STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

DON SHOOTER
CHAIRMAN 2014
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GAIL GRIFFIN
JOHN McCOMISH
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** R E V I S E D **

JOINT LEGISLATIVE BUDGET COMMITTEE
Wednesday, December 17, 2014
1:30 P.M.
House Hearing Room 4 [Room Number Changed]

MEETING NOTICE

- Call to Order

- Approval of Minutes of September 30, 2014.

- DIRECTOR'S REPORT (if necessary).

- EXECUTIVE SESSION
  A. Arizona Department of Administration, Risk Management Services - Consideration of Proposed Settlements under Rule 14.
  B. Arizona Department of Administration - Risk Management Annual Report.
  C. JLBC Annual Performance Review per Rule 7.

1. ARIZONA DEPARTMENT OF ADMINISTRATION
   A. Review of Plan to Reduce Federal Reimbursement for Excess Balances.
   B. Consider Approval of Employer Sanctions Enforcement Distributions.
   C. Review of ASET Projects (Automation Projects Fund).
   D. Review Report on Public Safety Broadband. *

2. ATTORNEY GENERAL
   A. Review of Allocation of Settlement Monies - State v. McKesson Corporation.
   B. Review of Quarterly Reports on Legal Settlements. *

3. DEPARTMENT OF REVENUE
   A. Review of Data Capture Project (Automation Projects Fund).
   B. Review of Tax Data Analysis Expenditure Plan. *
   C. Review of Electronic Tobacco Tax Filing System Project (Automation Projects Fund).

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

5. DEPARTMENT OF EDUCATION - Review of Transwestern Settlement.

6. STATE BOARD OF EDUCATION - Review Changes to Achievement Testing Program.

7. DEPARTMENT OF ECONOMIC SECURITY - Review of Transition Funding Expenditure Plan - Data Center.

8. AHCCCS/DEPARTMENT OF HEALTH SERVICES/DEPARTMENT OF ECONOMIC SECURITY - Review of Revised Capitation Rates.

* Consent Agenda - These items will be considered in one motion and testimony will not be taken.

The Chairman reserves the right to set the order of the agenda.
~~12/9/14~~
12/11/14
lm

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MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

September 30, 2014

The Chairman called the meeting to order at 1:53 p.m., Tuesday, September 30, 2014, in Senate Appropriations Room 109. The following were present:

Members:	Senator Shooter, Chairman	Representative Kavanagh, Vice-Chairman
	Senator Cajero Bedford	Representative Alston
	Senator Griffin	Representative Gowan
	Senator McComish	Representative Kwasman
	Senator Melvin	Representative Lesko
	Senator Pancrazi	Representative Mach
	Senator Tovar	Representative Olson
	Senator Yarbrough	Representative Ugenti

APPROVAL OF MINUTES

Hearing no objections from the members of the Committee to the minutes of June 19, 2014, Chairman Don Shooter stated that the minutes would stand approved.

ARIZONA DEPARTMENT OF ADMINISTRATION (ADOA) - Review of ASET Mainframe Upgrade (Automation Projects Fund).

Ms. Rebecca Perrera, JLBC Staff, stated that this item is for a review of a $2.9 million FY 2015 expenditure plan from the Automation Projects Fund for improvements to the State Data Center at the Arizona Strategic Enterprise Technology (ASET) Office in ADOA. The JLBC Staff presented options to the Committee.

<u>Representative Kavanagh moved</u> *that the Committee give a favorable review to ADOA's $2,900,000 in proposed FY 2015 expenditures from the Automation Projects Fund for improvements to the State Data Center at the Arizona Strategic Enterprise Technology (ASET) Office in ADOA with the following provisions:*

(Continued)

A. *As a result of further planning, procurement, and implementation efforts, should there be a change in the proposed costs or lease agreement terms of 10% or more, the State Data Center (SDC) team within ADOA-ASET must amend the Project Investment Justification (PIJ) to reflect the changes and present it to Information Technology Authorization Committee (ITAC) for review and approval prior to further expenditure of funds.*
B. *ADOA request Committee review should additional funds be required in excess of the $2.9 million allocated.*
C. *A favorable review by the Committee does not constitute an endorsement to fund an increase in rates charged to agencies for Information Technology (IT) products and services.*

The motion carried.

ARIZONA DEPARTMENT OF ADMINISTRATION (ADOA) - Review of ASET Security Enhancement Projects (Automation Projects Fund).

Ms. Rebecca Perrera, JLBC Staff, stated that this item is for a review of a $2.8 million FY 2015 expenditure plan from the Automation Projects Fund for security enhancement projects for the Arizona Strategic Enterprise Technology (ASET) Office in ADOA. The JLBC Staff presented options to the Committee.

Representative Kavanagh moved that the Committee give a favorable review to ADOA's $2,776,600 proposed FY 2015 expenditures from the Automation Projects Fund for security enhancement projects for the ASET Office in ADOA with the following provisions:

A. *Should there be a change in the proposed costs of 10% or more, the Security, Privacy and Risk (SPR) team within ADOA-ASET must amend the PIJ to reflect the changes and present it to ITAC for review and approval prior to further expenditure of funds.*
B. *ADOA shall notify the Committee if funds are transferred between security enhancement projects. In addition, ADOA shall request Committee review should additional funds be required in excess of the $2,776,600 allocated for security enhancement projects.*

The motion carried.

ARIZONA DEPARTMENT OF ADMINISTRATION (ADOA) - Review of ASET Administrative Costs (Automation Projects Fund).

Ms. Rebecca Perrera, JLBC Staff, stated that this item is for review of a $3.3 million FY 2015 expenditure plan from the Automation Projects Fund for statewide project management for the ASET Office in ADOA. The $3.3 million includes 4 priority areas:

• Project Management	$2,151,700
• Enterprise Architecture	$500,000
• E-Government	$325,000
• Security, Privacy, and Risk	$348,400

The JLBC Staff presented options to the Committee.

