STATE OF ARIZONA

Joint Legislative Budget Committee

1716 WEST ADAMS
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JOINT LEGISLATIVE BUDGET COMMITTEE
Monday, November 25, 2002
8:00 a.m.*
Senate Appropriations Room 109

AGENDA

- Call to Order

- Approval of Minutes of October 24, 2002.

- DIRECTOR'S REPORT (if necessary).

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

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

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

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

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

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

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

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

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

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

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

10. AHCCCS - Report on Cost Sharing Measures.

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

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

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MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

October 24, 2002

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

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

APPROVAL OF MINUTES

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

DIRECTOR'S REPORT

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

EXECUTIVE SESSION

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

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

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

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

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

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

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

The motion carried.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Respectfully submitted:

_____
Cheryl Kestner, Secretary

_____
Richard Stavneak, Director

_____
Senator Ruth Solomon, Chairman

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

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CHRISTINE WEASON

DATE: October 17, 2002

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

THRU: Richard Stavneak, Director

FROM: Jennifer Vermeer, Assistant Director

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

Request

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

Recommendation

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

Analysis

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

(Continued)

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

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

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

RS/JV:lm

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CHRISTINE WEASON

DATE: October 16, 2002

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

THRU: Richard Stavneak, Director

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

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

Request

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

Recommendation

The JLBC Staff recommends a favorable review of the request.

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

Analysis

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

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

(Continued)

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

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

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

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

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

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

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

RS:JY:ss

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CHRISTINE WEASON

DATE: October 17, 2002

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

THRU: Richard Stavneak, Director

FROM: Gina Guarascio, Senior Fiscal Analyst

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

Request

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

Recommendation

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

Analysis

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

RS/GG:ck

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CHRISTINE WEASON

DATE: October 17, 2002

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

THRU: Richard Stavneak, Director

FROM: Stefan Shepherd, Senior Fiscal Analyst

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

Request

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

Recommendation

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

Analysis

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

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

(Continued)

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

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

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

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

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

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

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

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

RS/SSh:jb

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CHRISTINE WEASON

DATE: October 17, 2002

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

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

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

Request

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

Recommendation

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

Analysis

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

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

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DATE: October 17 2002

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

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

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

Request

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

Recommendation

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

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

Analysis

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

(Continued)

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

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

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

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

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

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

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

(Continued)

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

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

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

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

RS:PS:ss

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

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

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

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

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

RS:PS:ss

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CHRISTINE WEASON

DATE: October 16, 2002

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

THRU: Richard Stavneak, Director

FROM: Jennifer Vermeer, Assistant Director

SUBJECT: AHCCCS - REPORT ON COST SHARING MEASURES

Request

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

Recommendation

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

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

Analysis

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

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

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

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

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

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

RS/JV:lm

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CHRISTINE WEASON

DATE: October 17, 2002

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

FROM: Richard Stavneak, Director

SUBJECT: REPORT ON RECENT AGENCY SUBMISSIONS

Request

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

Recommendation

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

Reports

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

F. Department of Health Services - Report on Transfer Allocation

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

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

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

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

G. JLBC Staff - Report on Analysis of Fee Equity

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

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

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

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

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

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

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

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

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

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

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

I. State Parks Board - Report on Park Operating Expenditures

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

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

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

RS:lm

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Joint Legislative Budget Committee

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MARION L. PICKENS

DATE: November 20, 2002

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

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

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

Request

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

Recommendation

The Committee has at least 2 options regarding this item:

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

Analysis

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

(Continued)

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

RS:PS:ss

JANE DEE HULL
GOVERNOR

J. ELLIOTT HIBBS
DIRECTOR

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June 6, 2002

Senator Ruth Solomon, Chairman
Joint Legislative Budget Committee
1716 W. Adams
Phoenix, AZ 85007

Dear Ms. Solomon:

We are submitting two areas to the Joint Legislative Budget Committee (JLBC) for review; the Retiree Accumulated Sick Leave (RASL) Fund pro rata payroll charge for FY03 and some recommended changes in the travel rates.

Retiree Accumulated Sick Leave (RASL)

A.R.S. §38-616 states that the pro rata payroll charge for the RASL Fund shall be established by the Director of the Department of Administration, subject to review by the JLBC. We recommend that the pro rata charge be maintained at the budgeted rate of .40 percent of the total benefit eligible payroll for FY03. This is within the limit established by statute and consistent with the State's appropriated budget.

Travel

Mileage Reimbursement: Effective January 1, 2002, the Federal Government increased the allowance for mileage reimbursement from 34.5 cents per mile to 36.5 cents per mile. At that time we reviewed the impact on the State. Due to significant reductions in gas prices last fall and our budget conditions, we did not feel an increase was warranted. However, gas prices have increased substantially once again. This latest increase is expected to be maintained. Accordingly, we request your review of this item.

Lodging: The Federal Government has adjusted their lodging allowances for several locations. We have reviewed these changes and are recommending some adjustments to the State's maximum lodging rates (see attached). For in-state lodging we are recommending 2 increases and 2 decreases. For out-of-state lodging, we are recommending increases to 7 of the top 20 most traveled destinations by State agencies. For the remaining out-of-state destinations, we are recommending decreases for 35 cities/seasons. The budgetary impact of these lodging changes is expected to be insignificant.

If you have any questions or need any additional information, please call me at 542-2122.

Sincerely,

D. Clark Partridge
Acting State Comptroller

Attachment

cc: J. Elliott Hibbs
Lee Baron
Tom Betlach
Kristine Ward
Richard Stavneak
Paul Shannon

STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: November 20, 2002

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

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

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

Request

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

Recommendation

The Committee has at least 2 options regarding this item:

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

Analysis

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

(Continued)

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

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

RS:PS:ss

JANE DEE HULL
GOVERNOR

J. ELLIOTT HIBBS
DIRECTOR

ARIZONA DEPARTMENT OF ADMINISTRATION
FINANCIAL SERVICES DIVISION • GENERAL ACCOUNTING OFFICE
STATE CAPITOL • 1700 WEST WASHINGTON • ROOM 290
PHOENIX, ARIZONA 85007
Phone: (602) 542-5601 • Fax: (602) 542-5749

June 6, 2002

Senator Ruth Solomon, Chairman
Joint Legislative Budget Committee
1716 W. Adams
Phoenix, AZ 85007

Dear Ms. Solomon:

We are submitting two areas to the Joint Legislative Budget Committee (JLBC) for review; the Retiree Accumulated Sick Leave (RASL) Fund pro rata payroll charge for FY03 and some recommended changes in the travel rates.

Retiree Accumulated Sick Leave (RASL)

A.R.S. §38-616 states that the pro rata payroll charge for the RASL Fund shall be established by the Director of the Department of Administration, subject to review by the JLBC. We recommend that the pro rata charge be maintained at the budgeted rate of .40 percent of the total benefit eligible payroll for FY03. This is within the limit established by statute and consistent with the State's appropriated budget.

Travel

Mileage Reimbursement: Effective January 1, 2002, the Federal Government increased the allowance for mileage reimbursement from 34.5 cents per mile to 36.5 cents per mile. At that time we reviewed the impact on the State. Due to significant reductions in gas prices last fall and our budget conditions, we did not feel an increase was warranted. However, gas prices have increased substantially once again. This latest increase is expected to be maintained. Accordingly, we request your review of this item.

Lodging: The Federal Government has adjusted their lodging allowances for several locations. We have reviewed these changes and are recommending some adjustments to the State's maximum lodging rates (see attached). For in-state lodging we are recommending 2 increases and 2 decreases. For out-of-state lodging, we are recommending increases to 7 of the top 20 most traveled destinations by State agencies. For the remaining out-of-state destinations, we are recommending decreases for 35 cities/seasons. The budgetary impact of these lodging changes is expected to be insignificant.

If you have any questions or need any additional information, please call me at 542-2122.

Sincerely,

D. Clark Partridge
Acting State Comptroller

Attachment

cc: J. Elliott Hibbs
Lee Baron
Tom Betlach
Kristine Ward
Richard Stavneak
Paul Shannon

Lodging Analysis
June 6, 2002

Effective October 1, 2001, the Federal government adopted new rates for the reimbursement of lodging costs incurred by employees traveling on government business. The following is a brief review of the Federal changes, recommendations of how these changes should be applied to Arizona reimbursement rates, and an estimate of the effects the recommended changes would have on Arizona if our recommendations are adopted.

Executive Summary

We are recommending that out-of-state rates increase to the Federal rate for 7 of the top 20 most traveled destinations by State agencies. For the remaining out-of-state destinations, we recommend decreasing the State rate to match the Federal rate for 35 cities and seasons. For In-State lodging rates, we are recommending matching the federal rates resulting in an increase for two locations and a decrease for two locations. Although the proposed increases are more frequently visited locations, we believe the increases will be negligible.

Out-of-State Lodging

The most recent changes in the Federal lodging rates of the 631 domestic per diem rates for cities and seasons were distributed as follows: 54% of all rates increased, 6% of all rates decreased, and 40% of all rates remained the same.

Within the top twenty city locations most visited by Arizona employees traveling for the State, the changes were distributed as follows: 35% increased, 0% decreased, and 65% remained the same. These top twenty destinations represent approximately 52% of all reimbursed Arizona lodging. The average increase for these top twenty was 6.91%.

We propose that we change Arizona rates to coincide with Federal rates for the top twenty cities. We further propose that for the remaining 608 domestic per diem rates, we decrease Arizona rates where the Federal rates have been decreased and leave them unchanged where the Federal rates have remained the same or have increased. The distribution of changes among all other domestic per diem rates is as follows: 55% increased, 6% decreased, and 39% remained the same.

If one assumes that percentages of increase or decrease upon base is ratably allocated among all locations, then it might be argued that, as a whole adopting Federal lodging rates across the board would result in an increase equal to the average rate of change times the difference between the percentage of destinations increasing minus the percentage of destinations decreasing.

The overall, weighted increase for the top twenty destinations is 6.91%. One could estimate the likely percentage change for all destinations by multiplying the percentage of destinations increasing among the top twenty locations (35%) times their frequency (52%) and then subtracting the percentage of decreasing locations among the remaining destinations (6%) times their distribution (48%) and, finally, multiplying this remainder times the rate increase experienced among the top twenty (6.91%). This approach would yield a likely across-the-board increase in cost of 1.78%.

When considering out-of-state rates, it should be kept in mind that destination to many out-of-state trips are to conferences. The reimbursements for conference accommodations are not governed by the overall reimbursement rates. Therefore, many State travelers will be reimbursed at rates other than those shown in this analysis, and any analysis we perform in this area is therefore bound to contain inaccuracies.

In-State Lodging

2002 Federal rates for reimbursement of lodging for stays in Arizona have decreased by 0.3% under those for 2001. We recommend that Arizona modify its rates to reflect current Federal rates, including all increases and decreases.

Summary

If one can estimate a 1.11% increase in out-of-state lodging based on the recommended changes, the net effect on the State's finances is minimal.

We have attached the following spreadsheets:

1. Overall analysis of the projected overall impact on the General and Other Funds that would result from the adoption of the GAO's recommendations.

2. Out-of-state and in-state lodging spreadsheets which list in order of dollar volume of expenditure, the projected impact of the recommended changes to the out-of-state lodging rates.

3. 2002 Domestic per diem rates proposed changes for Top 20 Locations, All Other Locations, and In-State locations.

STATE OF ARIZONA

Joint Legislative Budget Committee

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MARION L. PICKENS

DATE: November 20, 2002

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

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

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

Request

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

Recommendation

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

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

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

(Continued)

Analysis

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

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

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

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

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

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

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

(Continued)

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

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

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

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

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

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

RS:PS:ss

JANE DEE HULL
GOVERNOR

J. ELLIOTT HIBBS
DIRECTOR

ARIZONA DEPARTMENT OF ADMINISTRATION
HUMAN RESOURCES DIVISION
100 N. Fifteenth Avenue, Suite 261
Phoenix, Arizona 85007
(602) 542-5482

October 1, 2002

The Honorable Ruth Solomon
Chair, Joint Legislative Budget Committee
Arizona State Senate
1700 West Washington Street
Phoenix, AZ 85007

Dear Senator Solomon:

Attached is the first bimonthly report on the implementation process of self-insurance. This bi-monthly report is required pursuant to Chapter 328, 45th Legislature, 2nd Regular Session. We look forward to sharing the progress with you and the Committee at the October meeting of the Joint Legislative Budget Committee. If you have any questions related to this report, please contact me at 542-4788.

Sincerely,

Susan Strickler
Self-Insurance Project Manager

SS/KP/lg

cc: J. Elliott Hibbs, Director, ADOA
Kathy Peckardt, Human Resources Director
Richard Stavneak, Director, JLBC
Kristine Ward, Acting Director, OSPB

ADOA
Arizona Department of Administration

Self-Insurance Progress Report

October 1, 2002

Chapter 328, 45th Legislature, 2nd Regular Session, mandates the Arizona Department of Administration (ADOA) to self-insure group health and dental benefits by October 1, 2003 and requires bi-monthly reporting on the implementation progress. ADOA has developed a plan to implement self-insurance by October 1, 2003. The following outlines the progress to date in key areas of program implementation:

Project Budget

HB2708 appropriated $1.5 million in FY '03 for costs associated with the implementation of the self-insurance program.

Identified expenditures are:

- A Project Manager
- Communication costs
- Professional and outside services

Interviews were conducted for a Project Manager. Due to the condensed implementation timeframes and unique procedures associated with State government (procurement process, legislative requirements, budget restraints, etc.), the current Benefits Manager was appointed as the Self-Insurance Project Manager. This enabled ADOA to lower potential program expenses, since existing staff, operating equipment, and current resources could be utilized at no additional cost to the program.

The consulting firm of Mercer Human Resource Consulting had previously been assigned by ADOA to assist in the facilitation of the CIGNA contract renewal. Based on the success of this renewal and Mercer's experience in state implementation of self-insurance, the firm was secured for program implementation and organizational transition.

The following table outlines the anticipated and incurred-to-date budget expenditures related to the implementation of self-insurance:

	Anticipated	Incurred as of 9/30/02	Appropriation
			$1,500,000
Personal Services			
Project Manager	$ 68,200	$ 11,847	
Assistance-40%[1]	$ 17,500		
Employee Related Expenditures			
PM- 24% ERE	$ 15,000	$ 2,520	
Assistance- ERE	$ 3,900		
Communication Costs[2]	$ 150,000		
Professional and Outside Expenditures			
Mercer Consulting	$1,195,400	$136,735[3]	
Alternative Analysis[4]	$ 50,000		
Total	**$1,500,000**	**$151,102**	
REMAINING BALANCE			**$1,348,898**

[1] Staff assistance will be necessary on a part-time basis for activities associated with implementation. It is estimated this will be required at 40% of the associated FTE.

[2] Four direct-mail newsletters will be distributed to employees/retirees between the months of October and March explaining the transition to self-insurance and necessary plan information.

[3] Mercer invoices- $51,997 incurred in July; $84,738 incurred for August

[4] A scope of work has been distributed to all contracted consulting firms for analysis and advantages/disadvantages of all available options for group health/dental coverage during FY '04. The scope will be awarded within the next 15 days.

