs account for 20% of the overall increase.
3. Prescription drug costs account for another 10% of the overall increase.

Budget Impact

As detailed in Attachment 1, the overall budget impact as a result of the new acute care rates is estimated to be $162.2 million in total funds of which an estimated $53.9 million is state match. This impact is calculated by using the JLBC estimated FY 2007 member months times the current capitation rates and comparing that cost to the new rates.

Policy Changes

Per the new legislative mandate in ARS 36-2901.06 and 36-2941, AHCCCS has not included any changes beyond the limits that are now delineated in law.

Should you have any questions on any of these issues please feel free to contact Tom Betlach at (602) 417-4483.

Sincerely,

Anthony D. Rodgers
Director

c: Gary Yaquinto, OSPB
Richard Stavneak, JLBC

Attachments

ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

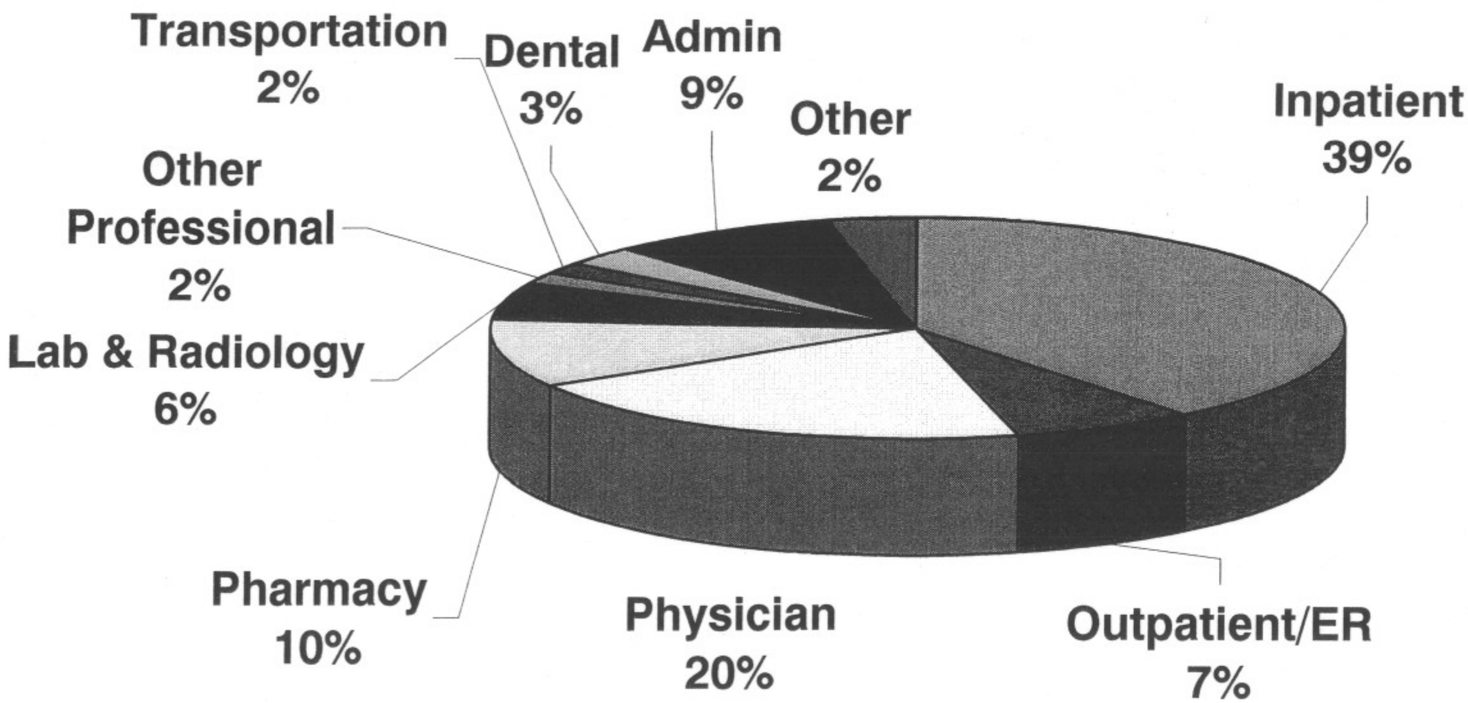
Budget Impact of FY 2007 Capitation Rate Increases
(Rates Weighted Accross All Reinsurance Deductibles)
Attachment 1

	Statewide Rates SFY06	Statewide Rates SFY07	FY07 Population	SFY06 Rate with FY 07 Pop.	SFY07 Rate with FY 07 Pop.	Change Inc. (Dec.)	Percent Impact
Title XIX TANF/SOBRA	$ 161.05	$ 170.08	6,921,504	1,114,708,200	1,177,209,400	62,501,200	5.6%
Title XIX SSI w/ Medicare	$ 185.82	$ 184.60	732,163	136,049,500	135,160,400	(889,100)	-0.7%
Title XIX SSI w/o Medicare	$ 577.65	$ 636.86	642,245	370,991,200	409,022,800	38,031,600	10.3%
Title XIX AHCCCS Care	$ 425.94	$ 438.44	1,240,704	528,468,900	543,975,600	15,506,700	2.9%
Title XIX MED	$ 827.68	$ 974.27	58,812	48,677,700	57,298,900	8,621,200	17.7%
Title XIX Prior Period	$ 267.20	$ 308.27	530,907	141,858,300	163,662,600	21,804,300	15.4%
Title XIX Other	$ 1,974.28	$ 2,071.39	140,676	277,733,800	291,394,900	13,661,100	4.9%
Title XXI Children	$ 118.97	$ 123.82	685,644	81,571,100	84,896,400	3,325,300	4.1%
Title XXI Parents	$ 223.90	$ 222.04	180,948	40,514,300	40,177,700	(336,600)	-0.8%
Acute Subtotal	$ 246.15	$ 260.72	11,133,603	2,740,573,000	2,902,798,700	162,225,700	5.9%
					Acute State Impact	53,883,900	
					Acute Federal Impact	108,341,800	
ALTCS (EPD)	$ 3,062.92	$ 3,209.64	308,100	943,685,700	988,890,100	45,204,400	4.8%
ALTCS (EPD) Prior Period	$ 853.63	$ 942.44	8,245	7,038,200	7,770,400	732,200	10.4%
ALTCS Acute Only	$ 642.30	$ 669.68	3,900	2,505,000	2,611,800	106,800	4.3%
ALTCS Subtotal	$ 2,976.56	$ 3,120.34	320,245	953,228,900	999,272,300	46,043,400	4.8%
					ALTCS State Impact	15,378,500	
					ALTCS Federal Impact	30,664,900	
Total Budget Impact	$ 322.49	$ 340.68	11,453,848	3,693,801,900	3,902,071,000	208,269,100	5.6%
					Total State Impact	69,262,400	
					Total Federal Impact	139,006,700	

NOTES:

1) Population estimates for FY 2007 are taken from the JLBC Appropriations Report - Member Years multiplied by twelve to approximate annual member months. The exception is Prior Period which is based on the preliminary AHCCCS FY07 rebase. ALTCS was split between EPD, PP, and Acute Care Only using the preliminary AHCCCS ALTCS forecast for FY07.
2) Title XIX Other category includes Deliveries, Hospital Supplemental Payments, AIDS/HIV and Family Planning.
3) Title XXI Children rates are weighted based on total mm by age group for SFY 2006 and SFY 2007 forecast.
4) Federal Share is based on weighted FMAP and enhanced FMAP for SFY 2007 of 66.60% for Title XIX and 76.62% for Title XXI.