Representative Kavanagh moved that the Committee give a favorable review to ADOA's $3,325,100 in FY 2015 expenditures from the Automated Projects Fund for statewide project management for the ASET Office in ADOA with the following provisions:

(Continued)

A. ADOA's request has 4 priorities. ADOA shall notify the Committee if funds are transferred between projects within a priority area. In addition, ADOA shall request Committee review if funds are transferred between priorities. Further, ADOA shall request Committee review should additional funds be required in excess of the $3,325,100 allocated.
B. ADOA is to report by November 21, 2014 their plans for expending $1,300,000 in unused FY 2014 project management funds.

The motion carried.

ARIZONA BOARD OF REGENTS (ABOR) - Review of FY 2015 Tuition Revenues.

Ms. Micaela Larkin, JLBC Staff, stated that ABOR requests Committee review of its expenditure plan for tuition revenue amounts greater than the amounts appropriated by the Legislature, and all non-appropriated tuition and fee revenue expenditures for the current fiscal year. The JLBC Staff presented options to the Committee.

Senator Shooter noted that JLBC, the Governor's Office and ABOR are working together to clarify the issues regarding the appropriation status of tuition monies.

Representative Kavanagh moved that the Committee give a favorable review of ABOR's expenditure plan. The motion carried.

ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM (AHCCCS) - Review of Seriously Mentally Ill (SMI) Interagency Agreement with the Department of Health Services (DHS).

Mr. Andrew Smith, JLBC Staff, stated that AHCCCS is requesting Committee review of its report on the interagency agreement with DHS for providing integrated acute care and behavioral health services for Medicaid-eligible SMI adults in Maricopa County. The JLBC Staff presented options to the Committee.

Ms. Jennifer Carusetta, Chief Legislative Liaison, AHCCCS, responded to member questions.

Representative Kavanagh moved that the Committee give a favorable review to the Seriously Mentally Ill interagency agreement with DHS with the following provisions:

A. AHCCCS is to report to the Committee by March 31, 2016, on any findings involving the integration of care or health outcomes for all Medicaid populations that occurred as a result of the Integrated Regional Behavioral Health Authority (RBHA) contract. The March 31, 2016 date coincides with AHCCCS' requirement to submit a written report to the Federal Center of Medicare and Medicaid Systems on this same subject.
B. DHS is to account for the SMI integrated acute care monies separately from all other monies it receives from AHCCCS in order to highlight the availability of funds.

The motion carried.

AHCCCS/DEPARTMENT OF HEALTH SERVICES (DHS)/DEPARTMENT OF ECONOMIC SECURITY (DES)/DEPARTMENT OF CHILD SAFETY (DCS) - Review of Proposed Capitation Rate Changes.

Mr. Andrew Smith, JLBC Staff, stated that this item is to review the AHCCCS, the DHS, the DES and the DCS capitation rate changes for the following programs:

(Continued)

- Acute Care
- Children's Rehabilitative Services
- Arizona Long Term Care System (ALTCS) for the Elderly and Physically Disabled
- ALTCS DES/Developmentally Disabled (July 1, 2014 through June 30, 2015)
- DCS/Comprehensive Medical and Dental Program (update for October 1, 2014 through June 30, 2015)
- DHS/Behavioral Health Services.

The JLBC Staff presented options to the Committee.

Ms. Shelli Silver, Assistant Director, AHCCCS, responded to member questions.

Representative Kavanagh moved that the Committee give a favorable review to the proposed capitation rate changes. The motion carried.

ARIZONA DEPARTMENT OF CORRECTIONS (ADC) - Review of FY 2014 Bed Capacity Report.

Ms. Micaela Larkin, JLBC Staff, stated that ADC is requesting Committee review of its FY 2014 bed capacity report. The JLBC Staff presented options to the Committee.

Representative Kavanagh moved that the Committee give a favorable review to the FY 2014 bed capacity report. The motion carried.

ATTORNEY GENERAL (AG) - Review of FY 2013 Uncollectible Debts.

Mr. Matt Gress, JLBC Staff, stated that the AG requests Committee review of its FY 2013 listing of uncollectible debts referred to the AG by state agencies for collection. The listing totals $44.9 million for FY 2013. The JLBC Staff presented options to the Committee.

Representative Kavanagh moved that the Committee give a favorable review of the FY 2013 listings of uncollectible debts referred to the AG by state agencies for collection. The motion carried.

ATTORNEY GENERAL (AG) - Review of Quarterly Reports on Legal Settlements.

Mr. Matt Gress, JLBC Staff, stated that AG requests Committee review of its quarterly reports on the receipts to and disbursements from the Consumer Protection - Consumer Fraud (CPCF) Revolving Fund, the Consumer Restitution and Remediation Revolving Fund, and the Antitrust Enforcement (AE) Revolving Fund, as well as deposits made to the General Fund.

The intent of the General Appropriation Act provision is to review the AG's allocation of legal settlements among the various funds. In the fourth quarter of FY 2014, the AG deposited $63,900 to the CPCF Revolving Fund, $227,900 to the Restitution Subaccount, $27,200 to the Remediation Subaccount, and $136,100 to the AE Revolving Fund. The JLBC Staff presented options to the Committee.

Representative Kavanagh moved that the Committee give a favorable review of the AG's allocation of legal settlements among the various funds. The motion carried.

(Continued)

DEPARTMENT OF CHILD SAFETY (DCS) - Review of Transition Funding Expenditure for Administrative Expenses.

Mr. Ben Beutler, JLBC Staff, stated that this item requires Committee review prior to any monies being expended from the Arizona Department of Administration's (ADOA) $25.0 million appropriation for DCS transition expenses. At its June 2014 meeting, the Committee favorably reviewed DCS' request to spend $3.6 million in administrative expenses. DCS is requesting Committee review of an additional $7.4 million in FY 2015 administrative expenses. The JLBC Staff presented options to the Committee.

Mr. Charles Flanagan, Director, Department of Child Safety and Family Services, DCS, responded to member questions.