Project Timeline- Appendix A

The timeline attached displays the program implementation deadlines and estimated timeframes anticipated with the specified activities.

Roles and Responsibilities- Appendix B

The attached matrix illustrates the identified roles and responsibilities between ADOA and Mercer Human Resource Consulting.

Self-Insurance Advisory Council

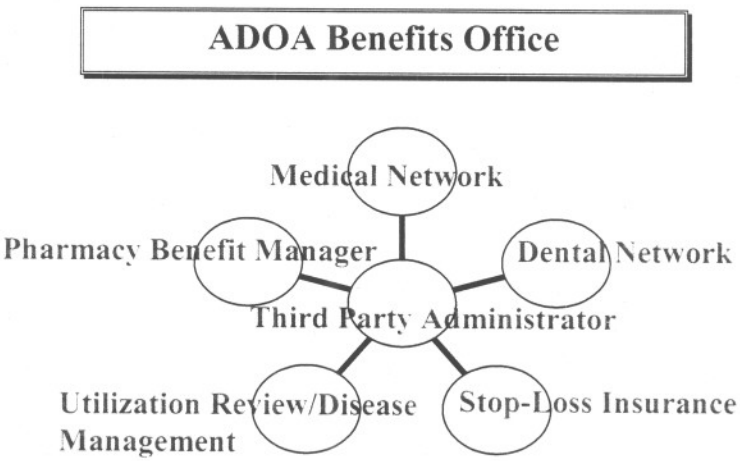
This council was established to provide an open forum in which agencies, universities, and retiree representatives could offer feedback and ensure this feedback is incorporated from all customer segments by ADOA. The Council is comprised representatives of:

- ✓ 9 Large Agencies
- ✓ Supreme Court
- ✓ Board of Regents
- ✓ The 3 Universities
- ✓ ASRS/PSRS
- ✓ OSPB/JLBC
- ✓ Retiree Representatives
- ✓ House/Senate Staff

The Council initially met on August 6, 2002, with two subsequent meetings held to date. Meetings will be held semi-monthly through December until the required Request for Proposals (RFPs) are released.

Program Vendors

Six vendors will be required for program operation:



- Third Party Administrator: The third party administrator will perform the day-to-day operations of the program. This will include payment of claims; call center operation for incoming medical and network calls; accumulation of utilization data for program analysis; and integration of the 5 service vendors.

- Medical Network: **ADOA will not contract with medical providers directly**. Medical networks are available for "rent"- or a fee to use what has already been established. These networks handle all of the operational and administrative functions associated with medical contracting and will perform the physician credentialing, facility accreditation, and network enhancement necessary to provide the State with physicians, hospitals, and medical facilities for the program. The network provider will also administer quality assurance guidelines. **The State will contract with the network, therefore, the legal liability associated with direct physician care, credentialing and questionable facility accreditation will be avoided**.
- Pharmacy Benefit Manager: **The Pharmacy Benefit Manager (PBM) will supply a network of affiliated pharmacies statewide.** The PBM will also provide a mail-order pharmacy service to assist in the reduction of costs. PBMs traditionally operate from a clinical perspective- not cost driven like an insurance company. This will provide greater flexibility with pharmacy issues and allow for better management of prescription costs. The PBM will also provide analytical data to assist the State in policy decisions impacting pharmaceutical costs such as emphasis on generic drugs, formulary performance, and possible modifications on the State requirements for program improvement.
- Utilization Review/Disease Management: The Utilization Review (UR) provider will assist in the medical management of severe or identified conditions. This provider will be staffed with medical personnel, including RN's and a Medical Director. The UR provider will assist in standard industry practices within the medical industry, such as average inpatient hospital stays and physical therapy guidelines. The UR provider will work in tandem with the third party administrator, the medical/dental network and the State. The UR provider will track medical and dental utilization patterns to assist the State in targeting key areas for improvement or modification of the program.
- Dental Network: Again, the State will "rent" a dental network for statewide coverage. This network will be responsible for quality assurance, dental accreditation, availability of specialty providers, and contract issues.
- Stop-Loss Coverage: The State will bid on stop-loss insurance coverage to protect the Fund from higher-than-expected costs. The State will only be responsible for claims under a specified limit, such as $250,000. This will allow the State to monitor the frequency of severe claims for reserve and financial purposes. This coverage is necessary during the beginning phase of self-insurance while claim history is developed and reserves are being built. Coverage will be reviewed within 3 to 5 years for possible termination.

The ADOA Benefits Office will manage all vendor activities. The additional responsibilities associated with self-insurance are discussed below under "Benefit Operations".

RFP Distribution

Program RFPs are in development and scheduled to be released in November. It is anticipated the responses will be received by February and contract awards are scheduled to take place in March. This will afford the State sufficient time to synchronize eligibility data, work with the various contractors for program coordination, and prepare for a full-positive Open Enrollment in August. The RFP committees will consist of Self-Insurance Advisory Council members and other specialists within the State.

Benefit Operations

The ADOA Benefits Office will continue to be responsible for eligibility determinations, payroll deductions, retirement deductions and/or direct payments, open enrollment, all financial activities related to Fund management, vendor management (life insurance, short-term disability, long-term disability, flexible spending accounts, vision coverage, day care center oversight) and agency assistance on benefit issues. The self-insured program will add or enhance to the Benefit Operations the following responsibilities:

- Financial Management and Accounting- Additional reconciliation will be necessary to ensure accurate premium payments are deposited from the payroll system, direct payments are deposited on a timely basis, and all exception reports are immediately reconciled. The Benefits Office will be responsible for increased reconciliation, data and trend analysis, and comparisons of Fund cash flow to member eligibility.

- Vendor Management- The State will be responsible for increased vendor oversight. Currently, there are minimal performance standards within the CIGNA contract related to financial and data reporting. With the advent of self-insurance, significant reporting and performance requirements will be necessary to maintain member satisfaction and fund solvency.

- Program Overview and Management- There will also be significant data and trend analysis required for program management. Oversight will also be necessary for continual program flow, customer satisfaction, and program development.

Due to the above increased responsibilities, ADOA has requested 7 additional FTEs as part of the FY '04 budget request, transfer of 1.5 FTEs from the Pro-Rata Fund and reclassification of 5 current HITF positions, for a total of $490,200 (NOTE: Staffing levels would still be below staffing levels of other states that oversee a self insurance program):

Total FTE Request	**8.5**
Personal Services	**$ 377,100**
Employee Related Expenses	**$ 78,600**
Operating Expenses (Supplies, etc.)	**$ 24,000**
Equipment- 7 PCs ($1,500 each)	**$ 10,500**
TOTAL FTE & Associated Expenditures	**$ 490,200**

Appeals Process

ADOA continues to research options for an appeals process. Currently, CIGNA handles all first and second level appeals. Arizona statutes governing health plans require the Department of Insurance to handle and monitor appeals above the first and second level. This is done through the Office of Administrative Hearings. Arizona governing statutes and Department of Insurance requirements, which apply to private insurance companies, would not be applicable for the self-insured program. Therefore, an internal appeals process must be created which may or may not mirror established procedures for private industry.

Other states have created an appeals board or governing entity to handle employee or retiree appeals. Due to the present budget constraints, ADOA is exploring options currently available within the State structure. This involves two choices:

- Office of Administrative Hearings- All appeals above the third-party administrator level would go directly to the Office of Administrative Hearings (OAH). An Administrative Law Judge (ALJ) would evaluate the appeal and render a decision. Two alternatives then exist. One, to allow the ALJ Decision to become binding without review by the Agency Director. This would allow employees and retirees to appeal the ALJ Decision directly to Superior Court. The second, to allow the director of ADOA to review appeals of decisions made by OAH, and then allow appeals to Superior Court.

- Independent Review Organization- These organizations provide a panel review of appeals. Research is in process to determine the average fees and availability in Arizona. This review would be done without the employee/retiree present, but would be medically based since the panel would be comprised of physicians and medical providers.

Research findings on costs of each option, advantages and disadvantages, and any statutory or rule requirements needed for each option will be reported in the next progress report.

Available FY '04 Options

As a contingency plan, ADOA will be researching all available health and dental options for FY '04. Each option will be analyzed should self-insurance not proceed for advantages/disadvantages and the costs associated with each option. These options include renewal of the current CIGNA contract; self-insuring the PPO plan only; self-insuring the pharmeceutical portion of the program while maintaining a fully insured HMO/POS/PPO plan; any and all options available to the State for FY '04.

CIGNA Renewal Comparison

Research has been done to determine health insurance costs for FY '04 if the current CIGNA contract was renewed another year and for comparison with the costs of self-insurance:

	Plan Year				
	2002	Current- 2003		2004	
	Initial Contract Year	Contractual Rate Cap[5]	Negotiated Increase	Contracted Rate Cap[6]	Potential Contracted Increase[7]
HMO					
Maricopa	N/A	15%	15%	30%	15%
Pima	N/A	18%	18%	36%	18%
POS					
Maricopa	N/A	22%	17%	44%	27%
Pima	N/A	25%	17%	48%	31%
PPO	N/A	30%	25.6%[8]	60%	47%

The plan year 2004 contractual rate caps are based on increases over the initial (2002) contract rates. The contract language allows for increases in the 2004 plan year based on the difference between the second year (2003) contracted rate cap and the negotiated increase in 2003. The 2004 contracted rate caps are double the 2003 rate caps. With the current health care market, increasing trends in medical costs, and claims utilization reported for the first quarter of this plan year, an average 24% increase in health insurance premiums can be expected in FY '04 based on the aforementioned contract caps.

Implementing a Self Insurance Program

Even if there was no mandate, self-insurance makes sense- however, it may not be the appropriate time to implement a self-funded program.

ADOA would prefer to have at least 3 more months before the required implementation to ensure it is done thoroughly and efficiently, but can and will complete the task on time. ADOA believes delaying the implementation for 1 year should be considered to ensure the State is fiscally strong enough to handle the financial requirements of self-insurance.

A major concern is whether the necessary reserves will be allowed to build and be retained within the Fund to ensure the solvency of the self-insurance program. ADOA is currently researching available options to preserve the Fund reserve once it is established.

Reserve Build-Up

Reserves will be necessary to guarantee the fiduciary responsibility of meeting claims liability incurred during the plan year, but paid in the following months. As a prudent business decision, reserves will allow ADOA to be fiscally prepared for potential claims fluctuation on an ongoing basis. Actuarially recommended reserves range from 18-26% of incurred claims on an annual basis. The cash flow analysis attached in Appendix A will produce a 19% claims reserve based on incurred claims at the end of FY '04. This claim reserve will not increase after the first year as claim payments level off. Consequently, in future years, it will represent a smaller percentage of incurred claims as future claims costs rise.

---

[5] Rate caps are on initial contract rates

[6] 2nd year rate cap provided in initial CIGNA proposal, but there is no reference in Best and Final Offer.

[7] Difference between 2004 contractual rate cap and 2003 negotiated increase on total premium.

[8] Rate increase shown is on the current paid amount (90% of total premium net of retrospective payment), comparative increase on total premium was 13%.

A reserve build-up can occur within the HITF Fund throughout the plan year due to the offset of program expenses with anticipated premium deposits. A funded increase of 24% health insurance premiums and 8.5% in dental premiums could result in a $52 million claims reserve at the end of FY'04. This reserve build-up has been outlined in the FY '04 budget proposal; however, continued discussions will be necessary to identify an appropriate figure to meet our fiscal responsibilities. **Appendix C illustrates the cash-flow analysis with the reserve build-up**. This reserve is composed of employee contribution dollars as well as employer dollars collected each pay period.

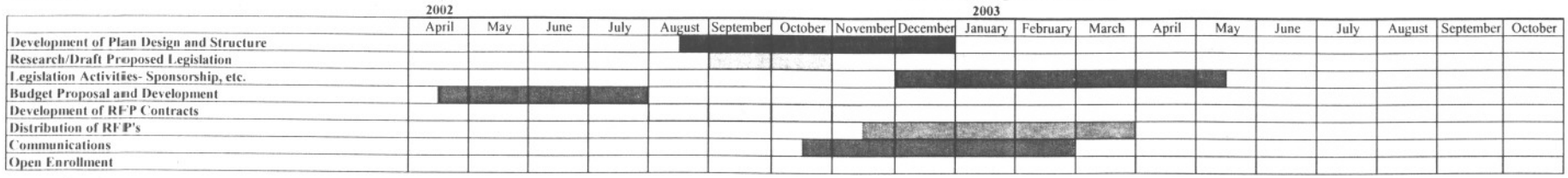
A secondary concern is the expectation that self-funding the State's group health and dental benefits will save money. **ADOA does not believe this transition will reap any significant reduction in health/dental expenditures on behalf of the employees or the State**.

The implementation of self-insurance is consistent with the State's goals in providing quality, cost-effective health care to employees/retirees while maintaining financial efficiency within the program:

- Self-insurance allows large employers to **better control costs** and insulate themselves from drastic fluctuations in the insurance.
- The State can begin to **address employees' concerns** regarding network and physician choice.
- Focusing on employee long-term health will offer the State the opportunity to improve the health of it's workforce, not just meet the immediate health care needs for a specified contract period. **Employees will be able to manage their health, not just their care**.
- Self-insuring is the direction of the health care marketplace. Many employers and states have successfully switched to self-insurance **to gain more control over their health care data** upon which to base quality policy and financial decisions.