AHCCCS Acute Care
CYE 07 Capitation Rate Impact
Service Category % of Overall Rate Increase
Attachment 2



Overall Rate Increase 5.9%

*Other includes PT, DME, NF and HH

Acute Care Actuarial Memorandum

I. Purpose:

The purpose of this actuarial memorandum is to demonstrate that the Acute Care capitation rates were developed in compliance with 42 CFR 438.6(c). It is not intended for any other purpose.

II. Overview of Rate Setting Methodology:

The contract year 2007 (CY07) rates were developed as a rate update from the previously approved contract year 2006 (CY06) capitation rates. The CY07 rates cover the twelve month contract period of October 1, 2006 through September 30, 2007.

The Acute Care rates were developed from historical Acute Care data including Arizona Medicaid managed care encounter data (via an extract that provides utilization and cost data, referred to as the "databook"), as well as health plan financial statements. Other data sources include programmatic changes, Center for Medicare and Medicaid Services (CMS) National Health Expenditure Report estimates and Global Insight Prospective Hospital Market Basket Inflation Index (GI) information.

Trend rates were calculated from the databook and other sources on a unit cost and/or utilization basis by category of service (COS) and a cap was applied to limit the negative and positive trends to a reasonable level. Experience adjustments were calculated using profit/loss information from the health plan financial statements as well as the encounters per member per month (PMPM) compared to the capitation rate. These adjustments also include state mandates, court ordered programs and other program changes, if necessary. For more information on trends and experience adjustments see the Trend and Experience sections.

The Acute Care program has a large membership base, which allows for the experience data to be analyzed by the different rate cells, which are comprised of members with similar risk characteristics. The rate cells were analyzed by major categories of aid (COA), i.e. risk groups, and COS. In addition, Arizona Health Care Cost Containment System (AHCCCS) develops rates by Geographic Service Area (GSA).

The experience data includes only Acute Care Medicaid eligible expenses for Acute Care Medicaid eligible individuals, as well as reinsurance amounts. The Prior Period Coverage (PPC) rates are reconciled to a maximum 2% gain or loss. Additional payments are made for HIV/AIDS members receiving certain drugs, for Medical Expense Deduction members via a Hospital Supplemental payment, and for members giving birth via a Maternity Delivery Payment.

The general process in developing the prospective rates involves trending (with experience adjustments) the CY06 capitation rates to the midpoint of the effective period, which is April 1, 2007. The next step involves the deduction of the reinsurance offsets. Following this calculation, the projected administrative expenses, risk/contingency margin and premium tax are added to the projected claim PMPMs to obtain the capitation rates. In the final step, an eligibility choice adjustment is applied creating budget neutral results. Each step is described in the sections below. In addition there are sections dedicated to the development of other rates including, but not limited to, the Maternity Delivery Payment, PPC rates and HIV/AIDS rates.

III. Projected Trend Adjustments

The trend analysis includes both the financial data experience and the encounter data experience. Financial data experience is from the contract year ending September 2003 through March 2006. Encounter data experience is from the contract year ending September 2003 through June 2005. In addition to using encounter and financial data, AHCCCS used information from CMS National Health Expenditure (NHE) Report estimates, GI information, and changes in AHCCCS' Professional and Outpatient Fee Schedules, Dental Fee Schedule, Transportation Schedule and other sources. AHCCCS developed utilization and unit cost trend estimates using the encounter data. These trends were developed by major COA and COS, with a cap on the percentage increase and decrease to smooth out unreasonable trends. Once these trends were developed they were analyzed by comparing the results to reports and studies (for example the CMS NHE report). The utilization and unit cost trend rates used in projecting the claim costs are summarized in the Appendix in Table A1. The prospective PMPM trends are shown below in Table I.

Table I: Prospective Average Annual PMPM Trends

PMPM Trends					
Categories of Service	TANF & KidsCare Combined	SSI With Medicare	SSI without Medicare	HIFA	TWG
Hospital Inpatient	11.1%	13.9%	13.7%	11.8%	5.4%
Outpatient Facility	2.8%	4.0%	4.0%	4.2%	-1.0%
Emergency Room	6.0%	10.8%	7.2%	5.3%	4.5%
Primary Care	5.1%	6.4%	5.5%	5.2%	2.4%
Referral Physician	5.0%	6.4%	5.5%	4.6%	2.4%
Other Professional	6.3%	5.1%	1.8%	10.1%	1.2%
Pharmacy	8.0%	11.6%	4.8%	15.2%	3.7%
Other	6.8%	9.8%	9.8%	10.3%	6.0%

Hospital Inpatient Trends

Using the data sources mentioned in Section II and emphasizing the AHCCCS encounter data, the inpatient utilization varied by -3.8 to 5.6 percent annually, depending upon rating group. For CY07 AHCCCS used the encounter data to develop the inpatient unit costs which varied between 7.6 to 10.0 percent annually. On a combined basis, the per member per month (PMPM) trends for inpatient hospital have been trended at 5.4 to 13.9 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

Hospital Outpatient and Emergency Room Trends

Based on Chapter 279, Laws 2004, effective July 1, 2005, AHCCCS changed the hospital outpatient and emergency room reimbursement methodology in order to help control costs and to allow for a better prediction of trends. AHCCCS developed a new prospective outpatient hospital payment methodology based on a procedure code level fee schedule that is derived from Medicare's Outpatient Hospital Prospective Payment System (OPPS). This process applies to all in-state and out-of-state non-Indian Health Services hospitals. The methodology patterns itself after the OPPS by grouping together procedures that are similar in nature for the purpose of determining a fee. However, instead of assigning fees from the Medicare national database, the AHCCCS Outpatient Fee Schedule (OPFS) is populated with fees based on AHCCCS hospital specific data.