Representative Kavanagh moved *that the Committee give a favorable review of administrative funding for the first 6 months of FY 2015 totaling $6,502,700, or an additional $2,895,300 above that reviewed by the Committee in June and that involves extending the 40 employees for another quarter and the laptops. In addition, DCS shall report on the number of filled administrative positions and the year-to-date transition expenditures 30 days after the end of each calendar quarter.* The motion carried.

DEPARTMENT OF ECONOMIC SECURITY (DES) - Review of Transition Funding Expenditure Plan - Data Center.

Mr. Tom Ritland, JLBC Staff, stated that this item requires Committee review prior to any monies being expended from the Arizona Department of Administration's (ADOA) $25.0 million appropriation for the establishment of DCS and the relocation of the DES Data Center. DES requests Committee review of $500,000 for the planning phase of the data center relocation and $2.5 million to begin implementing the network infrastructure in the new space. The JLBC Staff presented options to the Committee.

Mr. Aaron Sandeen, Deputy Director and State Chief Information Officer, ADOA, responded to member questions.

Representative Kavanagh moved *that the Committee give a favorable review of $500,000 for the planning phase of the Data Center relocation and did not review the $2.5 million of the implementation phase. In addition, the Committee recommended the following provisions:*

A. DES is to receive ITAC approval before spending any amount above the $500,000 planning monies. ITAC may consider the full project at their November meeting.
B. DES is to submit more detailed information regarding the split between State and Federal funding for the Data Center relocation by October 31, 2014. The submission is to address how equipment purchase and leasing arrangements will affect federal financial participation.
C. The Committee's action does not constitute an endorsement of DES' full $7.0 million plan.

The motion carried.

JLBC STAFF - Review of Agency Legal Services Charges.

Mr. Matt Gress, JLBC Staff, stated that this item is for review of agency funding sources for the Attorney General (AG) legal services charges for general agency counsel. The charges total $1.8 million, the same amount as last year. The allocation of charges to each agency also remains unchanged.

(Continued)

Representative Kavanagh moved that the Committee give a favorable review of the fund source reports for the AG legal services charges. The motion carried.

EXECUTIVE SESSION

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

At 2:56 p.m. the Joint Legislative Budget Committee went into Executive Session.

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

At 3:50 p.m. the Committee reconvened into open session.

Representative Kavanagh moved that the Committee approve the recommended settlements proposed by the Attorney General's office in the cases of:

- *Pritchett v. State of Arizona*
- *Barber, et al. v. State of Arizona, et al.*
- *Hannah v. State of Arizona, et al.*
- *Rape/Dawson v. State of Arizona, et al.*

The motion carried.

Without objection, the meeting adjourned at 3:52 p.m.

Respectfully submitted:

Kristy Paddack

Kristy Paddack, Secretary

Richard Stavneak

Richard Stavneak, Director

Senator Don Shooter, Chairman

NOTE: A full audio recording of this meeting is available at the JLBC Staff Office, 1716 W. Adams. A full video recording of this meeting is available at http://www.azleg.gov/jlbc/meeting.htm.

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DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Rebecca Perrera, Fiscal Analyst RP

SUBJECT: Arizona Department of Administration - Review of Plan to Reduce Federal Reimbursement for Excess Balances

Request

Pursuant to an FY 2015 General Appropriation Act footnote, the Arizona Department of Administration (ADOA) has submitted for review its plan to reduce the level of federal reimbursements regarding excess balances from funds other than the Special Employee Health Insurance Fund (HITF).

The department's submission does not directly address a plan to reduce federal liability associated with excess balances. As a result, JLBC Staff has developed several alternatives.

Recommendation

The Committee has at least the following 4 options:

1. Endorse ADOA's current approach of continuing to carry excess balances and reimburse the federal government.

2. Recommend that any excess balances be proportionately returned to the state and the federal government.

3. Reduce internal service rates to eliminated excess balances.

4. Take no action.

(Continued)

Analysis

ADOA funding consists of several Enterprise Funds whose purpose is to charge fees to state agencies for the provision of administrative and infrastructure services. Enterprise Funds include the Automation Operations Fund and the Capital Outlay Stabilization Fund.

The federal government pays into these funds for its proportional share of services. In order to receive Federal Funds, the state enters into a contractual obligation with the federal government, which restricts some uses of these monies. If the state then uses these funds in restricted ways, the federal government requires that the state pay back a proportional share of these funds.

One federal restriction stipulates that they will require reimbursement of their share of any Enterprise Fund balance above a level equal to 60 days of expenditures. ADOA maintains balances above this level primarily in 4 internal service funds — the Automation Operations Fund, the Information Technology (IT) Fund, the Personnel Fund, and the State Motor Pool Fund

In FY 2014, the federal government charged the state $3.9 million for FY 2013 excess balances in these 4 funds and the Telecommunications Fund. This bill was paid from the Risk Management Fund. Because the Risk Management Fund also has a federal participation rate, the state must also pay a federal reimbursement for using the Risk Management Fund to resolve other federal liabilities.

The state could maintain the current balance levels in these funds and continue to reimburse the federal government. Carrying these balances allows for some stability of cash flow and provides funding for significant capital expenditures such as large-scale IT equipment. There are 2 other methods to address the issue of excess fund balances:

1. Rate Reduction - ADOA could reduce the rates charged to agencies for internal services. Because revenue is generated from many fund sources, it is difficult to translate a rate reduction into recognizable General Fund savings. ADOA has not provided specific methods to reduce rates.

2. Fund Transfer - If ADOA maintains the current rate structure, the Legislature could transfer excess balances to the General Fund along with continuing to reimburse the federal government. This alternative would generate approximately $12.4 million of one-time revenue for the General Fund.

Reducing the excess balances in these funds would limit ADOA's ability to purchase capital equipment using large cash balances and may require the department to use lease or lease-purchase financing mechanisms to acquire new equipment. We would note, however, that even with the current available excess fund balances, ADOA has recently utilized lease financing in acquiring a new mainframe for the State Data Center. Short-term lease-purchase financing may also be more appropriate in situations where an asset will depreciate quickly.