Appendix A

Self-Funding Milestones



Development of RFP Contracts*

1-Aug First Meeting to Brainstorm RFP Language
*PPO/EPO Medical Network
*Dental Network
*Vision Plan
*Third Party Administration
*Insurance Coverages
15-Aug Team Division to Research Providers
15-Sep First Report to Group on Team Results
15-Oct First Draft of RFP Language
15-Nov Census and Data Compiled for RFPs

15-Oct Agency Liaison Briefings
25-Oct 1st Newsletter to Employees
6-Dec 2nd Newsletter to Employees
28-Feb 3rd Newsletter to Employees

15-Aug First Draft of Structure and Plan Design
1-Oct Final Proposed Structure and Plan Design
31-Dec Policies and Procedures Developed for Implementation

Distribution of RFP's

15-Nov Distribution of RFP's
1-Dec Bidders Conference
15-Jan Review Committees Developed
10-Feb RFP's Due to SPO
14-Feb RFP's Sent For Analysis
28-Feb Best and Final Requested
14-Mar Best and Final Due
31-Mar Contracts Awarded

15-Apr Brainstorming of Budget Needs- HITF
1-May First Draft of Budget Proposal
31-Jul Final '04/'05 Budget Proposal to Director

Research/Draft Proposed Legislation

1-Sep Team Recommendation for Legislation
1-Oct Rough Draft of Legislation
1-Nov Submission of Proposed Legislation

1-Dec Sponsor Identified
15-Dec Bill(s) Submitted
15-Jan Session Begins
1-May Bill Passed

Open Enrollment

15-Mar Development of Enrollment Booklet
7-Apr OE Forms and Books Submitted for Final Approval
14-Apr OE Forms and Books to Print
1-Jun OE Forms and Books Ready for Distribution
1-Jul Newsletter
1-Aug 2nd OE Newsletter
18-Aug Open Enrollment Begins
12-Sep Open Enrollment Ends

APPENDIX B

	ADOA / STATE	MERCER
Communications	Creation of agency or employee newsletter/payroll stuffer/written materials	Review and feedback on written material
	Development of communication strategy target dates; tactical details	Review, recommendations and feedback on communication strategy and details
	Review and approval of logo and "branding"	Design and development of logo and "branding"
	Instruction on, final review and approval of presentation materials	Design and development of legislation presentations; presentations at request of ADOA
	Creation of statutorily directed legislature/Governor reports "from ADOA"	Review, recommendations and feedback on reports and written material
	Field requests and inquiries from legislature, constituents on project	Supply information, research, data, industry information as requested through requests and inquiries
	SIAC Committee: Define the agenda, facilitate meetings, prepare materials for presentations (this is now being handled jointly)	Review, recommendations and provide feedback on written material. Attend meetings. Prepare materials and present as requested.
Legislature	Development of legislative materials, including proposed budget and bi-monthly reports to JLBC	Review, recommendations and feedback on financial spreadsheets, analysis and written material
	Attendance at all JLBC, Committees, and Task Force meetings as requested by legislature	Attendance at all JLBC, Committees, and Task Force meetings as requested by legislature or ADOA
	Presentation before JLBC, Committees, and Task Force meetings as requested by legislature	Presentation before JLBC, Committee, and Task Force meetings as requested by legislature or ADOA
	Creation and development of proposed legislation	Research and recommendations for possible legislation; review and feedback on language
Analysis	Collection and assistance in accumulation of carrier data	Actuarial analysis of all CIGNA and prior carrier data regarding medical utilization. Analysis of all available dental claims and utilization data.
	Collection and assistance of eligibility/enrollment data	Actuarial and financial analysis of eligibility/enrollment data
	Receipt and review of findings, analysis and recommendations	Report findings and recommendations based on all analysis

Roles and Responsibilities for Self-Insurance

	ADOA / STATE	MERCER
Program Development	Initiation and attendance of all carrier meetings to discuss relationship and carrier data	Attendance and participation in all carrier meetings, as requested by ADOA
	Receipt and review of program recommendations; final decision on plan design, vendors and program operations	Recommend program structure including plan design, vendors and program operations, as developed from data analysis,funding availability and overall strategy and objectives
	Initiation of data requests, development of required data, employee surveys and other internal activities to assist in plan development.	All analysis, data review, development of possible plan options, development of plan recommendations, any and all activities associated w/ plan development as directed by ADOA.
Program Implementation	Jointly draft and develop 6 RFP's, RFP criteria and recruitment of committee members	Jointly draft and develop RFP's, RFP criteria and recruitment of committee members
	Attend RFP review committees; review RFP responses and analysis ; coordinate finalist presentations; Award contracts	Facilitate all RFP review committees; provide analysis of all RFP responses and comparative information; facilitate finalist presentations; make recommendations on final proposals for final award.
	Coordinate all planning meetings and activities associated with successful vendors.	Assist and facilitate meetings and activities associated with successful vendors. Initiate communication and working relationship with successful vendors.
	Develop data reports for tracking: vendor performance, claims utilization, premium payments	Review and analyze reports for recommendations and data maintenance. Provide feedback on appropriate historical and benchmark data to be used for comparative purposes.
	Perform business assessment of Benefits office to analyze processes and organizational structure, and to identify additional roles and responsibilities associated with new program and vendor management	Review and comment on the business assessment regarding activities and structure within the Benefits Office and the impact of self-funding
	Develop and coordinate all system enhancements necessary for data transfer between all vendors, ASRS, payroll, etc.	Assist in the coordination of data transfer with recommendations as necessary. Provide feedback and recommendations on testing to ensure all systems communicate properly.

Roles and Responsibilities for Self-Insurance

	ADOA / STATE	MERCER
	Establish appropriate banking and self-billing processes, and other administrative processes as necessary to assure coordination between vendors and State	Assist in establishing appropriate banking and self-billing processes and other administrative processes as necessary to assure coordination between vendors and State
Open Enrollment	Write enrollment booklet and newsletters content; coordinate printing and production	Review content of enrollment booklet and newletters; design enrollment booklet
	Receive and review presentations for delivery	Develop and design PowerPoint presentations for communications and training
Other	Other items not identified above, unless referred to Mercer for assistance	Other items not identified above or items from the ADOA/State column as requested by ADOA staff

APPENDIX C- HITF Revenue and Expenditure Projections
Based on Enrollment as of May 31, 2002

FY 2003 Total Medical and Dental Projections ($'s in thousands)		Mercer Est. Increase	FY 2004 Monthly	FY 2004 Annual
Monthly Emp/Ret Medical Premiums	$8,500.9		$10,541.1	$126,493.7
Monthly State Medical Premiums	$24,390.9		$30,244.8	$362,937.1
Total Medical Premiums	$32,891.9	24.0%	$40,785.9	$489,430.8
Monthly Emp/Ret Dental Premiums	$1,316.4		$1,428.3	$17,140.0
Monthly State Dental Premiums	$1,368.4		$1,484.7	$17,816.7
Total Dental Premiums	$2,684.9	8.5%	$2,913.1	$34,956.8
Total Monthly Receipts	$35,576.7		$43,699.0	
Total Monthly Carrier Premiums	$35,275.9			
			136,101.3	
Monthly revenue	$300.8		359,858.4	
(to cover admin & wellness costs)			495,959.7	

Assumptions:

1) **Based on Mercer Expected Cost Scenario. Mercer estimated increase in medical premium of 24% and dental premium of 8.5%.** 2) No significant change in enrollment or migration between plans. 3) Mercer formula used to estimate medical claims, dental clai

FY 2004 Total Medical and Dental Projections

	Jul-03	Aug-03	Sep-03	Oct-03	Nov-03	Dec-03	Jan-04	Feb-04	Mar-04	Apr-04	May-04	Jun-04	Totals
Beginning Balance	$ 16,522.6	$ 15,478.4	$ 14,434.3	$ 8,014.8	$ 2,709.6	$ 24,954.2	$ 37,990.1	$ 45,500.7	$ 48,591.0	$ 50,576.4	$ 51,825.0	$ 52,705.3	
Estimated Monthly Receipts	$ 35,576.7	$ 35,576.7	$ 35,576.7	$ 39,637.8	$ 43,699.0	$ 43,699.0	$ 43,699.0	$ 43,699.0	$ 43,699.0	$ 43,699.0	$ 43,699.0	$ 43,699.0	**$ 495,959.7**
General Fund Sweep													
Total Receipts	$ 52,099.3	$ 51,055.1	$ 50,011.0	$ 47,652.6	$ 46,408.6	$ 68,653.2	$ 81,689.1	$ 89,199.7	$ 92,290.0	$ 94,275.4	$ 95,524.0	$ 96,404.3	
Premium Payments	$ 35,275.9	$ 35,275.9	$ 35,275.9	$ 35,275.9									$ 141,103.6
Estimated Paid Claims Medical				$ 2,753.2	$ 13,766.2	$ 22,370.0	$ 27,532.3	$ 31,662.2	$ 32,694.6	$ 33,383.0	$ 33,727.1	$ 34,071.3	$ 231,959.9
Estimated Paid Claims Dental				$ 193.6	$ 967.9	$ 1,572.8	$ 1,935.8	$ 2,226.2	$ 2,298.7	$ 2,347.1	$ 2,371.3	$ 2,395.5	$ 16,308.9
Administrative Fees (TPA)			$ 5,375.3	$ 5,375.3	$ 5,375.3	$ 5,375.3	$ 5,375.3	$ 5,375.3	$ 5,375.3	$ 5,375.3	$ 5,375.3	$ 5,375.3	$ 53,753.0
Self funding Total Costs	$ -	$ -	$ 5,375.3	$ 8,322.1	$ 20,109.4	$ 29,318.1	$ 34,843.4	$ 39,263.7	$ 40,368.6	$ 41,105.4	$ 41,473.7	$ 41,842.1	$ 302,021.8
													$ 443,125.4
Admin & Wellness Appropriated Costs (FY03 $4.9024M+Critical Issue $11.2372M)	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 1,345.0	$ 16,139.6
Total Expenditures	$ 36,620.9	$ 36,620.9	$ 41,996.2	$ 44,943.0	$ 21,454.4	$ 30,663.1	$ 36,188.4	$ 40,608.7	$ 41,713.6	$ 42,450.4	$ 42,818.7	$ 43,187.1	
Ending Balance (Reserve)	$ 15,478.4	$ 14,434.3	$ 8,014.8	$ 2,709.6	$ 24,954.2	$ 37,990.1	$ 45,500.7	$ 48,591.0	$ 50,576.4	$ 51,825.0	$ 52,705.3	$ 53,217.2	

STATE OF ARIZONA

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DATE: November 18, 2002

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

THRU: Richard Stavneak, Director

FROM: Jake Corey, Fiscal Analyst

SUBJECT: SCHOOL FACILITIES BOARD – CONSIDER APPROVAL OF INFLATION INDEX

Request

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

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

Recommendation

The Committee has at least four options:

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

(Continued)

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

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

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

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

Analysis

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

Background Information

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

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

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

Options for the Current Index

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

(Continued)

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

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

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

SFB Cost Per Square Foot Factors
Current and Proposed

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

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

Affect on State Budget for K-12 Building Renewal

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

Affect on State Budget for New School Construction

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

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

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

(Continued)

New School Construction Report

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

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

RS:JC:ss

STATE OF ARIZONA SCHOOL FACILITIES BOARD
MEMORANDUM

TO: SENATOR RUTH SOLOMON, CHAIR
REPRESENTATIVE LAURA KNAPEREK, VICE CHAIR
RICHARD STAVNEAK, JLBC STAFF DIRECTOR

FROM: ED BOOT, INTERIM EXECUTIVE DIRECTOR

SUBJECT: INDEXING OF SCHOOL CONSTRUCTION COSTS

DATE: 8/8/02

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

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

Last August, JLBC approved a 0.6 percent increase based on the Marshall Evaluation Service index for class C (masonry bearing walls) construction in the Phoenix Market. The increase reflected inflation between July 2000 and July 2001.

The Marshall index lists the July 2001 to July 2002 increase in building costs at 4.8 percent. The impact of this increase on the dollars per square foot provided is reflected in Table 1. We recommend using this figure to update the statutory cost per square foot.

Table 1

Grade Level	Current Amount	Adjusted Amount
K - 6	$98.01	$102.71
7 - 8	$103.47	$108.44
9 - 12	$119.80	$125.55

The increase will affect both the building renewal and new construction programs. For building renewal there is no impact for FY 2003, and the estimated FY 2004 impact is $0 with the legislative suspension of the formula. The new construction impact is estimated at $9,912,807.79. This impact will be spread between FY 2003 and FY 2004.

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

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

STATE OF ARIZONA

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MARION L. PICKENS

DATE: November 20, 2002

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

THRU: Richard Stavneak, Director

FROM: Stefan Shepherd, Senior Fiscal Analyst

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

Request

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

Recommendation

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

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

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

Analysis

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

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

(Continued)

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

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

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

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

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

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

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

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

RS/SSh:jb

ARIZONA DEPARTMENT OF ECONOMIC SECURITY

Jane Dee Hull
Governor

1717 West Jefferson - P.O. Box 6123
Phoenix, Arizona 85005

John L. Clayton
Director

SEP 6 2002

The Honorable Ruth Solomon
Chairman, Joint Legislative Budget Committee
Arizona State Senate
1700 W. Washington
Phoenix, Arizona 85007

Dear Senator Solomon:

The Department of Economic Security respectfully requests to be placed on the September JLBC meeting agenda to notify the Committee of the insufficiency of funds in the General Assistance Program and to make recommendations on how to address the shortfall. We believe this is necessary to comply with Arizona Revised Statute 46-207.

Additional information including projected caseloads based on the new restrictive eligibility criteria will be provided to Stefan Shepherd, by Monday, September 9, 2002 for his review. Karen McLaughlin, Financial Services Administrator, is prepared to discuss this issue in greater detail with Stefan Shepherd prior to the committee meeting.

Please contact me at 542-5678 if you have any questions.

Sincerely,

John L. Clayton

c.
The Honorable Laura Knaperek
Vice Chairman, Joint Legislative Budget Committee

Table B

General Assistance Program Will Be Out of Funds by December 2002

It Is Estimated That $2,968,000 is Needed to Meet the Need Under the General Assistance Program

Month	Cases (A)	Benefits (B)	YTD (C)	Remaining Funds (D)	SSI (E)	Expenditures (F) Advocates + Medical
Jul-02	3,719	$574,574	$574,574	$1,633,412	$110,919	$33,333
Aug-02	3,596	$549,216	$1,123,790	$1,154,039	$103,176	$33,333
Sep-02	2,699	$412,660	$1,536,450	$830,680	$122,634	$33,333
Oct-02	3,040	$461,743	$1,998,193	$476,120	$140,516	$33,333
Nov-02	3,319	$507,454	$2,505,647	$45,613	$110,280	$33,333
Dec-02	3,319	$507,454	$3,013,101	-$384,894	$110,280	$33,333
Jan-03	3,319	$507,454	$3,520,555	-$815,401	$110,280	$33,333
Feb-03	3,319	$507,454	$4,028,009	-$1,245,908	$110,280	$33,333
Mar-03	3,319	$507,454	$4,535,463	-$1,676,416	$110,280	$33,334
Apr-03	3,319	$507,454	$5,042,917	-$2,106,924	$110,280	$33,334
May-03	3,319	$507,454	$5,550,371	-$2,537,432	$110,280	$33,334
Jun-03	3,319	$507,454	$6,057,825	-$2,967,940	$110,280	$33,334
Total					$1,359,485	

Notes:

1. Cases (A). July thru October 2002 cases are based on actual caseloads. The cases for the remainder of the year are an estimate.
2. Benefits (B). July thru October 2002 Benefits are based on actual caseloads. The Benefits for the remainder of the year are an estimate.
3. YTD Expenditures (C). July thru October 2002 Expenditures are based on actual expenditures. The Expenditures for the remainder of the year are an estimate.
4. Remaining Funds (D). Remaining funds are calculated by taking SFY 2003 appropriations of $2,130,000 ; adding SFY 2002 estimated SSI benefits (E); and subtracting Benefits (B) and Expenditures (Advocates for the Disabled and Medical Exams) (F).
5. SSI (E). SSI funds are based on estimated SSI payments for SFY 2003 of $1,359,485. (July - October 2002 SSI are based on actual payments. The remainder of SFY 2003 payments are estimated.
6. Expenditures (F). Expenditures are based on Advocates for the Disabled plus Medical Exams expenditures, divided by 12 months. (Medical Expenditures are based on SFY 2002 expenditures).

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

Jane Dee Hull
Governor

John L. Clayton
Director

SEP 13 2002

The Honorable Ruth Solomon
Chairman, Joint Legislative Budget Committee
Arizona State Senate
1700 W. Washington
Phoenix, Arizona 85007

Dear Senator Solomon,

I am writing to provide additional information on the General Assistance program as a follow up to my letter dated September 6, 2002.