This new methodology will allow AHCCCS to better control and predict future outpatient cost inflation while at the same time paying the hospitals a more equitable cost-based rate for services. Due to this methodology change, the hospital outpatient and emergency room unit cost inflation trends are not based on historical encounter trends, but on predicted future changes to the OPFS. Per the AHCCCS Rule for OPFS, on an annual basis the rates are to be adjusted by multiplying the rates effective during the prior year by the GI or by adjusting rates at varying levels with the total dollar impact equal to that of the GI inflationary increase. Based on this information unit costs have been trended at 4 percent annually. The utilization trends were developed using the data sources mentioned in Section II with emphasis on the AHCCCS encounter data. These trends were adjusted by -4.8 to 6.5 percent annually. On a combined basis, the PMPM costs for hospital outpatient and emergency room have been trended at -1.0 to 10.8 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

Physician and Other Services Trends

Using the data sources mentioned in Section II and emphasizing the AHCCCS encounter data, the assumed utilization for physicians and other professionals increased by -2.3 to 10 percent annually, depending upon rating group and category of service. Based on a review of the same sources, unit costs have been trended at -3.3 to 7.9 percent annually. On a combined basis, the PMPM costs for the physicians and other professionals have been trended at 1.2 to 10.1 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

Pharmacy Trends

Using the data sources mentioned in Section II and emphasizing the AHCCCS encounter data, the assumed pharmacy utilization increased by 3.1 to 9.9 percent, depending upon rating group. Based on a review of the same sources, unit costs have been trended at 0.2 to 4.9 percent. On a combined basis, the PMPM costs for pharmacy have been trended at 3.7 to 15.2 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

Other Services Trends

Using the data sources mentioned in Section II and emphasizing the AHCCCS encounter data and changes in transportation and dental fee schedules, the assumed PMPM costs for other services have been trended at 6.0 to 10.3 percent, depending upon rating group. These ranges are summarized in the Appendix in Table A1.

IV. Projected Experience Adjustments

The projected experience adjustments are calculated by GSA and COA using the health plan financial statements, AHCCCS encounter data and medical capitation rates.

The projected experience adjustments are a function of two components: a financial component and an encounter component. The financial component is based on the health plans' reported profit/loss (1st half of CY06) trended forward to CY07. The encounter component compares the CY06 medical capitation rate (before Part D adjustments) to the CY05 encounter data trended forward to CY06. This percentage is trended to CY07. Next, AHCCCS combines the financial and encounter percentage components to come up with a weighted average percentage, using 25% weight on the financial component and 75% on the encounter component. This weighted component is capped with a ceiling and floor to exclude unreasonable percentages. AHCCCS takes this final weighted experience adjustment and backs out the projected trend adjustments that are described in Section III. This final projected experience adjustment is then used to calculate the COS utilization, unit costs and PMPM experience adjustments.

The prospective PMPM experience adjustments are shown below in Table II. The prospective utilization and unit cost experience adjustments used in projecting the claim costs are summarized in the Appendix in Table A2.

Table II: Prospective Average Annual PMPM Experience Adjustments

PMPM Trends					
Categories of Service	TANF & KidsCare Combined	SSI With Medicare	SSI without Medicare	HIFA	TWG
Hospital Inpatient	-0.9%	-13.2%	3.4%	-11.3%	-2.4%
Outpatient Facility	-0.8%	-4.1%	1.0%	-4.4%	2.5%
Emergency Room	-1.6%	-10.4%	1.9%	-5.4%	-0.9%
Primary Care	0.4%	-6.5%	1.3%	-5.1%	0.7%
Referral Physician	-1.2%	-6.5%	1.3%	-4.7%	0.7%
Other Professional	-1.6%	-5.3%	0.5%	-9.4%	1.3%
Pharmacy	-3.2%	-11.5%	1.3%	-14.5%	-0.5%
Other	-2.6%	-9.6%	2.5%	-9.8%	-1.2%

The prospective combined PMPM experience and trend adjustments are shown below in Table III. The prospective combined experience and trend adjustments utilization and unit cost rates used in projecting the claim costs are summarized in the Appendix in Table A3.

Table III: Prospective Average Annual PMPM Trend and Experience Adjustments

PMPM Trends					
Categories of Service	TANF & KidsCare Combined	SSI With Medicare	SSI without Medicare	HIFA	TWG
Hospital Inpatient	10.0%	-1.2%	17.5%	-0.9%	2.9%
Outpatient Facility	1.9%	-0.3%	5.1%	-0.3%	1.5%
Emergency Room	4.3%	-0.8%	9.2%	-0.3%	3.6%
Primary Care	5.5%	-0.5%	6.9%	-0.2%	3.1%
Referral Physician	3.7%	-0.5%	6.9%	-0.3%	3.1%
Other Professional	4.6%	-0.5%	2.3%	-0.3%	2.5%
Pharmacy	4.5%	-1.2%	6.1%	-1.5%	3.2%
Other	4.0%	-0.8%	12.5%	-0.5%	4.7%

V. State Mandates, Court Ordered Programs and Program Changes

Due to the case of Ekloff vs Rodgers, a class action lawsuit against AHCCCS, members aged 3 through 20 who are incontinent as a result of a disabling condition, and who have a physician's prescription for incontinence supplies (i.e. diapers), are eligible to receive coverage for their incontinence supplies under the Acute program. The impact on the AHCCCS Acute Care program is estimated to be approximately $3,214,920 for CY07. The statewide impact is a 0.11% increase. This is the only program change proposed for CY07.

VI. Prospective Projected Net Claim PMPM

The CY06 utilization, unit costs and net claims PMPMs are trended forward and adjusted for experience trends, state mandates, court ordered programs and program changes to come up with the CY07 utilization, unit costs and net claims PMPMs for each COS and COA.

VII. Prospective Reinsurance Offsets

The CY06 reinsurance offsets were reviewed by AHCCCS for appropriateness and reasonableness using reinsurance encounter information. As a result of this review adjustments were made to the reinsurance offsets. The statewide prospective impact is -0.35%.

VIII. Prospective Administrative Expenses and Risk Contingency

The administrative expense is 9% for general administration, which was determined to be appropriate to cover the contractors' average expenses. The risk contingency load remained at 2.5% for the rate cohorts without a risk corridor and 2.0% for the PPC rate cohorts as it includes a 2.0% risk arrangement.

IX. Prospective Proposed Capitation Rates and Their Impacts

The proposed capitation rates equal the sum of the projected net claim PMPM (in Section VI) less the reinsurance offsets (in section VII) and the projected administrative expenses and risk contingency PMPM (in section VIII), divided by one minus the two percent premium tax. The final adjustment, which is a budget neutral adjustment, is the eligibility choice adjustment (in Section X). Appendix II contains the proposed capitation rates and the budget impact for all capitation rates using state fiscal year 2007 member months and actual health plans reinsurance deductible levels.