RS/RP:kp

Janice K. Brewer
Governor

Kathy Peckardt
Interim Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007

(602) 542-1500

November 13, 2014

The Honorable Don Shooter, Chairman
Joint Legislative Budget Committee
Arizona Senate
1700 West Washington Street
Phoenix, Arizona 85007

The Honorable John Kavanagh, Vice Chairman
Joint Legislative Budget Committee
Arizona House of Representatives
1700 West Washington Street
Phoenix, Arizona 85007

Dear Senator Shooter and Representative Kavanagh:

Pursuant to Laws 2014, Second Regular Session, Chapter 18, Section 105, the Arizona Department of Administration General Accounting Office is reporting for your review the plan to reduce the level of federal reimbursements regarding excess balances from funds other than the Special Employee Health Insurance Fund.

If you have any questions, please contact Clark Partridge at clark.partridge@azdoa.gov or (602) 542-5406 or Paul Shannon at paul.shannon@azdoa.gov or (602) 542-1510.

Sincerely,

Kathy Peckardt

Kathy Peckardt
Interim Director

Attachments

cc: Richard Stavneak, Director JLBC
John Arnold, Director OSPB
Rebecca Perrera, JLBC
Will Palmisano, OSPB
Paul Shannon, ADOA Assistant Director
Clark Partridge, State Comptroller

Report on Plan to Reduce Federal Reimbursements
Prepared by the Arizona Department of Administration, General Accounting Office
November 2014

Reporting Requirement

Laws 2014, 2nd Regular Session, Chapter 18 (HB 2703), Section 105, requires the Department of Administration to submit a plan to reduce the Federal reimbursement related to excess balances from funds other than the special employee health insurance trust fund to the JLBC.

General Federal Provisions

Title 2, Subtitle A, Chapter II, Part 200 (2 CFR part 200) establishes principles for determining the allowable costs incurred by State, local, and federally-recognized Indian tribal governments (governmental units) under grants, cost reimbursement contracts, and other agreements with the Federal Government (collectively referred to as "Federal awards"). The principles are for the purpose of cost determination and are designed to provide that Federal awards bear their fair share of cost recognized under these principles except where restricted or prohibited by Federal law. There is no provision for profit or other increment above cost.

The application of these principles is based on the fundamental premises that:

1. Governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices.

2. Governmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award.

3. Each governmental unit, in recognition of its own unique combination of staff, facilities, and experience, will have the primary responsibility for employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration of Federal awards.

These regulations apply to all central service and department/agency costs that are allocated or billed to State and local government departments and agencies. A cost is allowable only to the extent of benefits received by Federal awards and its conformance with the general Federal policies and principles. To be allowable under Federal awards, costs must meet the following general criteria:

1. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.

2. Be allocable to Federal awards under the provisions of 2 CFR part 200.

3. Be authorized or not prohibited under State or local laws or regulations.

4. Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.
5. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.
6. Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
7. Except as otherwise provided for in 2 CFR part 200, be determined in accordance with generally accepted accounting principles.
8. Not be included as a cost or used to meet cost sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation.
9. Be the net of all applicable credits.
10. Be adequately documented.

Unallowable Costs

Unallowable costs, excess costs due to noncompliance with cost policies by a non-Federal entity, increased costs due to failure to follow a disclosed accounting practice, and increased costs resulting from a change in cost accounting practice are all subject to Federal repayment and collection. These costs shall be refunded (including interest) to the Federal government in accordance with applicable Federal agency regulations.

Indirect Costs

Indirect costs are those costs incurred for a common or joint purpose benefiting more than one cost objective, and not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. The term "indirect costs" applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

Internal Service Funds

Internal service funds are used for operations serving other funds or departments within a government on a cost-reimbursement basis. Examples of internal service funds in ADOA include the Automation Fund, the Motor Pool Fund, the Personnel Fund, the Capital Outlay Stabilization Fund, the Health Insurance Trust Fund, and the Risk Management Fund. If charges for these operations are applied to Federal Awards, they are subject to the Federal cost principle requirements.

Billing Rates and Adjustments

Billing rates used to charge Federal awards shall be based on the estimated costs of providing the services, including an estimate of the allocable central service costs. A comparison of the revenue generated by each billed service (including total revenues whether or not billed or collected) to the actual allowable costs of the service will be made at least annually, and an adjustment will be made for the difference between the revenue and the allowable costs. These adjustments will be made through one of the following adjustment methods.

(a) A cash refund including earned or imputed interest from the date of transfer and debt interest, if applicable, chargeable in accordance with applicable Federal cognizant agency regulations to the Federal Government for the Federal share of the adjustment.

(b) Credits to the amounts charged to the individual programs.

(c) Adjustments to future billing rates.

(d) Adjustments to allocated central service costs. Adjustments to allocated central services will not be permitted where the total amount of the adjustment for a particular service (Federal share and non-Federal share) exceeds $500,000.

Working Capital Reserves

Internal service funds are dependent upon a reasonable level of working capital reserve to operate from one billing cycle to the next. Charges by an internal service activity to provide for the establishment and maintenance of a reasonable level of working capital reserve, in addition to the full recovery of costs, are allowable. However, these charges and the working capital reserve cannot be excessive. A working capital reserve as part of retained earnings of up to 60 days cash expenses for normal operating purposes is considered reasonable. The State has negotiated the maximum 60-day working capital limit for its applicable internal service funds.

Contributed Capital & Depreciation/Use Allowance

Many internal service funds need cash to accommodate asset growth. Since the Federal programs generally participate in expenditures as they receive benefit from the assets through depreciation or use allowance, the cash is typically generated through an initial investment from the State or through revenues collected in excess of allowable costs, the latter of which creates potential for an excess retained earnings balance. The larger the asset investment need, the more likely an excess balance will result. However, as assets are depreciated they can be replaced at the same value without creating an excess retained earnings balance. Substantial increases in replacement cost can also create pressure for an excess retained earnings balance.