The Department has provided JLBC staff with information about the current General Assistance caseload and projections for the remainder of the fiscal year. While the new statutory criteria that more closely links eligibility to SSI eligibility is being applied, the caseload has not declined sufficiently to stay within the current appropriation level.

We have explored options to address the shortfall but we believe that many of these options would require statutory changes (e.g. not providing caretaker benefits, reducing the length of time individuals may receive benefits, not providing benefits during appeals to the Social Security Administration, changing payment amounts, etc.) We believe that there are two non-statutory options to stay within the appropriated level: implementation of a waiting list or continuation of benefits until funds are exhausted.

Our current estimates indicate that a waiting list would have to be implemented in October and based on attrition, individuals may have to wait five (5) months until they could begin to receive benefits. The preferred approach would be to continue to provide benefits as long as funds are available since many individuals are in more of a crisis at the time of initial application and we would not have to devote resources to managing a waiting list. We estimate that funds would be exhausted in December 2002.

We are prepared to present this information at the September 19th JLBC meeting if you choose to put this on the agenda. Please contact me at 542-3937 if you need additional information.

Sincerely,

John Clayton

c. Laura Knaperek

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

RUTH SOLOMON
CHAIRMAN 2002
MARSHA ARZBERGER
TIMOTHY S. BEE
KEN BENNETT
JACK A. BROWN
SCOTT BUNDGAARD
EDWARD J. CIRILLO
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1716 WEST ADAMS
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HOUSE OF REPRESENTATIVES

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MARION L. PICKENS

DATE: November 18, 2002

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

THRU: Richard Stavneak, Director

FROM: Jill Young, Fiscal Analyst

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

Request

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

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

Recommendation

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

Analysis

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

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

RS:JY:ss

ARIZONA COMMISSION FOR POSTSECONDARY EDUCATION

2020 NORTH CENTRAL, SUITE 550
PHOENIX, ARIZONA 85004-4503
TEL: (602) 258-2435
FAX: (602) 258-2483
E-Mail: toni@azhighered.org
Website: http://www.acpe.asu.edu

November 12, 2002

The Honorable Laura Knaperek, Chair
Joint Legislative Budget Council
1716 West Adams
Phoenix, Arizona 85007

Dear Representative Knaperek:

As a modified lump sum agency, the *ARIZONA COMMISSION for POSTSECONDARY EDUCATION* (the *COMMISSION*) is required to request *JLBC* approval in order to transfer funds from Operations to Personnel Services.

Accordingly, the *COMMISSION* is requesting the *Committee's* approval to transfer $52,500 for personnel and ERE from the *Arizona Family College Savings Program (AFCSP)* and *Arizona College & Career Guide (ACCG)* to the Postsecondary Fund as well as $47,500 for Professional and outside Services and Other Operating Expenses, including *College Goal Sunday (CGS)* and other *Twelve Plus* programs, totaling $100,000.

The *COMMISSION'S* general administration from the State General Fund has been eliminated for FY 2003; therefore, we have no alternative but to use the aforementioned Postsecondary Funds from non-state funds to supplement this reduction.

Your consideration of this request is very much appreciated.

Respectfully,

Verna L. Allen
Executive Director

CC: Senator Ruth Solomon, Co-Chair, JLBC
JLBC Director
Jill Young, JLBC Budget Analyst
Dawn Nasary, OSPB Budget Analyst

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

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CHAIRMAN 2002
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HOUSE OF REPRESENTATIVES

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RUSSELL K. PEARCE
MARION L. PICKENS

DATE: November 19, 2002

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

THRU: Richard Stavneak, Director

FROM: Kim Hohman, Fiscal Analyst

SUBJECT: ATTORNEY GENERAL – REVIEW ALLOCATION OF SETTLEMENT MONIES

Request

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

Recommendation

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

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

Analysis

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

Consumer Fraud

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

(Continued)

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

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

Antitrust

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

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

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

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

RS/KH:ck

STATE OF ARIZONA
OFFICE OF THE ATTORNEY GENERAL
CONSUMER PROTECTION & ADVOCACY SECTION

JANET NAPOLITANO
ATTORNEY GENERAL

1275 WEST WASHINGTON, PHOENIX 85007-2926

MAIN PHONE: (602) 542-3702
TELECOPIER: (602) 542-4377

October 21, 2002

The Honorable Randall Gnant
President of the Senate
State Senate
1700 West Washington
Phoenix, Arizona 85007

The Honorable Jim Weiers
Speaker of the House
House of Representatives
1700 West Washington
Phoenix, Arizona 85007

The Honorable Ruth Solomon
Chair, Joint Legislative Budget Committee
1700 West Washington
Phoenix, Arizona 85007

Re: *Settlement with Sears, Roebuck and Co.*

Dear Madam and Gentlemen:

This Office will be filing today a Consent Judgment and an Assurance of Discontinuance with Sears, Roebuck and Co. (Sears) regarding alleged violations of the Arizona Consumer Fraud Act (A.R.S. § 44-1521 *et seq.*) The Consent Judgment is based on Sears' alleged violation of a 1993 Court order which directed Sears to clearly and conspicuously post signs in English and Spanish advising that service under Sears' maintenance agreements cannot be obtained in Mexico and can only be performed in an authorized service center in the United States. Pursuant to a separate Assurance of Discontinuance, Sears also must comply with general advertising standards for all merchandise, as well as standards for maintenance agreements.

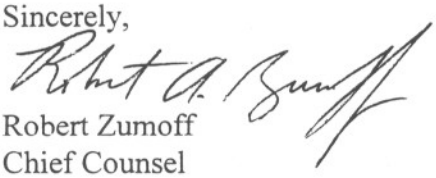
Under the two agreements, Sears will pay a total of $200,000 for investigative costs, attorneys' fees, and civil penalties. Pursuant to A.R.S. § 44-1531.01, these funds will be deposited in the consumer

fraud revolving fund to be used for consumer fraud education, investigations and enforcement operations.

Our notification to you of this settlement is made without prejudice to our Office's longstanding position that it is not under any legal obligation to provide notices of settlements to the Joint Legislative Budget Committee. We are providing this notification to you as a courtesy so that you will be aware of this important settlement.

Please call me at (602) 542-7701 if you have any questions regarding this matter.

Sincerely,



Robert Zumoff
Chief Counsel
Consumer Protection & Advocacy Section
(602) 542-7701
Fax: (602) 542-4377

cc: The Honorable Jack Brown
The Honorable Ken Cheuvront
Mr. Richard Stavneak
Ms. Kim Hohman
Mr. Michael Haener
Mr. John Stevens

STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

JANET NAPOLITANO
ATTORNEY GENERAL

1275 WEST WASHINGTON, PHOENIX, AZ. 85007-2926

MAIN PHONE : (602) 542-5025
FACSIMILE : (602) 542-4085

October 11, 2002

VIA HAND-DELIVERY

The Honorable Randall Gnant
President of the Senate
1700 West Washington
Phoenix, Arizona 85007

The Honorable Jim Weiers
Speaker of the House
House of Representatives
1700 West Washington
Phoenix, Arizona 85007

The Honorable Ruth Solomon
Chair, Joint Legislative Budget Committee
1700 West Washington
Phoenix, Arizona 85007

RE: Settlement with Household Finance Corp.

Dear Madam and Gentlemen:

This morning, our Office joined with 43 other states and the District of Columbia in announcing a settlement with mortgage lender Household Finance Corp. ("Household") regarding Household's alleged unfair and deceptive lending practices in the subprime market. (A copy of the Agreement in Principle is attached.) The states alleged that Household violated state laws by misrepresenting loan terms and failing to disclose material information to borrowers. Consumers complained that Household charged far higher interest rates than promised, charged costly prepayment penalties, or deceived consumers about insurance policies.

Household agreed to pay up to $484 million in restitution to consumers nationally. Arizona consumers could receive up to $5,502,500 in restitution. This money will be distributed directly to consumers by a national administrator, utilizing a formula to be determined later. Household will also pay the administrator $110,050 for the costs associated with the distribution

of funds to Arizona consumers. In addition, Household has agreed to pay the states up to $10.2 million for costs and attorneys fees. Arizona's share has not been determined, but will be no less than $200,000.

The states will file Consent Decrees in their respective states no later than December 15, 2002. On or about the date the Consent Decrees are filed, Household will pay the states their costs and attorneys fees. Within 90 days of that date, Household will pay into a settlement fund the up to $484 million, for distribution by the national administrator.

Our notification to you of this settlement is made without prejudice to our Office's longstanding position that it is not under any legal obligation to provide notices of settlements to the Joint Legislative Budget Committee. We are providing this notification to you as a courtesy so that you will be aware of this important settlement.

Please call me at (602) 542-7713 if you have any questions regarding this matter.

Very Truly Yours,

Paul A. Bullis
Division Chief Counsel
Telephone: (602) 542-7713
Facsimile: (602) 542-8885

cc: Hon. Jack Brown
Hon. Ken Cheauvront
Richard Stavneak
Kim Hohman
Michael Haener
John Stevens

STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

JANET NAPOLITANO
ATTORNEY GENERAL

1275 WEST WASHINGTON, PHOENIX, AZ. 85007-2926

MAIN PHONE : (602) 542-5025
FACSIMILE : (602) 542-4085

September 6, 2002

VIA HAND-DELIVERY

The Honorable Randall Gnant
President of the Senate
1700 West Washington
Phoenix, Arizona 85007

The Honorable Jim Weiers
Speaker of the House
House of Representatives
1700 West Washington
Phoenix, Arizona 85007

The Honorable Ruth Solomon
Chair, Joint Legislative Budget Committee
1700 West Washington
Phoenix, Arizona 85007

Re: State of New York, *et al.* v. Salton, Inc. (U.S. Dist.Ct. S.D.N.Y.)

Dear Madam and Gentlemen:

This morning, our office joined with 44 other states, the District of Columbia and the Commonwealth of Puerto Rico in settling antitrust claims against Salton, Inc. ("Salton"), the manufacturer of the "George Foreman" indoor contact grill. The settling jurisdictions, on behalf of themselves and as *parens patriae* on behalf of natural persons residing in their borders, filed a complaint alleging that Salton orchestrated an illegal resale price maintenance scheme that prevented retailers from discounting prices and excluded rivals from the marketplace, in violation of federal and state antitrust laws.

Salton has agreed to pay approximately $8,200,000 over three years to resolve the claims. Settlement funds are to be divided among the settling jurisdictions to benefit consumer and commercial interests. Arizonans' estimated share will total approximately $145,800. This money is for the benefit of Arizona consumers and will be distributed to consumers on a *cy pres* basis as described in the agreement. A draft of the settlement terms is attached.

Our notification to you of this settlement is made without prejudice to our office's long standing position that it is not under any legal obligation to provide notices of settlements to the Joint Legislative Budget Committee. We are providing this notification to you as a courtesy so that you will be aware of this important settlement.

Please call me at (602) 542-7713 if you have any questions regarding this matter.

Sincerely,

Paul A. Bullis
Public Advocacy Division Chief

Enclosures

cc: Hon. Jack Brown
Hon. Ken Cheuvront
Richard Stavneak
Kim Hohman
Michael Haener
Timothy Nelson
John Stevens
(w/ out enclosures)

STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

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1275 WEST WASHINGTON, PHOENIX, AZ. 85007-2926

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September 30, 2002

VIA HAND-DELIVERY

The Honorable Randall Gnant
President, Arizona State Senate
1700 West Washington
Phoenix, Arizona 85007

The Honorable Jim Weiers
Speaker of the House
House of Representatives
1700 West Washington
Phoenix, Arizona 85007

The Honorable Ruth Solomon
Chair, Joint Legislative Budget Committee
1700 West Washington
Phoenix, Arizona 85007

Re: Compact Disc Antitrust Litigation

Dear Madam and Gentlemen:

Earlier today, our office joined 39 other states and three territories in settling antitrust litigation against eight defendants in the United States District Court for the District of Maine. The litigation alleges that several music distributors (i.e. BMG Music and Bertelsmann Music Group, Inc., EMI Music Distribution, Warner-Elektra-Atlantic Corporation, Sony Music Entertainment, Inc., Universal Music Group, Inc., Universal Music & Video Distribution Corp. and UMG Recordings Inc.) and large music retailers (i.e. Trans World Entertainment Corporation, Tower Records, Musicland Stores Corporation) entered into illegal conspiracies intended to raise the price of prerecorded music to consumers.

The settlements have three major components:

1. Sales Practice Changes. Defendants have agreed to an injunction preventing them from forcing retailers to increase CD prices, thereby ensuring strong price competition between defendants.

2. Cash Component. Defendants have agreed to pay $67,375,000 in cash. A portion of this amount will be used, subject to court approval, to pay attorney's fees and costs, as well as costs of administering the settlement. The remainder will be directly distributed to consumers.

    - *Attorneys' fees and costs*. Our office will receive attorneys' fees for time expended on this matter. The amount, which has not yet been determined, must be approved by the court. Additionally, we will be reimbursed for all payments to the multi-state cost share fund, which was used for expert witness fees and other litigation expenses.

    - *Direct distribution*. Injured consumers will be provided the opportunity to file claims for direct cash distribution. Consumers will be told how to file a claim at a later date. The amount of cash to be provided to Arizona consumers depends upon how many such consumers file the appropriate claim. Importantly, in the event that the direct distribution claim rate exceeds the amount of funds available, the entire settlement amount will be rolled into a *cy pres* distribution. Under this scenario, $896,348 will be made available for *cy pres* distribution to benefit Arizona consumers.

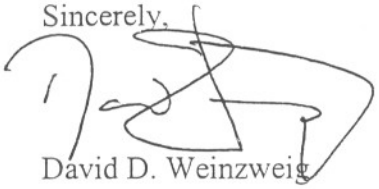
3. Product Component. Defendants have agreed to provide approximately 5,541,000 music CDs (valued at $75,500,000) for distribution by the state attorneys general to not-for-profit corporations, charitable groups and governmental entities (e.g. schools and libraries) for the benefit of all consumers in each state. Arizona will receive 99,532 CDs (valued at $1,359,791) for distribution to these entities.

A copy of each settlement agreement is attached for you convenience.

Our notification to you of this settlement is made without prejudice to our office's long standing position that it is not under any legal obligation to provide notices of settlements to the Joint Legislative Budget Committee. We are providing this notification to you as a courtesy so that you will be aware of this important settlement.

Please contact me if you have any questions.