X. Eligibility Choice Adjustment

AHCCCS evaluated eligibility choice data to determine if a selection bias by higher acuity individuals existed between the contractors. After considering the population size of rate cells within all geographic regions on an individual health plan basis it was decided that only Maricopa County contained enough data to credibly evaluate. Also for CY07 AHCCCS decided to exclude the SSI With Medicare risk group since their past experience and enrollment choice patterns could differ from current due to the implementation of Medicare Part D and the resulting Medicare Advantage Prescription Drug Special Needs Plans.

After completion of the analysis, AHCCCS concluded that an adjustment was necessary to five of the six contractors to compensate for selection bias. The budget neutral adjustment had an overall average impact, depending on the contractor, between a 2% decrease and a 3% increase on a PMPM basis.

XI. Cesarean Delivery Analysis

Analysis of five years of AHCCCS contractor experience covering CYE01 to CYE05 has indicated that the percentage of Cesarean births continues to increase statewide. As a result of this analysis, two adjustments were made.

AHCCCS Medicaid Managed Care Delivery Proportions		
Contract Year	Vaginal	Cesarean
CYE01 - Actual	79.4%	20.6%
CYE02 - Actual	77.7%	22.3%
CYE03 - Actual	76.7%	23.3%
CYE04 - Actual	75.6%	24.4%
CYE05 - Actual	74.0%	26.0%
CYE06 - Rates	75.0%	25.0%
CYE07 - Rates	74.0%	26.0%

First, the proportion of Cesarean births assumption built into the Maternity Delivery Payment rates was increased by 1.0 percent. This adjustment better matches the prevalence of Cesarean deliveries statewide. The impact of this adjustment is a 0.5% percent increase per delivery to the overall global maternity payment.

Second, the increase in the Cesarean birth assumptions required an adjustment to be applied to the TANF/KidsCare newborn rate cell. On average, women that have a Cesarean delivery stay in the hospital two days longer than women who deliver vaginally. An increase in the assumed percentage of Cesarean deliveries will result in newborns staying in the hospital for a longer time period. An adjustment to the inpatient COS was applied to the TANF/KidsCare newborn rate cell to account for this impact.

XII. Maternity Delivery Payment

The methodology followed in developing the Maternity Delivery Payment was similar to the methodology used in the development of the prospective capitation rates. This methodology involves updating CY06 rates with utilization and inflationary trends and program changes including, specifically, the increase in Cesarean births previously discussed. The impact is a 4.0% increase per delivery to the overall global maternity payment rate over the CY06 rate.

XIII. Title XIX Waiver Group (TWG) Rates

Effective October 1, 2001, AHCCCS obtained a waiver from CMS in order to receive federal funding for the TWG Proposition 204 population which includes non-categorically linked members under 100 percent of the Federal Poverty Level (FPL) and those eligible through spenddown status. Due to the relative newness of this population, these rates were reconciled to a maximum 2.0% percent gain or loss through CY06.

Upon review of the historical data for this population included in the databook, AHCCCS determined there is now sufficient data to use the same methodology that was used on all other prospective rate cells and to discontinue reconciling this population.

Using the historical data results in a 4.2% increase for the TWG population over the CY06 rates.

XIV. Extended Family Planning Services (FPS)

Financial analyses indicated that an adjustment to the FPS rates was needed for CY07. After reviewing the audited CY05 and six months of unaudited CY06 financials the FPS capitation rates for all AHCCCS contractors were trended forward at 6.0%.

XV. HIV/AIDS Supplemental Payment

The current HIV/AIDS supplemental payment cost and encounter data was reviewed and it was determined that an increase was needed. This rate has not been adjusted since CYE 04. AHCCCS used actual cost, utilization, and enrollment data for the CY04 and CY05 time periods. This data was utilized as the base in the development of the CY07 HIV/AIDS supplemental payment. This impact was an increase of 39.2% over CY06.

XVI. KidsCare and HIFA Rates

Continuing with the methodology of previous years, AHCCCS contractors will be paid one blended capitation rate that includes experience from both the traditional TANF Medicaid population and the Title XXI SCHIP population. The rate cohorts whose experience is blended together are detailed as follows:

- TANF < 1 and KidsCare < 1;
- TANF 1– 13 M&F and KidsCare 1 – 13 M&F;
- TANF 14 – 44 F and KidsCare 14 – 18 F; and
- TANF 14 – 44 M and KidsCare 14 – 18 M.

Recent cost and encounter data indicated that no adjustment specific only to one or the other of the COAs is necessary for CY07.

Effective January 1, 2003, AHCCCS implemented a new HIFA II Waiver population. This population is eligible for Title XXI funding and the total membership is subject to an enrollment cap.

Since AHCCCS now has reasonable encounter data and financial information on this risk group, AHCCCS used the same methodology that was used on all other prospective rate cells. The statewide impact across all HIFA cells is a -1.0% decrease over CY06 HIFA rates. For HIFA trends see Section III and Appendix I.

XVII. Prior Period Coverage Rates (PPC)

PPC rates cover the period of time from the first day of retroactive eligibility to the date of eligibility determination. An analysis of AHCCCS contractor financial data, encounter data and recent reconciliations indicates an increase for this population. The statewide impact is 15.4%. The PPC rates are reconciled to a maximum 2.0% gain or loss in CY07.

XVIII. Final Capitation Rates and Their Impact

Table IV below summarizes the adjustments made to the CY06 rates.

Table IV: Adjustments to CY06 Rates

AHCCCS Medicaid Managed Care Summary			
Adjustments to CY06 Rates	Prospective	PPC	Weighted Average
Trend:			
1. Utilization	3.04%	5.04%	3.14%
2. Inflation	2.94%	5.76%	3.08%
Experience Adjustments			
1. Utilization	-0.93%	1.91%	-0.78%
2. Inflation	-0.04%	1.88%	0.06%
Program Changes:			
1. Incontinence	0.12%	0.00%	0.11%
Total Percentage Change	5.4%	15.4%	5.9%

Arizona Long Term Care System (ALTCS) Actuarial Memorandum

I. Purpose:

The purpose of this actuarial memorandum is to demonstrate that the ALTCS capitation rates were developed in compliance with 42 CFR 438.6(c). It is not intended for any other purpose.

II. Overview of Bid Methodology:

Contract year ending 2007 (CYE07) represents the first year of the newly-awarded, competitively-bid contracts for the Arizona Health Cost Containment System (AHCCCS) ALTCS program. AHCCCS actuaries developed actuarially sound capitation rates and rate ranges for the twelve month period of the CYE 07 contract year (October 1, 2006 through September 30, 2007) to be used in the evaluation of the CYE07 bids submitted by prospective contractors. CYE07 can be classified as a rate development year rather than a rate update to the previously approved CYE06 capitation rates.