Private Consumer Rate of Interest

Section 30.18 of the Department of Health and Human Services' claims collection regulations (45 CFR Part 30) provides that the Secretary shall charge an annual rate of interest, which is determined and fixed by the Secretary of the Treasury after considering private consumer rates of interest on the date that the Department of Health and Human

Services (DHHS) becomes entitled to recovery. The rate cannot be lower than the Department of Treasury's current value of funds rate or the applicable rate determined from the "Schedule of Certified Interest Rates with Range of Maturities" unless the Secretary waives interest in whole or part, or a different rate is prescribed by statute, contract, or repayment agreement. The Secretary of the Treasury may revise this rate quarterly. The Department of Health and Human Services publishes this rate in the Federal Register. Since 2000, this rate has ranged from 9 $^{5/8}$ % to 14 $^{1/8}$ %.

The current rate of 10 $^{3/4}$ %, as fixed by the Secretary of the Treasury, is certified for the quarter ended September 30, 2014. This rate is based on the Interest Rates for Specific Legislation, "National Health Services Corps Scholarship Program (42 USC 250(B)(1)(A))" and "National Research Service Award Program (42 USC 288(c)(4)(B))." This interest rate will be applied to overdue debt until the Department of Health and Human Services (DHHS) publishes a revision.

Federal Offsets

If payment for Federal obligations is not made by the required date, it is forwarded to the DHHS Debt Management Branch for collection. If not resolved timely, it is then forwarded to the U.S. Treasury for offset. Until collected it is subject to the private consumer rate of interest, compounded daily. The offset is applied to draw requests submitted by State agencies. Since the amount was offset against a debt, the Federal government considers the draw request paid. Accordingly, State agencies have an immediate unexpected budget shortfall in the amount of the offset, potentially with no options for resolution. The resulting budget dilemma can also impair the program performance, which may in turn cause further Federal compliance issues and costs.

Resolution Options for Excess Balances

Federal repayment typically occurs when an excess retained earnings balance is significantly excessive or arises due to non-compliance. A minor excess retained earnings balance due to normal fluctuations in the course of business are not unusual and typically are resolved by revising future rates for services.

State Experience and Applicability

The Federal cost principles, 2 CFR part 200 (formerly 2 CFR Part 225 and Office of Management and Budget (OMB) Circular A-87), establish uniform administrative requirements and audit requirements for Federal awards. Costs charged to Federal awards must be necessary, reasonable, consistent, and allocable to Federal awards. These regulations govern all Federal awards to states and the State agrees to these rules when Federal dollars are accepted.

Since Federal awards are charged for the billed central services, internal service funds, and self-insurance funds, the Federal government has an interest in the activity of those funds (see Exhibit 1). The Federal government requires repayment of their share of any transfers and unallowable activities, plus interest (see Exhibit 2).

The Federal government also requires repayment of their share of excess retained earnings balances. The Federal regulations provide an allowance for a working capital balance (up to a maximum of 60 days). The State has negotiated acceptance of the maximum 60-day working capital balance for its applicable internal service funds. Amounts in excess of this 60-day working capital allowed reserve constitute an excess retained earnings balance. Simply stated, the computation consists of the beginning retained earnings balance, plus total revenues, less allowable costs, then comparing the resulting balance to the allowed working capital reserve to determine if there is an excess balance or reserve (see Exhibit 3). This comparison is often referred to as the A-87 reconciliation.

The cost principles were designed to be fair and equitable but intended for internal service funds not self-insurance funds. To date the State has been successful in defending the position that the Health Insurance Trust Fund (HITF) and Risk Management Fund require additional reserves. The A-87 reconciliation contains revenues, expenditures, transfers and other information reflected in the State's audited Comprehensive Annual Financial Report (CAFR). Like all other states, the Federal cognizant agency for the State of Arizona is DHHS. The division of DHHS responsible for reviewing the State's compliance recently changed its name from the Division of Cost Allocation (DCA) to Cost Allocation Services (CAS). As part of the review of the submitted information required for the billed central services, DHHS-CAS determines unallowable costs and requests repayment or other appropriate equitable resolution.

Typically once the DHHS-CAS makes a determination, they issue a determination letter, which generally requires payment within 30 days (see Exhibit 4). If payment is not received by DHHS by the determination letter deadline, the debt goes to collection. Then the offsets begin and continue reducing each State agency's Federal draw to $1 until the debt is reduced to zero. Each transaction includes a small fee. There is no predictability in the offsets. During fiscal years 2008 and 2009, a Federal liability of approximately $6 million was offset. The private consumer rate of interest, currently 10 $^{3/4}$ %, may be charged.

The State has been able to negotiate some alternative resolution terms in recent years. Since the State's budget/appropriation process is an annual exercise, DHHS-CAS has allowed the State to submit the liability to the Legislature for consideration and required repayment by July instead of issuing a 30-day demand for payment. DHHS-CAS has also used the State's internal rate of return by the State Treasurer, which was .8508% for fiscal year 2014, for determining amounts owed for interest obligations. However, if we do not pay within the specified deadline, the amount owed is sent to collections and the private consumer rate of interest is charged until the debt is satisfied.

Other Potential Outcomes

Continued noncompliance could result in the Federal government refusing to participate in the cost of the service being provided. The most recent calculation of Federal financial participation in HITF was 11.475% for the fiscal year 2013. Accordingly, approximately $85 million of the $736 million in annual revenue was from Federal sources. The most recent calculation of Federal financial participation in the Risk Management fund was 9.430% for the fiscal year 2013. Of the approximate annual revenue of $105 million, $10 million was from Federal sources.

If funds continue to be swept from HITF, the Federal government may determine that the reserve is excessive and not needed, and then ask for refund of the excess balance which would be approximately $14 million for the fiscal year 2013.

Regarding the Risk Management Fund, payments made for Federal liabilities are disallowed since that is not the permissible purpose of the fund. This triggers a required repayment of Federal dollars. If the repayment is made from the Risk Management Fund, an increased amount is required since a portion of the repayment includes Federal participation. The Federal government may require payment of the Federal share of the payment. Since fiscal year 2010, almost $29 million has been repaid to the Federal government, $23 million or 79% was from the Risk Management Fund (see Exhibit 5).