Sincerely,



David D. Weinzweig
Assistant Attorney General
Antitrust Unit
Telephone (602) 542-7578
Facsimile: (602) 542-9088

DDW:se

cc: Hon. Jack Brown
Hon. Ken Cheuvront
Richard Stavneak
Kim Hohman
Michael Haener
Timothy Nelson
John Stevens
(w/out enclosures)

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

RUTH SOLOMON
CHAIRMAN 2002
MARSHA ARZBERGER
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HOUSE OF REPRESENTATIVES

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LINDA J. LOPEZ
STEVE MAY
RUSSELL K. PEARCE
MARION L. PICKENS

DATE: November 19, 2002

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

THRU: Richard Stavneak, Director

FROM: Kim Hohman, Fiscal Analyst

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

Request

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

Recommendation

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

Analysis

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

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

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

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

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

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

Antitrust Enforcement Revolving Fund Expenditures

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

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

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

RS/KH:ck

STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

JANET NAPOLITANO
ATTORNEY GENERAL

1275 WEST WASHINGTON, PHOENIX, AZ. 85007-2926

MAIN PHONE : (602) 542-5025
FACSIMILE : (602) 542-4085

September 18, 2002

VIA HAND-DELIVERY

The Honorable Randall Gnant
President of the Senate
1700 West Washington
Phoenix, Arizona 85007

The Honorable Jim Weiers
Speaker of the House
House of Representatives
1700 West Washington
Phoenix, Arizona 85007

The Honorable Ruth Solomon
Chair, Joint Legislative Budget Committee
1700 West Washington
Phoenix, Arizona 85007

Re: Stericycle, Inc. Antitrust Settlement

Dear Madam and Gentlemen:

On September 18, 2002, the Office of the Arizona Attorney General ("Attorney General") filed a Complaint and Consent Decree in Maricopa County Superior Court that settled an antitrust investigation against Stericycle, Inc. ("Stericycle"). The investigation involved allegations that Stericycle violated the Arizona Uniform State Antitrust Act by: (1) unlawfully obtaining and/or maintaining its monopoly in the market for transporting chemotherapy waste by engaging in anticompetitive conduct that eliminated or delayed the ability of potential competitors to offer alternative services; and (2) unlawfully agreeing to divide geographic markets and customer bases with a competitor in the medical waste management industry.

Stericycle agreed to settle the allegations by paying the State of Arizona ("State") civil penalties and attorneys' fees totaling $320,000, and has agreed to change its business practices in Arizona by, among other things, opening its Chandler, Arizona incineration facility to other medical waste transporters and paying rebates to certain transporters that were excluded in the past. The settlement terms are outlined in a copy of the Consent Decree attached hereto. The attached Consent Decree has only been signed by the parties.

Our notification to you of this settlement is made without prejudice to our office's long standing position that it is not under any legal obligation to provide notices of settlements to the Joint Legislative Budget Committee. We are providing this notification to you as a courtesy so that you will be aware of this important settlement.

Please contact me if you have any questions.

Sincerely,

David D. Weinzweig
Assistant Attorney General
Antitrust Unit
Telephone: (602) 542-7578
Facsimile: (602) 542-9088

DDW:nac
Enclosures

cc: Hon. Jack Brown
Hon. Ken Cheuvront
Richard Stavneak
Kim Hohman
Michael Haener
Timothy Nelson
John Stevens
(w/ out enclosures)

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November 12, 2002

The Honorable Ruth Solomon
Chair, Joint Legislative Budget Committee
1700 W Washington
Phoenix, AZ 85007

Dear Senator Solomon:

This letter is written to report the intended use of expenditures from the Antitrust Enforcement Revolving Fund (ATRF). All revenues received by the ATRF are appropriated. However, a footnote to the general appropriations act states, "Before the expenditure of any Antitrust Enforcement Revolving Fund receipts in excess of $138,800 in FY 2003, the Attorney General shall submit the intended uses of the monies for review by the Joint Legislative Budget Committee."

With the recent Stericycle, Inc. antitrust settlement agreement, the estimated funds available for FY03 will exceed $405,000. The Office of the Attorney General estimates that the FY 2003 expenditures will be $405,000 for the following purposes:

- Personnel costs - $265,200
- Multi-state cases - $45,000
- Automotive report (legislatively mandated) - $34,200
- Operating costs - $60,600

These expenses represent the costs allowed by § 41-191.02. They include such items as filing fees, court costs, travel, depositions, transcripts, reproduction costs, expert witness fees, and investigations expenses.

If additional information would be helpful, please let me know.

Yours very truly,

Janet Napolitano
Attorney General

cc: The Honorable Laura Knaperek, Vice Chair, Joint Legislative Budget Committee
Richard Stavneak, JLBC
Kristine Ward, OSPB

STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: November 18, 2002

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

THRU: Richard Stavneak, Director

FROM: Jill Young, Fiscal Analyst

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

Request

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

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

Recommendation

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

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

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

(Continued)

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

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

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

Analysis

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

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

Community College District Use Plans

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

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

(Continued)

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

Maricopa County Community College District Office Proposal

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

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

Arizona University System Proposal

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

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

(Continued)

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

Government Information Technology Agency Letter

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

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

Logistical Issues

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

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

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

RS/JY:ss
Attachment

STATE OF ARIZONA

Joint Legislative Budget Committee

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MARION L. PICKENS
CHRISTINE WEASON

DATE: August 15, 2002

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

THRU: Richard Stavneak, Director RS

FROM: Jill Young, Fiscal Analyst jy

SUBJECT: COMMUNITY COLLEGES – REVIEW OF THE OPERATIONS AND BUSINESS PLAN FOR ARIZONA LEARNING SYSTEMS

Request

Pursuant to a footnote in the General Appropriations Act (Laws 2002, Chapter 327), an operations and business plan for continued statewide use and financial viability of the Arizona Learning Systems (ALS) must be submitted to the Joint Legislative Budget Committee (JLBC) for its review or ALS will terminate by the end of August 2002. ALS did not submit a plan, therefore, the system will terminate at the end of August 2002. The Committee has the responsibility to direct the disbursement of ALS state-funded assets upon termination.

Recommendation

The Committee has at least 3 options:

1. Allow community college districts to retain equipment upon termination of ALS.

2. Sell all or part of the equipment upon termination of ALS. We do not have a precise estimate of the current value of these assets, but the sale could possibly generate $300,000.

3. Transfer state-funded assets of ALS to an alternate management group for statewide use. The Arizona Area Health Education Center (AHEC) has submitted a proposal to JLBC to assume management of the system and continue its statewide use through the collaboration of AHEC, the universities and the community colleges.

   If the Committee would like to pursue this issue, JLBC Staff believes more information is necessary. The major issues to be resolved are: 1) the financial viability of the system and 2) the interest of the community colleges to participate.

(Continued)

The JLBC Staff recommends that ALS staff be retained during the transition period to coordinate the termination of ALS and disbursement of state-funded assets and that any remaining funds be reverted to the General Fund.

Analysis

History

ALS is a consortium of Arizona's 10 community college districts to promote distance learning across district boundaries using Internet, interactive video-conferencing (ITV), and other technologies. The ALS telecommunications plan, originally approved by JLBC in December 1996, was to create a coalition of educational and governmental agencies that would contract with a private company to construct a network that would be available for lease. In addition to increasing educational opportunities, ALS was to spur economic development by making advanced telecommunications accessible to the private sector in rural areas.

ALS was intended to develop in 3 phases: 1) Construct a pilot network of 10 sites, one in each community college district, for the delivery of distance learning classes; 2) Expand the ALS network to another 67 community college sites; and 3) Expand the ALS network to university and K-12 sites. At the request of the community college districts and the State Board of Directors for Community Colleges (State Board), the Arizona Legislature appropriated $1.1 million in FY 1997 and $2.8 million in FY 1998 to implement Phase 1 of the ALS network. No additional monies have been appropriated for ALS since FY 1998. A FY 2002 budget request by the State Board for Phase 2 was not approved by the Legislature, although one community college district has procured ALS compatible equipment for additional sites at its own expense.

ALS started classes in Spring 2001 and continued offerings through Spring 2002. The courses were both ITV and Internet-based. Any revenue generated by ALS classes was split between the originating college, receiving college and ALS. ALS enrollment for each of the semesters is as follows:

	Spring 2001	Fall 2001	Spring 2002
Enrollment	3	2	113

The low enrollment has been attributed to insufficient marketing and student awareness, lack of course integration with specific certificate or degree programs, and inadequate staffing.

If ALS terminates, Arizona students have at least 2 options for distance learning from public institutions. Maricopa County Community College District, through its Rio Salado campus, offers Internet courses and on-line student services. Northern Arizona University also offers a variety of courses and degree programs over the Internet and ITV.

Budget

As of August 2002, approximately $3.5 million has been expended for network implementation, network management and operations, academic development, and ALS administrative support. Approximately $391,000 remains unexpended to date from the FY 1998 appropriation and interest earned, which would be transferred to the General Fund in the event that ALS is terminated. The following table shows the breakdown of expenditures in each category.

(Continued)

ALS Expenditures	
Network Implementation	$1,737,700
Network Management & Operations	674,500
Academic Development	475,600
ALS Administrative Support	626,800
Total Expenditures	**$3,514,600**

The annual operating expenses for ALS are approximately $500,000. Current funding would only cover operating expenses for part of FY 2003.

Recent Legislation

The State Board wrote a report to JLBC in April 2002 regarding ALS, which conveyed concerns that the system cannot continue operations as it has. The following 2 paragraphs are excerpts from the conclusion if the report:

> "The State Board, therefore, respectfully recommends that the next six months be used for the pursuit and drafting of a business and operational plan/model that will bring together the myriad potential participants for the future of this statewide system.
>
> Should such a request not be considered affirmatively by JLBC, then the State Board recommends Alternative B which terminates the operation of the Network and provides its associated equipment to each of the community college districts for their use, and returns all unencumbered funds to the State of Arizona."

In response to the State Board conclusions concerning ALS, a footnote was created in the General Appropriations Act (Laws 2002, Chapter 327). It reads:

> "Arizona learning systems shall develop an operations and business plan for continued statewide use and financial viability of the system. If a plan is not developed and submitted to the joint legislative budget committee for its review by July 31, 2002, Arizona learning systems shall terminate by the end of August 2002. If Arizona learning systems is terminated, state-funded assets for the Arizona learning systems shall be disbursed as directed by the joint legislative budget committee and any remaining state appropriations for Arizona learning systems shall be returned to the state general fund."

As of July 31, 2002, JLBC did not receive an operations and business plan from ALS for continued statewide use. Therefore, ALS will terminate as of the end of August 2002.

JLBC has the responsibility to direct the disbursement of the state-funded assets of ALS. State-funded assets include video and telecommunications equipment at one site in each of the 10 community college districts and hub equipment housed at Rio Salado Community College. At the time of purchase in 2000, equipment costs totaled approximately $1.1 million. It is difficult to estimate the current value of the equipment. The ALS Executive Director estimates that the video equipment may be worth 30-40% of the original value and the telecommunications equipment may be worth 10% of the original value.

(Continued)

Options

There are at least 3 options for ALS:

1. Allow community college districts to retain equipment upon termination of ALS.
   This option could allow continued connectivity within districts that have procured additional compatible equipment. Mohave County, for example, has purchased ALS compatible equipment for additional college sites to increase communication and broaden course offerings within the district. The state, however, will not recoup any of its investment.

2. Sell all or part of the equipment upon termination of ALS.
   This option allows some the state's investment to be recouped. If a district has invested in the network by purchasing ALS compatible equipment for multiple district sites, as a result of this option, the district may be required to expend funds for replacement equipment in order to continue using its internal network or connectivity may be disabled.

3. Transfer state-funded assets of ALS to an alternate management group for statewide use.
   The Arizona Area Health Education Centers (AHEC) has submitted a proposal to JLBC for the continued statewide use of the system. AHEC proposes to assume management of the network and pay for operations with existing funds. AHEC views its future role as the "anchor tenant" for the network that would collaborate with others to expand the network's use and ensure its financial viability.

   AHEC is a program through the Arizona Board of Regents housed within the University of Arizona Health Sciences Center that attempts to improve the supply and distribution of health care professionals through community/academic educational partnerships. AHEC strives to attract under-represented ethnic and racial students into the health professions. Additionally, the organization focuses its attention on supporting the state's health professionals with continuing training and career enhancements. AHEC proposes to use the network primarily to deliver health education and training across the state through the creation of Arizona Health Outreach Network (AzHON). AzHON would serve as a communication interface between the University of Arizona Health Science Center, AHEC, and the community colleges.

If the Committee is interested in pursuing this third option, we recommend receiving clarification on the following issues:

- AHEC proposes to work with the community college districts in the provision of health education. We have not had an opportunity to receive feedback from the community college districts in their interest in cooperating in such a venture.

- After discussions with community colleges, we recommend that AHEC develop a financial plan to demonstrate that AzHON will be self-supporting. It is unclear how AHEC will fund operations past FY 2003 if partners and other revenue sources are not found. AHEC has received approximately $4.4 million for the last 2 years from Proposition 204. JLBC Staff does not anticipate available Proposition 204 money for public health programs after FY 2003.

- Finally, if community college districts did not choose to participate, it would be useful to understand how AHEC would utilize the network.

Copies of the State Board's report to the JLBC (April 2002) and the full AHEC proposal are available upon request.

RS:JY:ss

STATE OF ARIZONA

Joint Legislative Budget Committee

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MARION L. PICKENS

DATE: November 18, 2002

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

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

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

Request

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

Recommendation

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

Analysis

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

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

(Continued)

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

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

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

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

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

RS:PS:ss

JANE DEE HULL
GOVERNOR

GITA

CRAIG STENDER
DIRECTOR

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

To: Senator Ruth Solomon, Arizona Senate
Representative Laura Knaperek, Arizona House of Representatives
Richard Stavneak, Joint Legislative Budget Committee (JLBC)

CC: Elliott Hibbs, Department of Administration
Tim Boncoskey, Arizona Department of Administration

From: Craig Stender, Government Information Technology Agency C.S.

Date: October 15, 2002

Re: **IT Monitoring Quarterly Status Report on DOA HRIS**

This Status Report reflects Government Information Technology's (GITA) September update for the Department of Administration's Human Resource Information System (HRIS) project as requested by the Committee. The Department of Administration will provide their quarterly project update under separate cover.

Based on feedback and informational updates from the HRIS project team, the project appears to be on time and on budget.

Status of major accomplishments to date:

- The most significant deliverable (Approved Development Items) was given to Project Management Office (PMO) for review and approval in mid-September. Meta Group and GITA personnel have assisted the PMO in the review and approval of these items. To date, more than half of the items have been approved and released to the developers.

- IBM's Project Management Review team interviewed contractors, State employees and assistant directors of DOA during their internal review process. The IBM project team received a "B" grade for the HRIS project and specific areas of concern have been addressed.

- On September 30, Integration Testing began to validate the configurations developed as a result of earlier work to describe and test the new work processes. As configurations are proved, they will then be ready for transformation into the Arizona format. Integration Testing is the longest duration and most complex series of tasks undertaken by the project so far.

- The original data cleansing report in August contained over 2,200 errors; today, it has decreased to 900. Normal cleansing error rates for a project of this scale would be 4,000-5,000 according to Meta Group.

- The HRIS team and DPS reached an agreement on DPS not using Lawson's "Time and Attendance" functionality. DPS will continue to use their legacy system until they can adapt their business processes to use Lawson's functionality.

Continue to monitor Phase I issues:

- The need for the development of an Advisory Governance body that would include all major agencies for the purposes of driving the State to full utilization of the system's capabilities still needs to be investigated.

- The majority of activities remaining in Phase I (to be completed by April 2003) will be application coding, unit and system testing, training and communications to the users.

- Some agencies serviced by CAMP are still lagging in their requirements to HRIS but, due to their small numbers, it is not a critical issue at this time.