Rate ranges were set for the long term care capitation rates for Maricopa, Pima, Pinal and Yavapai counties. Pima, Pinal and Yavapai counties also had capitation rates published, with prospective contractors allowed the option to bid the rates or accept the published rates. Capitation rates for all other counties were published with no option to bid. Prior Period Coverage (PPC), Acute Care Only, and HIV/AIDs rates were set by AHCCCS. Table I below summarizes the competitive bid options.

Table I: Bid Options

Rate Cohort	County	Rate Ranges Developed by AHCCCS	Rates Developed/ Published by AHCCCS	Competitve Bid Allowed by AHCCCS
Long Term Care	Apache	No	Yes	Yes
Long Term Care	Cochise	No	Yes	Yes
Long Term Care	Coconino	No	Yes	Yes
Long Term Care	Gila	No	Yes	Yes
Long Term Care	Graham	No	Yes	Yes
Long Term Care	Greenlee	No	Yes	Yes
Long Term Care	LaPaz	No	Yes	Yes
Long Term Care	Maricopa	Yes	No	Yes
Long Term Care	Mohave	No	Yes	Yes
Long Term Care	Navajo	No	Yes	Yes
Long Term Care	Pima	Yes	Yes	Yes
Long Term Care	Pinal	Yes	Yes	Yes
Long Term Care	Santa Cruz	No	Yes	Yes
Long Term Care	Yavapai	Yes	Yes	Yes
Long Term Care	Yuma	No	Yes	Yes
HIV/AIDs	All Counties	No	Yes	No
PPC	All Counties	No	Yes	No
Acute Only	All Counties	No	Yes	No

For the counties which only had a published rate option, bidders had to accept the published rates and sign an attestation that they agreed that the rates were adequate for the services to be provided under the contract. For the counties in which bidders could or had to bid, capitation rates had to fall within the actuarially sound rate ranges to be accepted. For the counties that had both a published rate option and a bid option, the bidders could either accept the published rates or they could bid on the rates. If they accepted the published rates they had to sign an attestation that they agreed with the rates. If they bid on the rates their rates had to fall within the actuarially sound rate ranges to be accepted. Each contractor submitting a bid rate that was extended an award, and accepted the offer, had a final capitation rate that fell within the rate ranges.

III. Overview of Rate Setting Methodology:

Since CYE07 is a rate development year, AHCCCS actuaries developed a new base time period with which to develop CYE07 rates and rate ranges. Medicaid managed care encounter data was used as the primary data source in development of the base time period. In addition, AHCCCS created two rate cells for the ALTCS population: a dual rate cell and a nondual rate cell. AHCCCS also rolled the ventilator dependent population into the regular non-ventilator dependent population so there will no longer be separate ventilator and non-ventilator rates. AHCCCS rates for the ALTCS population do not differ by gender and/or age, but do differ by region as well as the newly created dual and nondual rates.

In developing the rates and rate ranges, various sources of information were used including audited financial statements, encounter data, fee for service rate increases, increased placement in Home and Community Based Settings (HCBS), and actual cost and utilization experience reported by program contractors. For the encounter trends, a cap amount was set to limit the negative and positive trends to reasonable levels. When using quarterly financial statements AHCCCS used a regression analysis in projecting the trend rates. This regression analysis used adjusted claims per member per month (PMPM) to adjust for outliers. No other adjustments were made.

The encounter and audited financial experience only includes ALTCS Medicaid eligible expenses for ALTCS Medicaid eligible individuals. In addition, the experience includes reinsurance amounts and share of cost (SOC). Additional payments are given for HIV/AIDS members.

The general process for the prospective rate calculation involved trending the base period claim PMPMs to the midpoint of the effective period, or April 1, 2007, and applying the mix percentage (see Section VII). The next step involves adjustments for share of cost offset and, if applicable, any program changes. In the final step, the projected administrative expenses, risk/contingency margin and premium tax are added to the projected claim PMPMs to obtain the capitation rates. Each step is described in the sections below. There are also separate sections describing the PPC population, the Acute Care Only population and the HIV/AIDS supplemental payment.

IV. Base Period Experience:

AHCCCS used historical encounter data for the time period from October 1, 2002 through June 30, 2005. The encounter data has proven to be reliable in the past and the appropriateness of the data for rate setting purposes is expected to continue.

V. Projected Trend Rates

The trend analysis includes both the encounter data experience and the financial data experience from the quarter ending October 2001 through the quarter ending September 2005. For the trends, AHCCCS developed a range of reasonable claim PMPMs that was equal to plus and minus one and a half standard deviations from the mean. AHCCCS adjusted any claim PMPMs that fell outside of that range, by bringing them to either the top or bottom of the range depending on if the claim PMPM was above or below the range. AHCCCS then applied the statistical method of linear regression to the logarithm of the claim PMPMs to obtain the projected trend rates by service category. These encounter and financial trend rates were then compared with trend rates from sources such as the changes to the State's fee-for-service (FFS) schedule and the Program Contractors' (PC) subcontracted rates. The trend rates developed were used to bring the base encounter data to the effective midpoint of the contract year.

The final trends for the Nursing Facility (NF) component were selected from changes to the State's FFS schedule as well as changes to the State's FFS schedule in the past few years that are not reflected in the encounter data. The final trend rates for Home and Community Based (HCBS) services include the changes to the State's FFS schedule as well as trend information from the PC audited financial statements and the encounters. For the Acute Care Component, the trends were developed using both the encounters and financial information. The trend rates used in projecting the claim costs are identified in Table II.

Table II: Average Annual Trend Rate before Mix and SOC

Service Category	Combine
Nursing Facility	5.9%
Home	14.7%
Community	4.9%
Acute	4.6%
Case Management	6.1%

VI. Projected Gross Claim PMPM

The claim PMPMs were trended to the midpoint of the effective period, which is April 1, 2007.

VII. Mix Percentage

The CYE07 combine mix percentages are set using a combination of current placement percentages, program growth/saturation and the number of ALTCS members. These sources were reviewed by contractor and by county, over an 18-month period. A separate mix percentage for individuals in the home and individuals in alternative community settings was developed.

It appears that CYE07 will follow the same trend as that in CYE06, which showed certain counties hitting their saturation point with the number of members that are placed in HCBS settings. This results in small changes in the HCBS placement percentages. The HCBS and NF placement percentages can be found in Table III.