Negotiation

As previously mentioned, there are some limited opportunities to negotiate various resolutions to Federal liabilities. For reasonably small liabilities, we have been able to address them by waiting to see if they are corrected by cyclical fluctuations in operations, through rate reductions, or by other management initiatives planned to bring internal service fund operations into compliance. However, these options dissipate when the Federal liability becomes large, generally in excess of $500,000. As indicated, the State has been successful in delaying the timing of the due date on the demand for payment to give the legislature an opportunity to address the obligation. Negotiation options are also significantly limited when Federal liabilities are generated by clear non-compliance with Federal cost principles.

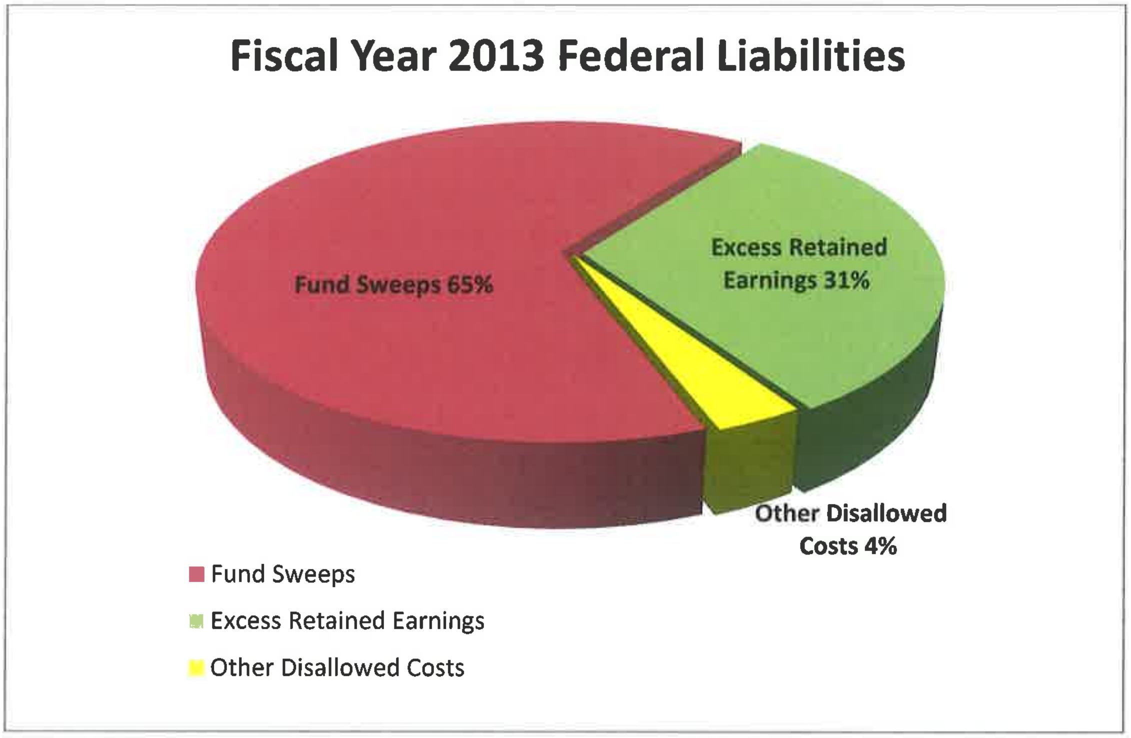
Underlying Causes of Federal Liability

Over the past 5 years, the sweeping of internal service funds is clearly the predominant cause of Federal liability. A chart reflecting the relative proportions of the underlying causes of FY 2013 Federal liabilities is shown below. The excess retained earnings portion consists of many aspects, but the largest and most significant part relates to the Automation Fund, which stems from revenues being significantly greater than allowed expenditures for the past few years. This would normally be corrected through rate reduction, but a number of critical capital investments and other authorized projects are dependent upon this revenue stream.

Another ongoing issue is related to the allowability of certain Information Technology Fund (formerly the GITA Fund) costs (primarily the Project Investment Justification review). ADOA has proposed a partial solution to this issue by moving these consistently disallowed costs to an alternative funding source.

For most internal service funds, the State typically does not provide sufficient capital contributions to finance asset growth needs. Accordingly, this increases the potential for excess retained earnings balances.

The vast majority of other underlying issues related to the remaining excess retained earnings portion are due to a variety of factors, including the development of rates. These items are inherently part of the operational process. They are expected to continue since it is common and expected that actual results generally differ somewhat from planned performance.



<u>Suggestions to Reduce the Federal Liability</u>

1. Don't sweep internal service funds. This is the single largest contributor to the Federal liability. Only allowable operating expenditures that are consistent with the purpose of the fund and equitably benefit Federal programs are permitted from internal service funds. Fund sweeps, non-operating transfers and other activity that does not benefit Federal programs increases the Federal liability.

2. If sweeps of internal service funds are needed, plans should include the repayment of the applicable Federal participation portion. This would include evaluating any existing contributed capital in the internal service fund and the impact on the excess retained earnings calculation.

3. Provide funding for significant asset investment needs. This can occur due to expanded program service demands or significant cost increases.

4. Reduce the rates charged for services provided in cases of continued over-recovery.

5. Charges for services should be fair, equitable, and related to the service provided.

6. Grant ADOA authority to settle Federal obligations with JLBC and OSPB oversight. This flexibility would provide the opportunity to resolve Federal liabilities sooner, which eliminates additional interest. It also eliminates potential disruptions to program services and related budget problems.

1B

STATE OF ARIZONA

Joint Legislative Budget Committee

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 926-5491

FAX (602) 926-5416

http://www.azleg.gov/jlbc.htm

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Rebecca Perrera, Fiscal Analyst RP

SUBJECT: Arizona Department of Administration - Consider Approval of Employer Sanctions Enforcement Distributions

Request

Pursuant to Laws 2014, Chapter 18, Section 4, the Arizona Department of Administration (ADOA) has requested that the Committee approve distribution of $329,110 of the $513,200 FY 2015 appropriation for the enforcement of immigration-related employer sanctions.