GITA's opinion on Phase I:

- The design portion of Phase I is complete. HRIS is entering the construction and testing portion of Phase I. The work is well defined, but more tedious. The project team will be working on much shorter term tasks and deliverables that are more time sensitive. The HRIS Management Team is monitoring the project closely and GITA feels that Phase I is in good shape.

Phase II issues to monitor:

- Phase II functionality allows for a great amount of business re-engineering that will move paper-based business processes to "paperless." Phase II will include a pilot test of several agencies that will use the new features and functions (e.g., workflow analysis, data warehouse capabilities, custom and standard report capabilities, etc.) of the system that do not exist in the current environment. This new functionality will

need to have a marketing/educational plan in place to ensure full usage. Full usage will allow the State to realize efficiency gains. Our concern is ensuring that the large- and medium-size agencies utilize the tools purchased with HRIS.

Conclusion:

- GITA believe the HRIS project is getting back on target and considerable progress has been made since the last report. GITA will continue to closely monitor the progress of the project.

Should you require additional information and/or clarification, please contact me at 602/364-4770.

CS:mc

JANE DEE HULL
GOVERNOR

J. ELLIOTT HIBBS
DIRECTOR

TIMOTHY BONCOSKEY
PROJECT DIRECTOR

Arizona Department of Administration

Human Resources Information Solution

3443 North Central Avenue, 17th Floor, Phoenix, Arizona 85012 • (602) 274-8583 • FAX: (602) 274-8629

October 11, 2002

The Honorable Ruth Soloman, Chairman
Members, Joint Legislative Budget Committee
Arizona State Legislature
1700 West Washington Street
Phoenix, Arizona 85007

Dear Senator Solomon and Members of the Committee:

This letter and the attached September monthly report reflect the status of the HRIS project. This Quarterly update was request by the Committee as part of the favorable review of the HRIS expenditure plan last January. The Government Information Technology Agency (GITA) will provide their quarterly report on the project under separate cover.

The development efforts of the project continue to be "On-time and On-budget". The operational plan for HRIS (the FY 2004 budget) has been prepared and shared with your staff. Since the last report the following events have occurred and contract deliverables received:

Significant July Achievements

- Revised Fit Gap Analysis completed and delivered.
- CRP 2 Documentation delivered.
- Baseline Configuration 90% complete.
- ATF Training Workbooks and Navigational Tutorial completed and distributed.
- HRMS Data Cleansing team data identification report programming complete.
- Launched bi-weekly email to Agency Heads from HRIS Chair Bill Bell.
- Began weekly "critical path" report on project status.

Significant August Achievements

- *Baseline Configuration* milestone completed and approved.
- HRMS Data Cleansing kicked off with Agencies.
- Agency Interface workshops scheduled and conducted.

Significant September Achievements

- The TEST1 product line (Final Test Configuration) was created and Integration Test kicked off.
- The functional team demonstrated the hiring of an applicant, tax and benefits entry, time entry, overtime calculation, gross-to-net payroll calculation, time accrual update, payment processing, payroll close, time accrual processing, and online viewing of payroll information via the Employee Self Service portal.
- The HRIS team and DPS reached a mutually beneficial resolution of issues relating to DPS' participation.
- Prepared for and participated at the Inter-Agency Cabinet meeting of 9/18.
- Prepared and participated in IBM Project Management Review which was conducted September 16-18. The Project received the coveted and planned for "B" rating from the review team.

The following **Contract Deliverables** were accepted and approved by the State:

- Harmonization Assessment Document (D.8)
- Change Readiness Assessment Report (D.9)
- Updated High Level Implementation Strategy (D.10)
- Transition Management Strategy (D.11)
- Package Integration Standards and Procedures Document (D.13)
- Development Standards and Procedures Document (D. 14)
- Future Process/Function Attributes Document (D.17)
- Future Process Definition Document (D.18)
- Detailed Fit Gap Analysis Document (D.19)
- Future Organization Design Document (D. 22), added (D.22B)
- Approved Development Items List (D.23), interfaces and reports pending
- Configuration Parameters Document (D.24), edits pending
- Deployment Education and Training Plan (Section 7, D25 and D29)
- Change Leadership Plan (D.26)
- Communications Plan (D.27)

If you need any further information or have additional questions, please contact me at 542-1500, or Tim Boncoskey, HRIS Project Director, at 274-8571.

Sincerely,

William Bell
Deputy Director

Cc: J. Elliott Hibbs, ADOA Director
Kris Ward, OSPB Director
Richard Stavneak, JLBC Staff Director
Craig Stender, GITA Director
Tim Boncoskey, HRIS Project Director

STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: November 20, 2002

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

THRU: Richard Stavneak, Director

FROM: Paul Shannon, Senior Fiscal Analyst

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

Request

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

Recommendation:

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

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

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

(Continued)

Background

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

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

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

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

Analysis

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

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

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

(Continued)

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

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

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

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

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

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

(Continued)

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

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

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

Full VOIP Implementation Financing
Proposed Amortization Schedule

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

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

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

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

RS:PS:ss

JANE DEE HULL
Governor

J. ELLIOTT HIBBS
Director

ARIZONA DEPARTMENT OF ADMINISTRATION
OFFICE OF THE DIRECTOR
100 North Fifteenth Avenue, Suite 401
Phoenix, Arizona 85007
(602) 542-1500

November 18, 2002

NOV 1 8 2002

The Honorable Ruth Solomon
Chair, Joint Legislative Budget Committee
Arizona State Senate
1700 West Washington
Phoenix, Arizona 85007

Dear Senator Solomon:

This is to request that the joint report on Statewide Telecommunications Services, prepared by the Arizona Department of Administration and the Government Information Technology Agency, be placed on the agenda for the upcoming November meeting of the Joint Legislative Budget Committee. This report, which is required by Chapter 327, 45th Legislature, Second Regular Session, has been delivered to you under separate cover.

We look forward to presenting the results of this extensive review and our recommendations for privatization of telecommunications services to the Committee. If you have any questions related to this report, please contact me at 542-1500, or Craig Stender at 364-4770.

Sincerely,

J. Elliott Hibbs
Director

Cc: Craig Stender, GITA
Richard Stavneak, JLBC
Kristine Ward, OSPB

I. *Executive Summary*

Purpose

This report has been prepared in response to requirements in House Bill 2706 (Appendix A). The Arizona Department of Administration (ADOA) and the Government Information Technology Agency (GITA) were tasked in that bill with reviewing telecommunications options and submitting a plan to the Joint Legislative Budget Committee (JLBC) by November 1, 2002. All options developed were intended to improve service delivery and increase the fiscal efficiency of Arizona statewide telecommunications services.

Recommendations

Arizona State Government should pursue either a Shared Service or a Privatized service delivery model. (These service delivery models are described in detail in the body of the report). The ADOA prepared cost analyses on both of these models. The ADOA Privatized financial analysis was based upon the State retaining ownership of the assets. Both of the ADOA cost analyses showed favorable 5-year budget impacts. An alternative Privatization scenario, private ownership of assets, is favored by GITA. However, the ADOA cost evaluation contained in the body of the report concludes that the Privatized Model appears to offer more potential.

A detailed discussion on the cost analyses begins on page 33 of the report. It should be noted that this recommendation is a radical departure from the existing service delivery model.

Further, given the internal weaknesses identified in the Factor Analysis contained within the body of the report, Arizona State Government needs to:

- Adopt a centralized governance model with strong executive authority and Legislative involvement.
- Depending upon which method of privatization is selected, centralized telecommunications funding to leverage resources and gain greater accountability may be desirable.
- Strongly consider the resources available in the private sector either through an outsource (leveraging the economies of scale available through public/private partnerships) or co-source (shared services) to improve efficiency, acquire expertise and ease the financial burden.

Study Methodology

The team used a variety of data collection methods, including an extensive review of the literature and a survey of fourteen of the largest agencies representing 80% of the State's telecommunications expenditures. Further, data analysis tools included the use of the Gartner Group Total Cost of Ownership (TCO) Manager Models. Finally, strategic analysis tools were also used, including an Internal Factor Evaluation (IFE) and an External Factor Evaluation (EFE).

Findings and Conclusions

Factor Analysis
The Internal Factor Evaluation (IFE) indicates that the current statewide telecommunications delivery systems are inadequate. Further, the External Factor Evaluation (EFE) clearly indicates that present statewide strategies are neither taking advantage of emerging opportunities nor avoiding external threats.

Gartner Analysis
The Gartner analysis indicates that there are significant opportunities for cost reductions through consolidation including personnel and transmission.

- For the Wide Area Data Network, the State spent $2,764,056 more on transmission facilities, personnel, hardware and software than its best-in-class clone. In the area of personnel, the State has more IT WAN FTEs than would be utilized by a best-in-class organization. Personnel costs for the State were $2,010,145 higher than the best-in-class.

- By directing more traffic to its private network (PTN access) and by utilizing dedicated circuits to long distance carriers (VNS access), the peer is able to obtain a better cost per minute than the State who is sending more traffic over the public network (VNS usage). For the Wide Area Voice Network, the State is, therefore, paying $2,248,332 more than the best-in-class clone.

When compared with the Statewide Total Cost of Ownership figure, $66,368,703 across all fund sources, the Gartner analysis reveals potential savings of 11%. A detailed discussion begins on page 16 of the report.

State Government and Voice over Internet Protocol/IP (VoIP) Telephony
While there were no current applications driving State government towards a wholesale implementation of VoIP/IP Telephony, there are standard business needs (e.g., infrastructure gaps, equipment obsolescence, security, and disaster recovery) that support gradual migration. A detailed discussion begins on page 12 of the report.

Service Delivery Options
Delivery of telecommunications services can vary both by structure and by method. Four viable options were analyzed for this report: "As Is," Decentralized, Shared Services, Privatized (Outsourced). These options are discussed in detail in the body of the report.

- The results of the cost evaluation indicate that the "As Is" and Decentralized service delivery models do not produce favorable 5-Year budget impacts.
- As discussed earlier in the recommendation section of the report, the results of the cost evaluation indicate that the Shared Services and Privatized service delivery models do offer favorable 5-Year budget impacts with the Privatized Model offering the most potential. Between the Shared Services and the Privatized views, five-year savings ranging from $3.6 million to $5.6 million would be realized over the current service delivery model.

- Privatization offers significant benefits to the State: 1) the State gets already trained and competent personnel for new technologies, 2) if the vendor provides the equipment and services, the State does not need to make large capital investments, 3) with the rapid changing of technology and evolving standards with VoIP/IP Telephony, the State avoids the position of servicing debt on obsolete equipment as the vendor is now responsible for upgrading the technology, 4) vendor management is simplified, and 5) Service Level Agreements (SLAs) are financially driven.

  With the privatized model, there is a wide spectrum of options for private sector participation. These options may be classified into two groups: those that retain public ownership of the assets while contracting out management, operation, and even investment, and those that involve at least partial or temporary private ownership of assets.

Short-Term Cost Savings Opportunities

Ten potential short-term cost savings opportunities totaling $5,025,000 were identified by a team composed of the Governor's Office of Strategic Planning and Budgeting, GITA, Department of Administration, and four (4) agencies.

The short-term costs savings opportunities included $2.5 million for the sale and lease-back of the Arizona telecommunications services central switching mechanism. ATS solicited information from equipment wholesalers, equipment manufacturers, and telecommunications carriers to determine the residual value of the MSL-100. No one expressed interest in buying the switch outright. However, several parties were interested in obtaining the switch as part of a package deal to buy the customer base or as a trade-in against new equipment acquisitions.

The short-term cost savings opportunities included $700,000 through the prepayment of carrier services. This option was eliminated from consideration due to issues regarding the financial viability of various telecommunication carriers, Federal restrictions, and cash flow concerns.

Of the $1,825,000 remaining amount, $1,523,571 in savings has been realized and efforts continue on this initiative.

Next Steps

- Seek any legislative changes required to adopt a centralized governance model with strong executive authority and Legislative involvement.
- Seek legislative changes, if required, to centralize telecommunications funding.
- Establish a telecommunications stakeholder committee with Legislative input.
- Secure an appropriation for consultant support to draft a Request for Proposal (RFP), understanding that the outside consultant would be removed from bidding.
- Convene RFP committee, establish a charter, assign work groups, and define requirements.
- Create an RFP to outsource all statewide telecommunications operations with Service Level Agreements (including call center operations, billing, and customer relationship elements) that would provide full flexibility for vendors to bid on all degrees of ownership.
- Finalize, publish and issue the RFP.
- Review RFP responses including vendor responses regarding Statewide FTE transition.
- Award contract(s). Target: October 2003.

STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: November 19, 2002

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

THRU: Richard Stavneak, Director

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

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

Request

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

Recommendation

The Committee has at least three options:

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

(Continued)

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

Analysis

Pay Stipends

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

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

Hiring Bonus Program

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

Privatization

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

RS:TV:ss

Arizona Department of Corrections

1601 WEST JEFFERSON
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JANE DEE HULL
GOVERNOR

TERRY L. STEWART
DIRECTOR

November 6, 2002

The Honorable Ruth Solomon
Arizona State Senate
1700 West Washington Street, Suite 110
Phoenix, Arizona 85007

The Honorable Laura Knaperek
Arizona House of Representatives
1700 West Washington Street, Suite 114
Phoenix, Arizona 85007

Dear Senator Solomon and Representative Knaperek:

I am requesting the following issues as agenda items for the next Joint Legislative Budget Committee (JLBC):

- ASPC-Lewis Rast Unit pay stipend
- A hiring bonus program for the ASPC-Lewis, Eyman and Florence prisons

Your decision not to hear these agenda items for the October JLBC meeting has guaranteed further delay of opening the Arizona State Prison Complex (ASPC) Lewis Rast Unit. We were seeking your support for a geographic pay stipend and a hiring bonus program, which when applied together, have proven integral to our ability to attract and retain security staff at ASPC-Lewis. As we stated in our October request, we believe we can absorb the costs of these programs in Fiscal Year (FY) 2003, but may need Legislative support in FY 2004.

Although state leadership restored funding to the Department to open the 350 bed Rast Unit beginning in July of this year, the Rast Unit remains unopened due to the Department's inability to hire Correctional Officer IIs (CO IIs) at ASPC-Lewis. The Department currently has nearly 4,000 more inmates than it has designated beds with which to house them. It is critical that the 350 Rast Unit beds be made available to house inmates.

The current CO II vacancy rate is 18.44% for all state prisons, which has steadily increased since July 2002 when the vacancy rate was 15.81%. For the same period, the ASPC-Lewis vacancy rate increased to 32.24% from 26.64%; ASPC-Eyman increased to 20.25% from 18.29%; and ASPC-Florence increased to 22.26% from 18.03%. As you can see, we are losing ground rapidly.

As demonstrated in my letter dated October 8, 2002, the hiring bonus program at ASPC-Lewis was empirically successful in decreasing the Lewis vacancy rate from nearly 50% in December 2000 to 0% by July 2001. I have enclosed a copy of the October 8 letter which provides a full explanation of the history of pay stipends and the suggested hiring strategies.

I appreciate your consideration of these matters for the next JLBC meeting.