Table III: Combine Mix Percentages weighted by projected Member Months from CYE07

GSA	CYE06		CYE07		Difference
	NF Mix	HCBS Mix	NF Mix	HCBS Mix	HCBS Mix
GSA 40 (Pinal, Gila)	35.0%	65.0%	34.8%	65.2%	0.2%
GSA 42 (LaPaz, Yuma)	45.7%	54.3%	46.4%	53.6%	-0.7%
GSA 44 (Apache, Coconino, Mohave, Navajo)	40.2%	59.8%	38.5%	61.5%	1.7%
GSA 46 (Cochise, Graham, Greenlee)	41.7%	58.3%	40.4%	59.6%	1.3%
GSA 48 (Yavapai)	41.5%	58.5%	43.0%	57.0%	-1.5%
GSA 50 (Pima, Santa Cruz)	39.6%	60.4%	39.5%	60.5%	0.1%
GSA 52 (Maricopa)	36.7%	63.3%	35.0%	65.0%	1.7%
Statewide	38.0%	62.0%	36.8%	63.2%	1.2%

VIII. Projected Net Claim PMPM

The Nursing Facility and Home and Community Based Services projected gross claim PMPMs were adjusted for the mix percentages. The projected gross claims PMPMs were discounted for the recipients' Share Of Cost (SOC). The SOC component is fully reconciled with each PC. The reinsurance offset is already included in the acute care component of the rates for the elderly and physically disabled (EPD) population.

IX. Administrative Expenses and Risk Contingency

The administrative expenses range from 5.3% to 9.8% of net medical expenses plus case management. The risk contingency ranges from 2% to 4.3% of the total capitation rate.

X. Proposed Capitation Rates and Their Impacts

The proposed capitation rates for the EPD population equal the sum of the projected net claim PMPM (in Section VIII) and the projected administrative expenses and risk contingency PMPM (in section IX) divided by one minus the two percent premium tax. Table IV shows the proposed capitation rates for the EPD population statewide, combining dual and nondual risk groups. Table V shows the proposed capitation rates for the EPD population statewide for the dual and nondual risk groups.

Table IV: Statewide Projected Net Capitation PMPM EPD Combine

Service Category	Gross CYE06 Rate *	Mix	Net CYE06 Rate *	% Gross Change	% Net Change	Gross CYE07 Rate	Mix	Net CYE07 Rate
Nursing Facility	$ 4,183.00	38.0%	$ 1,589.54	5.9%	2.6%	$ 4,430.14	36.8%	$1,630.29
Share of Cost			$ (272.14)		-3.1%			$ (263.65)
Net Nursing Facility			$ 1,317.40		3.7%			$1,366.64
HCBS - Home	$ 1,169.14	45.6%	$ 533.13	14.7%	13.9%	$ 1,340.99	45.3%	$ 607.47
HCBS - Community	$ 1,286.65	16.4%	$ 211.01	4.9%	14.4%	$ 1,349.11	17.9%	$ 241.49
Case Management			$ 98.86		6.1%			$ 104.86
Acute Care			$ 526.18		4.6%			$ 550.56
Administration			$ 189.97		4.3%			$ 198.21
Risk Contingency			$ 62.97		21.0%			$ 76.22
Premium Tax			$ 59.99		7.0%			$ 64.19
Net Capitation PMPM			$ 2,999.51		7.0%			$3,209.64

* Does not include the Vent Rates, whereas CY07 includes vents

Table V: Statewide Projected Net Capitation PMPM Dual and NonDual EPD Rates

Service Category	Gross CYE07 EPD Dual Rate	Mix	NET CYE07 EPD Dual Rate	Gross CYE07 EPD NonDual Rate	Mix	NET CYE07 EPD NonDual Rate
Nursing Facility	$ 4,241.77	39.6%	$ 1,679.74	$ 6,159.00	22.1%	$ 1,361.14
Share of Cost			$ (249.20)			$ (342.26)
Net Nursing Facility			$ 1,430.54			$ 1,018.88
HCBS - Home	$ 1,280.07	41.5%	$ 531.23	$ 1,551.40	65.9%	$ 1,022.37
HCBS - Community	$ 1,284.11	19.0%	$ 243.98	$ 1,915.71	11.9%	$ 227.97
Case Management			$ 104.68			$ 105.84
Acute Care			$ 229.74			$ 2,296.58
Administration			$ 173.79			$ 331.07
Risk Contingency			$ 68.50			$ 118.28
Premium Tax			$ 56.78			$ 104.51
Net Capitation PMPM			$ 2,839.24			$ 5,225.50

XI. Acute Care Only Members

As in prior years, members who are only eligible for the acute care services in the ALTCS program will be paid the acute care component plus the case management and administrative components. Since the reinsurance policy is the same for these members as for the other ALTCS members, the same reinsurance offset is appropriate. This rate was not open to competitive bid.

XII. Prior Period Coverage (PPC) Rates

PPC rates cover the period of time from the first day of retroactive eligibility to the date of eligibility determination. The PPC rates were not open to a competitive bid. PPC rates are reconciled to a ten percent profit/loss corridor.

AHCCCS will allow HCBS services to be covered during the PPC period for CYE07. Prior to CYE07 ALTCS applicants, who were in need of long term care services while waiting for their application to be approved, would only be covered by AHCCCS for nursing facility services during the prior period time frame. Therefore, more applicants who might have safely and effectively received HCBS services, either in their own home or an Assisted Living Facility, were instead admitted to a nursing facility. This prior period admission to a nursing facility, usually following a hospital stay, occurred due to the lack of a prior period HCBS funding source.

AHCCCS believes that allowing HCBS services to be covered in PPC will have a budget neutral impact, due to the differences in capitation amounts for NF and HCBS costs. For every one member diverted from a NF, at least two members could be serviced in an HCBS setting. In addition, it is more difficult to discharge members already in a NF placement at the time of enrollment to an HCBS setting after enrollment.

AHCCCS used the actual PPC cost and PPC enrollment data for the CYE04 and CYE05 time periods. This data was utilized as the base in the development of the CYE07 PPC rates. Historical trends were developed and reviewed for appropriateness. Due to the relatively short PPC time period, AHCCCS actuaries analyzed the data by combining rate cohorts or geographic regions to enhance statistical credibility when needed.

XIII. HIV/AIDS Supplemental Payment

AHCCCS reimburses its contractors with a separate HIV/AIDS Supplemental Payment (HASP) for enrollees that have contracted the HIV/AIDS virus. This supplemental payment was developed to cover the costs of HIV/AIDS medications and lab testing, and was not open to a competitive bid.

AHCCCS used actual cost, utilization, and enrollment data for the CYE04 and CYE05 time periods. This data was utilized as the base in the development of the CYE07 HASP. This will be the first rate increase the HASP rate has had since CYE04. This rate has increased by 39.2% over CYE06.

XIV. Proposed Capitation Rates and Budget Impact

Table VI includes the net capitation rates on a statewide basis for all rate cells as well as the estimated budget impact based off of CYE07 projected member months. Appendix I shows dual and nondual EPD rates by county and program contractor.