Recommendation

The Committee has at least the following 2 options:

1. Approval or disapproval of ADOA's request to distribute $329,110 of the $513,200.

2. Approval of a different allocation plan.

Under either option, the JLBC Staff recommends the following provision:

A. ADOA may distribute funding to a county attorney or sheriff whom subsequently decides to apply for the funds.

The Legislature may also want to consider reverting unused funds to the General Fund, which would require legislation.

Analysis

The FY 2015 General Appropriation Act appropriated $1.2 million to ADOA for the County Attorney Immigration Enforcement Special Line Item. A General Appropriation Act footnote specifies that, of this amount, $700,000 shall be specifically allocated to Maricopa County as follows: $200,000 to the Maricopa County Attorney and $500,000 to the Maricopa County Sheriff.

(Continued)

Subject to approval by this Committee, the remaining amount of $513,200 is to be distributed by ADOA to all other county sheriffs and county attorneys for the enforcement of immigration-related employer sanctions. There is no statutory formula for the non-Maricopa distributions. This is the eighth year that funding for this purpose has been appropriated to ADOA in some form; however, this is the second year that JLBC is approving the distribution.

As required by a General Appropriation Act footnote, by October 1, 2014 county sheriffs and attorneys submitted reports to ADOA on the use of their FY 2014 funding, and on the intended use of prospective FY 2015 funds. County sheriffs' and attorneys' offices reported the following intended use for FY 2015 funding:

- 10 offices, for a total amount of $924,300, intend to use the funds to investigate and enforce employer sanctions laws by funding salaries, employee benefits, travel expenses and other related costs.
- 1 office, for a total amount of $7,127, intends to use the funds to educate local businesses and community members about employer sanctions laws.
- 1 office, for a total amount of $97,700, intends to use the funds to update equipment including vehicles and technological equipment, such as computers and tracking equipment.
- 18 offices either reported no intended use for the funds or did not submit a report.

Excluding the statutory Maricopa allocation in FY 2014, ADOA distributed $300,500 of the $513,200 to 14 of the 28 eligible county sheriffs' and attorneys' offices. Counties received funding based on their proportional share of population. ADOA did not distribute funds to county sheriffs' and attorneys' offices if the county officer has previously returned their FY 2013 funding, had reported no use for their FY 2014 funding or had failed to report any use of their FY 2014 funding. The unused $212,700 did not revert to the General Fund, as these monies are exempt from lapsing.

ADOA is now proposing a different distribution method for the FY 2015 appropriation. ADOA plans to distribute funding to any of the 28 county officers who request FY 2015 funding, regardless if FY 2014 funding was returned or unused. ADOA's proposal to distribute $329,100 to the 10 county officers who requested funding is shown in detail in *Attachment A*. As in FY 2014, these monies are distributed proportionately based on population.

In total, 18 of the 28 county offices declined FY 2015 funding or did not report any intended use of their FY 2015 funding. Therefore, ADOA does not plan to distribute their share of funds totaling $184,100.

The Committee may elect to allow distribution of funds to county officers that subsequently request their proportionate share of funds from the FY 2015 appropriation. The Committee may additionally recommend whether unused funds are reverted to the General Fund for a savings of $(184,100), or are distributed to other county officers.

RS/RP:lm
Attachment

Attachment A

Employer Sanctions Distributions

	FY 2014 Distribution		Proposed FY 2015 Distribution	
Apache County Attorney	$ 7,127		$ 7,127	
Apache County Sheriff	0	1/	$ 7,127	
Cochise County Attorney	0	1/	0	4/
Cochise County Sheriff	0	1/	0	4/
Coconino County Attorney	13,396	2/	0	3/
Coconino County Sheriff	13,396		0	4/
Gila County Attorney	5,341	2/	0	3/
Gila County Sheriff	0	1/	0	4/
Graham County Attorney	0	1/	0	4/
Graham County Sheriff	0	1/	0	4/
Greenlee County Attorney	0	1/	0	3/
Greenlee County Sheriff	0	1/	0	4/
La Paz County Attorney	2,042		2,042	
La Paz County Sheriff	0	1/	0	4/
Mohave County Attorney	19,949		19,949	
Mohave County Sheriff	0	1/	0	3/
Navajo County Attorney	10,708		0	4/
Navajo County Sheriff	10,708	2/	0	3/
Pima County Attorney	97,687		97,687	
Pima County Sheriff	0	1/	97,687	
Pinal County Attorney	37,447	2/	37,447	
Pinal County Sheriff	37,447		0	4/
Santa Cruz County Attorney	4,726		0	4/
Santa Cruz County Sheriff	0	1/	0	4/
Yavapai County Attorney	21,030		21,030	
Yavapai County Sheriff	0	1/	0	4/
Yuma County Attorney	19,507	2/	19,507	
Yuma County Sheriff	0	1/	19,507	
Total Allocated	**300,511**		**329,110**	
Total Unallocated	**212,689**		**184,090**	
Statutory Allocation - Maricopa	**700,000**		**700,000**	
Total Appropriation	**$1,213,200**		**$1,213,200**	

1/ Did not receive or accept FY 2014 funds.
2/ Did not use/returned FY 2014 funds.
3/ Reported no use for FY 2015 funds.
4/ Did not submit report or request FY 2015 funds.

Janice K. Brewer
Governor

Kathy Peckardt
Interim Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007

(602) 542-1500

October 29, 2014

RECEIVED
NOV 03 2014
JOINT BUDGET COMMITTEE

The Honorable Don Shooter, Chairman
Joint Legislative Budget Committee
Arizona State Senate
1700 West Washington Street
Phoenix, Arizona 85007

The Honorable John Kavanagh, Vice Chairman
Joint Legislative Budget Committee
Arizona House of Representatives
1700 West Washington Street
Phoenix, Arizona 85007

Dear Senator Shooter and Representative Kavanagh:

The Arizona Department of Administration (ADOA) is requesting to be placed on the next Joint Legislative Budget Committee agenda so that the committee can consider approval of our proposed distribution of monies to County Attorneys and County Sheriffs as required by Laws 2014, 2nd Regular Session, Chapter 18, Section 4.