Sincerely,

Terry L. Stewart
Director

TLS/HG/s

cc: George Weisz, Deputy Chief of Staff, Office of the Governor
Richard Stavneak, Director, Joint Legislative Budget Committee
Kristine Ward, Director, Governor's Office of Strategic Planning and Budgeting
Elliott Hibbs, Director, Arizona Department of Corrections
Charles L. Ryan, Deputy Director, Arizona Department of Corrections
Liza Burns, General Counsel/Legislative Liaison, Arizona Department of Corrections

Arizona Department of Corrections

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JANE DEE HULL
GOVERNOR

TERRY L. STEWART
DIRECTOR

October 8, 2002

The Honorable Ruth Solomon
Arizona State Senate
1700 West Washington Street, Suite 110
Phoenix, Arizona 85007

The Honorable Laura Knaperek
Arizona House of Representatives
1700 West Washington Street, Suite 114
Phoenix, Arizona 85007

Dear Senator Solomon and Representative Knaperek:

I am requesting the following issues as agenda items for the October Joint Legislative Budget Committee (JLBC):

- Arizona State Prison Complex (ASPC)-Lewis Rast Unit pay stipend
- A hiring bonus program for the ASPC-Lewis, Eyman and Florence prisons

History of Pay Stipends

The pay stipend program is critical to the Arizona Department of Correction's (ADC) ability to attract and retain staff at prisons located in geographic areas of the state that have proven extremely difficult to adequately staff. Since the mid-1980s, geographic pay stipends have been approved by the Arizona Department of Administration (ADOA) for certain correctional officer and medical professional staff classifications. Through the years, it has been necessary to continue and, in some cases, enhance the stipend program due to changing economic issues.

In every case where pay stipends have been approved, the ADC, ADOA and/or Governor's Office staff have notified Legislative Leadership of the importance of the pay stipend program before the Department implemented them. While Leadership did not commit to supporting the funding, they did in every case understand the need for competitive salaries. The Department's current liability for the pay stipend program is approximately $14 million, and to date the cost remains unfunded.

The pay stipend program has proven to be a successful strategy for targeted recruitment and retention of staff in many of the areas where it has been implemented. However, for (ASPC)-Eyman and ASPC-Florence, the stipends have only served to help mitigate a chronic and severe inability to attract and retain staff. Our experience shows that the location of the Eyman and Florence prison complexes in the town of Florence adds to this difficulty, e.g., competing with the availability of employment, housing and other features available in the metropolitan areas.

When ASPC-Lewis was sited near the town of Buckeye, the ADC raised concerns that the same hiring and retention problems that exist at the Eyman and Florence prison complexes would also exist at ASPC-Lewis. Our concerns proved valid. We could not attract correctional officers without a stipend. Even when we implemented a 10% stipend for Lewis in January of 2000, as of September 2000, 50% of the authorized correctional officer (CO II) positions remain unfilled. Consequently, we were unable to open nearly half of the 4,150 available prison beds at ASPC-Lewis due to this difficulty.

Legislative Intent

Despite the Legislature's intent to open the ASPC-Lewis Rast Unit in September 2002, the appropriation did not include funding to provide a stipend for the Rast positions. Consequently, recruitment efforts which began in June have been patently unsuccessful. It is evident that it will be many months before these beds can be activated. This state of affairs is not acceptable considering the ADC's current shortage of more than 3,800 beds resulting from the Department's predicted, and now realized, growth in inmate population.

Two Suggested Hiring Strategies

I believe your support for implementation and funding of two hiring strategies will, first, resolve the Rast Unit problem and, secondly, lessen the constantly eroding and critically high vacancy rates at the Lewis, Eyman and Florence prison complexes.

ASPC-Lewis Rast Unit Pay Stipend

The first hiring strategy is to provide ongoing funding for the approved but unfunded 10% hiring stipend at the Rast Unit. As indicated previously, the Department has absorbed the costs of geographic pay stipends through vacancy savings. However, we can no longer afford to absorb new costs associated with new stipends. Due to the already delayed opening of the Rast Unit, my staff and I believe the cost can be temporarily absorbed in Fiscal Year (FY) 2003, however, funding must be provided for FY 2004 and beyond. The recent budget cuts do not allow absorption of the 10% stipends, which are required to open the Rast Unit, on an ongoing basis. The annual cost for Personal Services and related marginal costs is $353,000.

Hiring Bonus Program

The second hiring strategy is to re-institute a hiring bonus program. As previously stated in this letter, the Department's inability to attract CO IIs at ASPC-Lewis has historically resulted in delayed prison bed openings, and it continues to delay the opening of the Rast Unit. The hiring problem in FY 2001 was resolved when a hiring bonus of $5,160 was approved in December 2000.

The hiring bonus was implemented for all new hires and lateral transfers in a manner that would obligate them to stay at ASPC-Lewis for two years. It also encouraged retention of incumbent personnel by paying an additional $100 per pay period for two years, thereby, providing hiring bonus parity. The hiring bonus was approved by Elliot Hibbs, Director, ADOA, however, no funding was provided through the appropriation process.

This hiring bonus program proved to be highly successful. The CO II vacancy rate of nearly 50% in December 2000 decreased to 0% by July 2001. The $5,160 hiring bonus portion of the program ended when a 0% vacancy rate was reached. Subsequent to the elimination of the hiring bonus, the Lewis operational vacancy rate has steadily eroded to levels comparable to the chronic operational vacancy rates at the Eyman (21.9%) and Florence (24.6%) complexes. The Lewis vacancy rate reached 32.3% as of September 24, 2002.

In order to resolve the immediate and growing vacancy rate of CO IIs, I believe it is imperative that a hiring bonus at ASPC-Lewis, ASPC-Eyman and ASPC-Florence be implemented immediately. Implementation would occur in the same manner that proved empirically successful at ASPC-Lewis in 2001.

We believe that the cost of the hiring bonus can be temporarily absorbed during FY 2003 due to the high vacancy rates experienced to date. However, if the program is as successful as expected, additional funds may be required to continue paying the incumbent $100 per paycheck portion of the program in FY 2004. This cost will be contingent upon the implementation date and the program's overall success rate.

In summary, we believe we can temporarily fund the required stipends for the Rast Unit this fiscal year. However, if additional funding for the stipend would not be authorized for FY 2004, then we could not afford to start them now. Additionally, we believe we can temporarily fund a hiring bonus program at Lewis, Eyman, and Florence, but must caution you that we may need supplemental funding in a worst case scenario. While we will make every attempt to apply both strategies within our appropriated resources, significant costs for overtime associated with short staffing, unanticipated costs for control of disturbances or other unforseen events preclude us from assuring you we can implement these programs within existing resources. In the final analysis, if you are not supportive of these two programs, the Rast beds will have to remain vacant until staff become available, and Florence and Eyman will have to continue to operate at dangerously low staffing levels.

I appreciate your consideration of these matters for the October JLBC meeting.

Sincerely,

Terry L. Stewart
Director

TLS/HG/s

cc: George Weisz, Deputy Chief of Staff, Office of the Governor
Richard Stavneak, Director, Joint Legislative Budget Committee
Kristine Ward, Director, Governor's Office of Strategic Planning and Budgeting
Elliott Hibbs, Director, Arizona Department of Administration
Chuck Ryan, Deputy Director, Arizona Department of Corrections
Liza Genrich, General Counsel/Legislative Liaison, Arizona Department of Corrections

STATE OF ARIZONA

Joint Legislative Budget Committee

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HOUSE OF REPRESENTATIVES

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CHRISTINE WEASON

DATE: October 16, 2002

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

THRU: Richard Stavneak, Director

FROM: Jennifer Vermeer, Assistant Director

SUBJECT: AHCCCS - REPORT ON COST SHARING MEASURES

Request

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

Recommendation

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

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

Analysis

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

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

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

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

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

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

RS/JV:lm

AHCCCS

Jane Dee Hull
Governor

Phyllis Biedess
Director

ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

Committed to excellence in health care

October 1, 2002

Mr. Richard Stavneak, Director
Joint Legislative Budget Committee
1716 W. Adams
Phoenix, AZ 85007

Dear Mr. Stavneak:

In accordance with Laws 2002, Chapter 327 § 6, AHCCCS is submitting the requested Cost Sharing Report that identifies new or additional cost sharing measures that could be implemented. The Report primarily discusses strategies that have a chance of approval by the Centers for Medicare and Medicaid Services (CMS).

Medicaid law is very restrictive about the amount of cost sharing that can be imposed on the traditional Medicaid population. There is more flexibility on expansion populations such as the 100% of Federal Poverty Level groups, KidsCare children and the parents of KidsCare children. Any proposal will require federal approval, which could take four to six months, and authorizing state legislation. The strategies that the Cost Sharing Report identifies as possibilities are: new as well as increased copayments and monthly premiums, a monthly premium for households with children enrolled in the long term care program and an initial enrollment fee for eligibility groups who have higher income levels.

Although the Cost Sharing Report contains estimates of the amount of new revenue that could be generated, the figures are optimistic and require several qualifications. First, not all of the revenue will directly benefit the General Fund. For example, copayments are collected by providers, not the AHCCCS program, and the total amount is used to determine a potential offset to an increase in capitation rates. For the Traditional Medicaid population, copayments must be waived if the enrollee can not afford to pay which reduces the rate of collection to about 2% for this population. Second, fees may have a chilling effect on enrollment and may actually increase health care costs if people wait to enroll until they are seriously ill. Third, the estimates for the expansion population are based on CMS' approval of a waiver that gives the state the ability to mandate a copayment or deny services. Finally, AHCCCS does not have solid experience in estimating all of the ramifications of higher cost sharing amounts. The actual revenue that may be generated could be lower than the forecasts or there may be unintended consequences that increase the cost to the program if healthy people do not enroll until they are sick.

AHCCCS wants guidance from the Joint Legislative Budget Committee before proceeding with these cost sharing measures. If a decision is made to pursue any or all of these strategies, CMS will need at least four to six months to make a decision. Therefore, AHCCCS believes that October 1, 2003 is the earliest date to operationalize changes to cost sharing. It will take at least 12 months from implementation to determine if the forecasts are accurate and if the strategies can save money for the program.

If you have any questions, please contact Lynn Dunton at (602) 417-4447.

Sincerely,

Phyllis Biedess
Director

Enclosure

c Jennifer Vermeer, Assistant Director, JLBC

Arizona Health Care Cost Containment System

Cost Sharing Options

Submitted to the Joint Legislative Budget Committee
Phyllis Biedess, AHCCCS Director
October 1, 2002

Cost Sharing Options

BACKGROUND

The Arizona Health Care Cost Containment System (AHCCCS) is required to report to the Joint Legislative Budget Committee (JLBC) on the savings that could be achieved in programs if application fees and other cost sharing measures are implemented. Laws 2002, Chapter 357, requires the report to discuss:

1) Savings associated with each option broken out by program, and

2) Administrative costs associated with implementing each option.

Guiding Principles

In preparing this report, AHCCCS used the following guiding principles.

- If allowable by federal law, AHCCCS eligible persons will have some form of cost sharing.
- Lower income populations will have lower cost sharing amounts.
- Impact on the provider community must be considered.
- Cost sharing will be implemented in the most efficient way to reduce administrative costs.
- Data will drive the conclusions.
- Any additional funds that are collected must be shared with the federal government at the Arizona FMAP rate.

Terms Used Throughout Document

- **ALTCS** - Arizona Long Term Care System - The AHCCCS program that provides long term care services to the elderly and physically or developmentally disabled persons.
- **CMS** - Centers for Medicare and Medicaid Services - The federal agency that regulates Medicaid.
- **Expansion population** - Persons added because of voter approval of Proposition 204 with income up to 100% of FPL.
- **HIFA** - A federal initiative that enabled Arizona to cover the parents of KidsCare children with 75% federal funding.
- **KidsCare children** - A program to cover children up to the age of 19 with household income up to 200% of FPL.

- **Traditional Medicaid** - Individuals who are aged, blind or disabled, a pregnant woman or children who have lower incomes than the Expansion population.

FINDINGS

AHCCCS reviewed federal law and regulations, practices in other states and waiver possibilities to determine the feasibility of requiring higher copayments, premiums and other cost sharing strategies for Traditional Medicaid, KidsCare children, HIFA parents and Expansion enrollees. Federal law and regulations are very clear that copayments must be nominal for Traditional Medicaid enrollees and must be waived if a person can not pay. Copayments amounts can be higher for Expansion populations. Considering these parameters, the state could request CMS approval for the following changes to current cost sharing requirements:

- Add new copayments and increase others through a waiver approved by CMS - this change will not increase revenue to the General Fund for the reasons explained below.

- Increase the monthly premium for KidsCare children and include a monthly premium for the new HIFA Parents.

- Request federal approval to collect monthly premiums for children enrolled in ALTCS. The estimates are based on a 5% premium for households with income above 221% of FPL. This threshold was chosen because it approximates the current eligibility level of 300% of SSI for the ALTCS program.

- Request waiver approval to impose an initial enrollment fee for KidsCare children, HIFA Parents and the Expansion population that must be paid before an applicant is enrolled with AHCCCS.

COPAYMENTS

The current copayment amounts are described in Appendices 1 and 2. Copayments are fixed amounts that are collected by providers, such as physicians or laboratories, at the time a service is rendered. In turn, the health plans or program contractors reduce reimbursement to these contracted providers to reflect the dollar amounts that are collected by the provider. Even at the nominal levels, the experience in Arizona and other states is that only about 2% of the possible copayments are collected from Traditional Medicaid populations since the copayment must be waived if the person can not afford to pay.

For the purposes of this report, AHCCCS used a 2% collection rate (25% for prescriptions) for the Traditional Medicaid population and a threshold of 50% and 75% as the collection rate for KidsCare children, HIFA parents and the Expansion population. If providers collect copayments at this level, the revenue that will be generated is between $7,000,000 and $10,250,000. However, increasing the copayments is not a direct fiscal benefit to the state since AHCCCS does not collect the copayments. Revenue that is generated by new or increased copayments will be considered as part of the actuarial analysis of capitation rates and could result in smaller capitation rate increases in the future.

Federal law is very specific about the amount of copayments and sets the following parameters:

1) Copayments must be nominal and waived for traditional Medicaid members who can not afford to pay.

2) No copayments can be imposed on:

- Family planning (Medicaid).
- Services received by children under 18 years of age, pregnant women, individuals receiving hospice care and institutionalized individuals (Medicaid).
- Well baby and well-child services (KidsCare).
- Routine preventive and diagnostic services (KidsCare).

3) Unless a waiver is granted by CMS, the maximum copayment is $3 for traditional Medicaid recipients.

4) SCHIP limits the amount of out-of-pocket expenses for copayments and monthly premiums to no more than five percent of the household income of KidsCare children and HIFA parents.

5) CMS will consider higher copayments on Expansion populations such as the Proposition 204 groups and HIFA parents.

6) States are required to return the federal share (FMAP) portion of the copayments to the federal government which reduces the amount of revenue that could be realized from new or increased copayments.