Table VI: Proposed Capitation Rates and Budget Impact

Rate Cell	CYE07 Projected MMs	CYE06 Rate	CYE07 Rate	Based on CYE07 Annualized Projected Member Months: Estimated CYE06 Capitation	Based on CYE07 Annualized Projected Member Months: Estimated CYE07 Capitation	Percentage Impact on CYE 06 estimated capitation
NonVent	305,998	$ 2,999.51	$ 3,209.64	$ 917,844,100	$ 982,143,400	7.0%
Vent	2,102	$ 12,294.41	$ 3,209.64	$ 25,841,600	$ 6,746,700	-73.9%
EPD [1]	308,100	$ 3,062.92	$ 3,209.64	$ 943,685,700	$ 988,890,100	4.8%
PPC	8,245	$ 853.63	$ 942.44	$ 7,038,200	$ 7,770,400	10.4%
Acute Only	3,900	$ 642.30	$ 669.68	$ 2,505,000	$ 2,611,800	4.3%
HIV/AIDs	564	$ 755.46	$ 1,051.86	$ 426,300	$ 593,500	39.2%
Total				$ 953,655,200	$ 999,865,800	4.8%

1) Includes both Vent and NonVent

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HOUSE OF REPRESENTATIVES

DATE: October 16, 2006

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

THRU: Richard Stavneak, Director

FROM: Leatta McLaughlin, Fiscal Analyst

SUBJECT: Arizona Commission on the Arts – Review of the Arizona Arts Endowment Fund and Private Contributions

Request

The Arizona Commission on the Arts requests the Committee review the report on private monies that are donated for use in conjunction with public monies from the Arizona Arts Endowment Fund.

Recommendation

The Committee has at least 2 options:

1) A favorable review since the Commission generated as much in private donations in CY 2005 as they received in public money in FY 2006.

2) An unfavorable review since they generated $(2) million less in private donations in CY 2005 than they did in CY 2004.

Since the advent of public funding in CY 1998, Commission grants have helped to generate private donations. From CY 1998 to CY 2000, annual private contributions ranged from $4.4 to $6.6 million. The slowdown in the economy reduced annual contributions to between $2.0 and $2.7 million from CY 2001 to CY 2003. Due to an improving economy and better communication with arts organizations, private contributions rebounded in CY 2004, with $5.2 million donated. Private contributions decreased by $(2) million in CY 2005 due to staff vacancies and the retirement of the prior director of the agency, which resulted in a lower level of communication with the arts organizations. These positions have since been filled.

(Continued)

Analysis

Pursuant to A.R.S. § 41-986F, the Committee shall annually review the Commission's records regarding private monies that are donated for use in conjunction with public monies from the Arizona Arts Endowment Fund. The Committee is to compare the level of private contributions to the state's contribution to the Arizona Arts Endowment Fund. There is no statutory requirement that private donations match public appropriations for the Arizona Arts Endowment Fund. At the time of the endowment's enactment, however, there was an expectation that additional state funding would leverage private contributions.

The public component of the legislation began in FY 1998 and consists of an annual appropriation of up to $2,000,000 to the Arizona Arts Endowment Fund from the General Fund, with the intent that the fund reach a total endowment of $20 million. These monies are then invested by the State Treasurer, who distributes the interest income to the Arts Commission to fund arts programs across the state.

In FY 2007, a total $7 million is appropriated to the fund. In addition, Laws 2006, Chapter 351 eliminated the statutory requirement to annually appropriate no more than $2 million from the General Fund to the Arts Endowment Fund, since the fund will have accrued the originally intended $20 million amount by the end of FY 2007.

Since FY 1998, the fund has earned approximately $1,980,710 in interest, $1,768,415 of which has been expended. In FY 2007, the Commission has committed $500,667 of these monies in the form of grants.

The private component of the legislation allows the Arts Commission to partner with non-profits such that the non-profit may receive, invest, and manage private donations: 1) to its own endowment, 2) to the endowment of other arts organizations, or 3) to the non-designated portion of the Arizona Arts Endowment Fund. Donors who wish to support endowments of a specific arts organization, such as the Phoenix Symphony, may do so. Such donations are administered by the individual arts organization but must conform to the rules adopted by the Arts Commission to qualify as a contribution to the Arizona Arts Endowment Fund. Several smaller arts organizations have arranged for the Arizona Community Foundation to administer endowments on their behalf. The Arizona Community Foundation is a tax-exempt charitable organization, which manages more than 700 funds with 11 affiliate organizations across the state.

Donors who wish to endow the arts generally, without designating a particular arts organization, may do so by giving to the private non-designated portion of the Arizona Arts Endowment Fund. The Arts Commission receives the interest income from these non-designated donations and distributes the earnings according to its policy.

The table below summarizes private contributions that have been collected since the establishment of the Arizona Arts Endowment Fund. Private contributions were less from 2001 to 2003 than in previous years due to the slowing economy. Contributions increased in CY 2004 due to the improving economy and better communication practices by the Arts Commission with their arts organizations. Private contributions decreased in CY 2005 due to a decrease in communications with the arts organizations because of staff vacancies; however, the agency is now fully staffed.

(Continued)

Private Donations to the Arizona Arts Endowment Fund, by Calendar Year

	1996 [1/]	**1997**	**1998**	**1999**	**2000**	
Designated	$1,682,700	$2,973,200	$5,799,600	$3,887,300	$6,559,000	
Non-Designated	0	76,500	545,300	475,900	69,300	
Totals	**$1,682,700**	**$3,049,700**	**$6,344,900**	**$4,363,200**	**$6,628,300**	
	2001	**2002**	**2003**	**2004**	**2005**	**Total**
Designated	$2,044,000	$2,728,500	$1,819,200	$5,066,600	$3,099,900	$35,660,000
Non-Designated	(24,400) [2/]	(44,500) [2/]	191,000	162,100	140,200	1,591,400
Totals	**$2,019,600**	**$2,684,000**	**$2,010,200**	**$5,228,700**	**$3,240,100**	**$37,251,400**

1/ 1996 reporting period is from April 15, when the legislation was passed, to December 31.

2/ Losses in 2001 and 2002 were a result of overall losses in investments at the Arizona Community Foundation.

RS/LMc:ym

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JOINT BUDGET COMMITTEE

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Arizona Commission on the Arts

DATE: September 1, 2006

TO: Richard StavneakDirector, JLBC
Leatta McLaughlinBudget Analyst, JLBC

FROM: Robert C. Booker, Executive Director

SUBJECT: Arizona Commission on the Arts-Review of the Arizona Arts Endowment Fund and Private Contributions

Request

The Arizona Commission on the Arts requests the Committee review the report on private monies that have been donated for use in conjunction with public monies from the Arizona Arts Endowment Fund.

Analysis

Pursuant to A.R.S. § 41-986F, the Committee shall annually review the Commission's records regarding private monies that are donated for use in conjunction with public monies from the Arizona Arts Endowment Fund. The Committee is to compare the level of private contributions to the state's annual $2 million contribution to the Arizona Arts Endowment Fund. There is no statutory requirement that private donations match public appropriations for the Arizona Arts Endowment Fund. At the time of the endowment's enactment, however, there was an expectation that additional state funding would leverage private contributions.

The public component of the legislation began in FY 1998 and consists of an annual appropriation of up to $2,000,000 to the Arizona Arts Endowment Fund from the General Fund. These monies are then invested by the State Treasurer, who distributes the interest income to the Arts Commission to fund arts programs across the state. Most recently the Arizona State Legislature appropriated the final funding of $7 million to the Arizona Arts Endowment Fund.

Since FY 1998, the fund has earned $1,980,710 in interest, $1,768,415 of which has been expended. For FY 2007, the Commission has committed $500,667 of these monies in the form of grants.

The private component of the legislation allows the Arts Commission to partner with non-profits such that the non-profit may receive, invest and manage private donations 1) to its own endowment, 2) to the endowment of other arts organizations or 3) to the non-designated portion of the Arizona Arts Endowment Fund. Donors who wish to support endowments of a specific arts organization, such as the Phoenix Symphony, may do so. Such donations are administered by the individual arts organization, but must conform to the rules adopted by the Arts Commission to qualify as a contribution to the Arizona Arts Endowment Fund. Several smaller arts organizations have arranged for the Arizona Community Foundation to administer endowments on their behalf. The Arizona Community Foundation is a tax-exempt charitable organization, which manages more than 700 funds with 11 affiliate organizations across the state.

Donors who wish to endow the arts generally, without designating a particular arts organization, may do so by giving to the private non-designated portion of the Arizona Arts Endowment Fund. The Arts Commission receives the interest income from these non-designated donations and distributes the earning according to its policy.

The table below summarizes private contributions that have been collected since the establishment of the Arizona Arts Endowment Fund.

Private Donations to the Arizona Arts Endowment Fund, by Calendar Year

	1996*	1997	1998	1999	2000	2001	2002	2003	2004	2005	Total
Designated	$1,682,685	$2,973,245	$5,799,633	$3,887,349	$6,559,045	$2,044,004	$2,728,474	$1,819,208	$5,066,582	$3,099,880	$35,359,139
Non-Designated	0	76,481	545,336	475,921	69,266	(24,446)	(44,518)	190,968	162,130	140,188	1,591,373
Totals	**$1,682,685**	**$3,049,726**	**$6,344,969**	**$4,363,270**	**$6,628,311**	**$6,628,311**	**$2,683,956**	**$2,010,176**	**$5,228,712**	**$3,240,068**	**$37,228,917**

*1996 reporting period is from April 15, when the legislation was passed, to December 31.

ARIZONA ARTSHARE

Summary of Endowment Contributions by Calendar Year

Arts Organization	1996*	1997	1998	1999	2000	2001	2002	2003	2004	2005	Total
Arizona Opera	11,642	7,207	25,350	5,070	69,376	231,870	0	0	0	245,809	596,324
Ballet Arizona	50,000	50,000	--	--	--	--	0	0	100,000	1,544,802	1,744,802
Flagstaff Symphony	--	--	16,085	--	--	--	200	0	4,020	12,895	33,200
Heard Museum	329,591	1,880	817	2,742	35,845	6,309	0	0	266,000	8,000	651,184
Museum of Northern Arizona	--	15,000	--	--	1,165,645	--	0	100	0	838,903	2,019,648
Orpheus Male Chorus of Phx	--	--	--	--	--	33,674	39,806	16,450	70,000		159,930
Phippen Museum	--	--	--	--	420,000	--	0	0	0	0	420,000
Phoenix Art Museum	549,000	1,116,635	718,230	559,912	122,244	416,000	35,000	1,379,524	4,209,945	321,500	9,427,990
Phoenix Boys Choir	--	--	818,673	--	143,057	184,067	86,094	0	9,462	0	1,241,353
Phoenix Symphony	30,000	--	3,125,000	1,311,680	3,363,968	418,890	2,413,395	66,707	148,122	46,000	10,923,762
Scottsdale Cultural Council	275,651	375,390	1,008,277	1,661,490	1,111,585	3,005	0	0	5,000	13,000	4,453,398
Sierra Vista Symphony Assc.	--	--	--	--	--	9,817	0	80,775	550	850	91,992
Tucson Arizona Boys Chorus									50,000	22,562	50,000
Tucson Museum of Art	5,500	33,131	42,109	27,910	32,298	19,139	34,684	5,000	36,840	24,597	261,208
Tucson Symphony	23,455	316,380	41,500	223,500	95,027	228,282	90,296	170,652	156,755	20,962	1,366,809
Subtotal:	**1,274,839**	**1,915,623**	**5,796,041**	**3,792,304**	**6,559,045**	**1,551,053**	**2,699,474**	**1,719,208**	**5,056,694**	**3,099,880**	**33,441,600**
Community Foundations	**1996***	**1997**	**1998***	**1999***	**2000**	**2001***	**2002**	**2003**	**2004**	**2005**	**Total**
Arizona Community Foundation	407,846	957,622	3,592	95,045	--	492,951		100,000	0	0	2,057,056
Community Foundation for Southern Arizona	--	100,000	--	--	--	--	29,000	0	9,888	0	138,888
Subtotal:	**407,846**	**1,057,622**	**3,592**	**95,045**	**0**	**492,951**	**29,000**	**100,000**	**9,888**	**0**	**2,195,944**
Arizona ArtShare (designated)		**76,481**	**545,336**	**475,921**	**69,266**	**(24,446)**	**** (44,518)**	**190,968**	**162,130**	**140,188**	**1,591,374**
TOTALS:	**1,682,685**	**3,049,726**	**6,344,969**	**4,363,270**	**6,628,311**	**2,019,558**	**2,683,956**	**1,910,176**	**5,228,712**	**3,240,068**	**37,228,917**

*1996 reporting period is from April 15 to December 31; Orpheum Theatre,Cross Culture Dance Resources, Bead Musuem, Pickard Arts & Culture Fund

*1998 Atlatl

*1999 Sun Cities Art Museum, Sun Cities Chamber Music, Sun Cities Symphony

*2001 Grand Canyon Music Festival, Herberger Christmas House Funds, Orpheus Sound Investments, Scottsdale Artists School, Sonoran Arts League

**Investment losses through 12/31/2004

UPDATED 2005 INFO. **8/31/2006**