Considering the federal requirements, CMS guidance and the experience in other states, the state could add or increase copayments as reflected in Table 1. In order for the state to generate revenue that merits an increase in copayments, it is essential that CMS allow the state to refuse a Medicaid service for KidsCare children and HIFA parents and Expansion populations if the copayment is not paid. To date, CMS has not approved any state's request to deny services if the Medicaid recipients can not afford to pay. If the request is not approved by CMS, physicians, hospitals and other providers must provide services and will be penalized if the state lowers reimbursement to account for copayments that can not be collected. Other waivers will be needed to increase copayments for the non-emergency use of the emergency room and for non-emergency transportation. CMS has not approved higher copayments for Traditional Medicaid populations but have approved a few waiver requests to increase copayments on Expansion populations.

Table 1-State Share of Revenue to Providers Due to Increased or Added Copayments (Does not include behavioral health and the RHBAs)

Program	Generic Prescriptions $2 Traditional Medicaid $5 All Others	Brand Name Prescriptions $2 Traditional Medicaid $8 Expansion and HIFA $5 KidsCare	Non-Emergency Use of the Emergency Room $6 Traditional Medicaid $10 KidsCare <150% $30 All Others	Non-Emergency Transportation $5 Traditional Medicaid and KidsCare <150% $10 All Others	All Other Services $2 Traditional Medicaid $5 All Others
Traditional Medicaid (1)	$322,000	$132,000	Negligible for this group since hospitals must stabilize an "emergency" and waive the copayment if the person can not pay	$8,000	$12,000 (Primary Dr.) $22,000 (Specialist) $3,000 (Lab and X-ray)
Prop 204 Expansion Groups (2)	$1,383,000-$2,074,000	$904,000-$1,355,000	$31,000-$46,000	$338,000-$507,000	$1,903,000-$2,854,000 (Primary Dr.) $589,000-$884,000 (Specialist) $881,000-$1,321,000 (Lab and X-ray)
HIFA Parents (2)	$83,000-$125,000	$55,000-$82,000	$3,000-$4,000	$15,000-$22,000	$118,000-$177,000 (Primary Dr.) $27,000-$40,000 (Specialist) $36,000-$54,000 (Lab and X-ray)
KidsCare <150% of the FPL (2)	$29,000-$44,000	$12,000-$18,000	Negligible	$4,000-$5,000	$0 (3) (Primary Dr.) $9,000-$13,000 (Specialist) $20,000-$30,000 (Lab and X-ray)
KidsCare >150% of the FPL (2)	$24,000-$35,000	$10,000-$14,000	$1,000	$6,000-$9,000	$0 (3) (Primary Dr.) $7,000-$10,000 (Specialist) $16,000-$24,000 (Lab and X-ray)
GRAND TOTAL	$1,841,000-$2,600,000	$1,113,000-$1,601,000	$35,000-$51,000	$371,000-$551,000	$3,643,000-$5,444,000

1. Traditional Medicaid estimates are based on collecting 2% of the copayments (25% for prescriptions) since a state can not deny services if the person can not pay.

2. KidsCare, HIFA and Expansion Populations estimates are based on collecting a range of 50% and 75% of the copayments. This percentage is dependent on getting CMS approval to deny services if the copayment is not paid.

3. There is no data on primary doctor copayments for KidsCare since copayments can not be assessed on well baby or well child visits.

4. Enrollment information as of 7/1/02

5. This is a snapshot of the data. Utilization and enrollment may change over time and increase or decrease the collections.

Administrative Costs

There will be new administrative costs at the health plan or program contractor level to pay providers to collect these copayments.

MONTHLY PREMIUMS

Premiums are monthly amounts a member pays to maintain enrollment in AHCCCS. The federal limitations are:

1) States can not charge a monthly premium on Traditional Medicaid populations.

2) There is some flexibility to assess a monthly premium on Expansion populations with approval by CMS.

3) AHCCCS may impose a premium for KidsCare children and HIFA parents but the combined total of all cost sharing can be not more than five percent of the household income.

4) States are required to return the federal share (FMAP) portion of the premium to the federal government which reduces the amount of revenue that the state may realize.

Monthly Premiums for KidsCare and HIFA Parents

As shown in Table 2, the state may assess a monthly premiums on HIFA Parents, impose a monthly premium for KidsCare children under 150% of the FPL and increase the monthly premium by $5 for all other KidsCare children between 150% to 200% of the FPL.

The estimated revenue is calculated based on 100% payment of the premiums since the premium must be paid in order to continue participation in the program.

Table 2-Increased Premium Amounts Based on 100% Collection (State Share Only)

Premiums/per month	100% to 150% FPL	150% to 175% FPL	175% to 200%FPL
KidsCare	$15 for one KidsCare child $25 for more than one KidsCare child	$20 for one KidsCare child $30 for more than one KidsCare child	$25 for a household with one KidsCare child $35 for more than one KidsCare child
	$1,312,000	**$472,000**	**$346,000**
Premiums/per month	**100% to 150% FPL**	**150% to 175% FPL**	**175% to 200%FPL**
HIFA Parents	$15 for each HIFA parent	$20 for each HIFA parent	$25 for each HIFA parent
	$1,348,000	**$225,000**	**$205,000**
		GRAND TOTAL	**$3,908,000**

Administrative Costs

AHCCCS currently collects premiums for the KidsCare Program. Administrative costs to increase the premiums can be absorbed by the agency.

Assess Monthly Premiums on Households With ALTCS Eligible Children

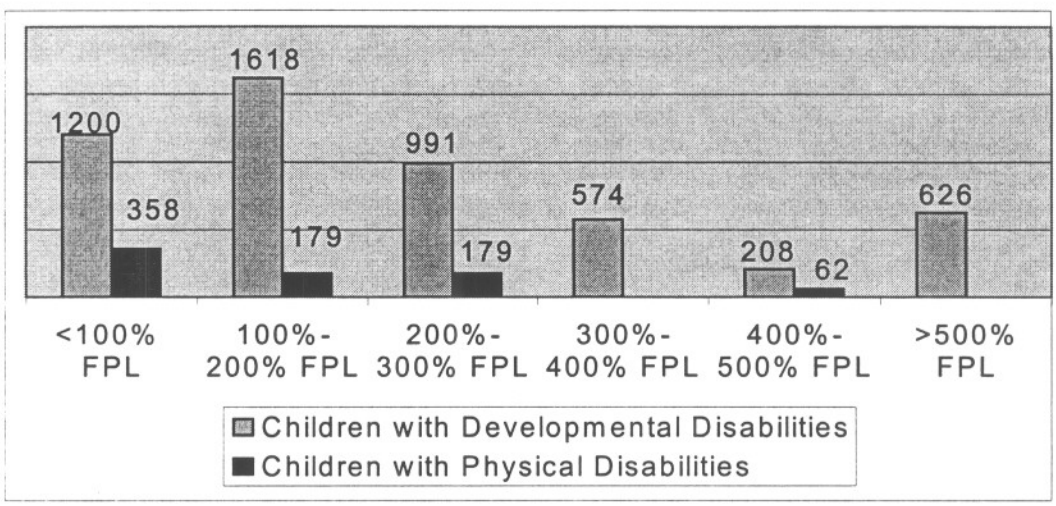
Currently, parental income is not counted when a child under the age of 18 applies for enrollment in ALTCS. In 1987, the state decided not to count parental income in order to cover as many disabled children as possible with federal funds and to reduce the waiting list for services provided to children with developmental disabilities.

There are almost 6,000 physically or developmentally disabled children enrolled in ALTCS who live at home with parents with household income levels that range from under 100% of the FPL to well over 1500% of the FPL (see Table 3). Even at the higher income levels, parents do not pay anything toward the cost of ALTCS services for their children.

The state could pursue a waiver from CMS that would allow the state to assess a monthly premium based on household income above 221% of the FPL for children enrolled in ALTCS. This FPL level approximates the current eligibility level of 300% of SSI that is used to determine financial eligibility for the ALTCS program. This FPL also targets households with higher income (e.g. a family of four with a monthly income of over $3,333).

CMS has advised the state that any change in the long term care program will require the state to negotiate a budget neutrality agreement for ALTCS, which will increase administrative costs to the agency for this task. If the state receives approval, rules must be promulgated to support the amount of the premiums.

Table 3- Households by Income Levels



An example of the amount of the monthly premium based on household income is depicted in Table 4.

Table 4-ALTCS Monthly Premiums (State Share Only)

5% of Household Income	Premium Amount	Estimated Total Revenue
Income from 221%-300% of FPL	$138	$410,000
Income above 300%-400% of FPL	$187	$416,000
Income above 400%-500 of FPL	$250	$263,000
Income above 500% of FPL	$312	$757,000
	GRAND TOTAL	**$1,846,000**

1. The ALTCS estimation was based on a sample size of 305 children under the age of 18 who reside at home with a parent.

2. The dollar figure represents a household of 3.

Enrollment Fees

Utah received CMS' approval to impose an enrollment fee on Expansion populations at the time of initial enrollment. The state could request a waiver from CMS to impose a $25 enrollment fee at the time of initial enrollment. AHCCCS has estimated the revenue that would be generated by this new fee in Table 5 but can not quantify the impact to the AHCCCS' budget if healthy people do not enroll until they are sick or what the amount of the increase in uncompensated care for hospitals and providers will be.

Table 5-Add a $25 Enrollment Fee at 100% Collection (State Share Only)

$25 Enrollment Fee	Increased Revenue
Prop 204 Expansion Groups	$595,000
HIFA Parents	$182,000
KidsCare Children	$483,000
TOTAL	**$1,260,000**

NECESSARY ACTIONS TO IMPLEMENT COST SHARING CHANGES

In order to increase or add copayments, enrollment fees and monthly premiums the legislature must amend AHCCCS' statutes and CMS must approve a waiver before the state could:

- Set copayment amounts above the "nominal" standard in federal and state law.
- Deny a service if a member refuses to pay the copayment.
- Add enrollment fees and increase or add new premiums.

ENHANCED REVENUE

Table 6 provides a total estimate of potential offset for higher copayments and new revenue that may be generated by new or higher premiums. These estimates are based on several variables including state and federal approval, enrollment numbers at today's levels or higher and the willingness of the providers to collect copayments.

Any budget estimate must take into account that copayments will not increase revenue to the state in the short term. The long term benefit to the state will depend on whether the amount of copayments that are collected by the providers is sufficient to warrant a future offset to the overall medical inflation cost that is factored into capitation rates to keep them actuarially sound.

Table 6-Estimated Collection of Higher and New Copayments

Source	Total Revenue	Federal Share	State Share	Statute Change	Waiver Request
Add Generic Prescription Copayment (1) • $2 Traditional Medicaid • $5 All Others	$5,801,000- $8,209,000	$3,959,000- $5,608,000	$1,841,000- $2,601,000	Yes	No
Add Brand Name Prescription Copayment (1) • $2 Traditional Medicaid • $5 KidsCare Children • $8 Expansion and HIFA	$3,494,000- $5,039,000	$2,381,000- $3,438,000	$1,113,000- $1,601,000	Yes	No
Increase Copayments for the Non-Emergency Use of the ER (2) • $6 Traditional Medicaid • $10 KidsCare Children <150% • $30 Expansion, HIFA, and KidsCare Children >150%	$111,000- $164,000	$76,000- $112,000	$35,000- $51,000	Yes	Yes
Add Copayment for Non-Emergency Transportation (2) • $5 Traditional Medicaid and KidsCare Children <150% • $10 Expansion, HIFA and KidsCare Children>150%	$1,162,000- $1,730,000	$791,000- $1,179,000	$371,000- $551,000	Yes	Yes
Increase/Add Copayment for Primary Doctor (2) • $2 Traditional Medicaid • $5 All Others	$6,362,000- $9,524,000	$4,329,000- $6,481,000	$2,033,000- $3,043,000	Yes	Yes
Increase/Add Copayment for Specialist (2) • $2 Traditional Medicaid • $5 All Others	$2,053,000- $3,045,000	$1,398,000- $2,075,000	$654,000- 970,000	Yes	Yes
Increase/Add Copayment for Lab and X-ray (2) • $2 Traditional Medicaid • $5 All Others	$3,016,000- $4,517,000	$2,058,000- $3,084,000	$956,000- $1,433,000	Yes	Yes
Total Copayments	$21,999,000- $32,228,000	$14,992,000- $21,977,000	$7,003,000- $10,250,000		

Over a 12-month period, premiums could generate new revenue to the state if CMS approves the waiver.

Table 7 - New or Higher Premiums

Source	Total Revenue	Federal Share	State Share	Statute Change	Waiver Request
Premiums for HIFA Parents and KidsCare Children	$17,050,000	$13,142,000	$3,908,000	Yes	Yes
Premiums for ALTCS	$5,638,000	$3,792,000	$1,846,000	Yes	Yes
Enrollment Fees	$4,720,000	$3,460,000	$1,260,000	Yes	Yes
Total Premium Collections	$27,408,000	$20,394,000	$7,014,000		
GRAND TOTAL	**$49,407,000-$59,636,000**	**$35,386,000-$42,371,000**	**$14,017,000-$17,264,000**		

1. Traditional Medicaid estimates are based on collecting 2% of the copayments (25% for prescriptions) since a state can not deny services if the person can not pay.

2. KidsCare, HIFA and Expansion populations estimates are based on collecting range of 50% and 75% of the copayments. This percentage is dependent on getting CMS approval to deny services if the copayment is not paid.

Appendix 1

AHCCCS Current Copayments

Traditional Medicaid

Service	Copayment
Non-emergency use of the emergency room	$5
Non-emergency surgery procedure	$5
Doctor's office or home visit and all diagnostic and rehabilitative x-ray and laboratory services associated with the visit	$1

KidsCare Children

Service	Copayment
Non-emergency use of the emergency room	$5

Appendix 2

Federal Copayment Limits

Traditional Medicaid

Copayments can range from $0.50 to $3 depending on the cost of the service.

Cost of Service	Copayment
0-$10	$0.50
$10.01-$25	$1
$25.01-$50	$2
$50.01 and higher	$3

*Non-emergency use of the emergency room can be increased from $5 to $6 with a waiver.

Exclusions

Copayments may not be charged on:

- Family planning; and
- Services received by children under 18 years of age, pregnant women, individuals receiving hospice care and institutionalized individuals.

KidsCare Children

For KidsCare children under 150% of the FPL, non-emergency use of the emergency room copayments cannot exceed $10 and copayments on all other services cannot exceed $5. Total cost sharing (copayments, premiums, and enrollment fees) cannot exceed 5% of the household annual income.

Total Out of Pocket @ 5% Cap

Family Size	5% of 100% FPL	5% of 150% FPL	5% of 175% FPL	5% of 200% FPL
1	443.00	664.50	775.25	886.00
2	597.00	895.50	1,044.75	1,194.00
3	751.00	1,126.50	1,314.25	1,502.00
4	905.00	1,357.50	1,583.75	1,810.00

Exclusions

Copayments may not be charged on:

- Well baby and well-child services, and
- Routine preventive and diagnostic services.

STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: November 20, 2002

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

FROM: Richard Stavneak, Director

SUBJECT: REPORT ON RECENT AGENCY SUBMISSIONS

Request

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

Recommendation

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

Reports

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

RS:lm