The schedule of distributions is attached. ADOA distributed the monies in proportion to the population of the county as determined in the 2010 Decennial Census. In cases where the official did not report on a use for the FY 2014 monies, refused the monies in 2014 and/or 2015, or reported that they did not have a use for the 2015 monies, ADOA did not propose a distribution.

Sincerely,

Kathy Peckardt

Kathy Peckardt
Interim Director

Attachment

cc: John Arnold, OSPB Director
Richard Stavneak, JLBC
Rebecca Perrera, JLBC
Will Palmisano, OSPB
Paul Shannon, ADOA

Proposed Distribution, Laws 2014, 2nd Regular Session, Chapter 18, Section 4: Enforcement of Title 23, Chapter 2, Article 2

County	Attorney/Sheriff	Official's Name	Proposed FY 2015 Allocation	
Apache	Attorney	Michael B. Whiting	$7,127.08	
Apache	Sheriff	Joseph Dedman, Jr.	$7,127.08	
Cochise	Attorney	Edward Rheinheimer	$0.00	*
Cochise	Sheriff	Mark J. Dannels	$0.00	*/***
Coconino	Attorney	David W. Rozema	$0.00	**/***
Coconino	Sheriff	William B. Pribil	$0.00	****
Gila	Attorney	Bradley D. Beauchamp	$0.00	***
Gila	Sheriff	Adam Shepherd	$0.00	*****
Graham	Attorney	Kenneth A. Angle	$0.00	*/***
Graham	Sheriff	Preston J. Allred	$0.00	*/***
Greenlee	Attorney	Derek D. Rapier	$0.00	*/***
Greenlee	Sheriff	Larry Avila	$0.00	****
La Paz	Attorney	Tony Rogers	$2,041.82	
La Paz	Sheriff	John Drum	$0.00	****
Maricopa	Attorney	William G. Montgomery	$200,000.00	
Maricopa	Sheriff	Joe Arpaio	$500,000.00	
Mohave	Attorney	Matthew J. Smith	$19,949.41	
Mohave	Sheriff	Jim McCabe	$0.00	*
Navajo	Attorney	Brad Carlyon	$0.00	****
Navajo	Sheriff	Kelly Clark	$0.00	**/***
Pima	Attorney	Barabara La Wall	$97,687.47	
Pima	Sheriff	Clarence W. Dupnik	$97,687.47	*
Pinal	Attorney	M. Lando Voyles	$37,447.12	
Pinal	Sheriff	Paul Babeu	$0.00	****
Santa Cruz	Attorney	George E. Silva	$0.00	****
Santa Cruz	Sheriff	Tony Estrada	$0.00	****
Yavapai	Attorney	Sheila Polk	$21,030.36	
Yavapai	Sheriff	Scott Mascher	$0.00	****
Yuma	Attorney	Jon R. Smith	$19,507.44	
Yuma	Sheriff	Leon N. Wilmot	$19,507.44	
		Total Allocated	**1,029,112.69**	
		Total Unallocated	**$184,087.31**	
		Total Appropriation	**$1,213,200.00**	

* Did not accept FY 2014 monies

** Returned FY 2014 monies

*** Declined/did not accept FY 2015 monies

**** Did not report/respond

1C

STATE OF ARIZONA

Joint Legislative Budget Committee

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 926-5491

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http://www.azleg.gov/jlbc.htm

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Rebecca Perrera, Fiscal Analyst RP

SUBJECT: Arizona Department of Administration - Review of ASET Projects (Automation Projects Fund)

Request

Pursuant to A.R.S. § 41-714, the Arizona Department of Administration (ADOA) has requested that the Committee review $335,500 in proposed FY 2014 expenditures from the Automation Projects Fund for projects at the State Data Center at the Arizona Strategic Enterprise Technology (ASET) Office in ADOA.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review.

2. An unfavorable review.

All projects have received relevant approvals from the ASET staff through the Project Investment Justification (PIJ) process. The JLBC Staff recommends that the Committee consider adopting the ASET provisions as part of its review. Specifically:

1. As a result of further planning and implementation efforts, should there be significant changes in the proposed cost, technology approach, scope of work, or schedule, ADOA-ASET must amend the PIJ to reflect the changes and submit an updated PIJ to the ADOA-ASET Strategic Oversight team for review, and approval as necessary.

2. ADOA-ASET must ensure that appropriate levels of security controls are in place prior to the migration of any service offerings that may involve sensitive, confidential, or Personally Identifiable Information (PII) data to the cloud.

(Continued)

Analysis

Background
The Automation Projects Fund consists of monies appropriated by the Legislature and administered by ADOA. Monies in the fund are to be used to implement, upgrade or maintain automation and Information Technology (IT) projects for any state agency. Pursuant to A.R.S. § 41-714, before monies are expended from the fund, ADOA must submit an expenditure plan to the JLBC for review.

If an IT project exceeds $1.0 million, statute requires additional approval by Information Technology Authorization Committee (ITAC). ITAC consists of members from both the public and private sectors and is staffed by ADOA. If a project funds internal staff or training, neither ITAC nor ASET approval is required.

Current Request
ADOA's ASET office operates and maintains the State Data Center (SDC), which provides mainframe computing to state agencies and other entities and processes billions of dollars of transactions per year. The FY 2014 General Appropriation Act appropriated $2.7 million to ADOA for projects related to the State Data Center. The JLBC has previously given a favorable review of $2.0 million of this amount. To date, ADOA has spent $1.4 million.

At its December 10, 2013 meeting, the committee favorably reviewed ADOA's "Shared Services Platform" project, which had an expected development cost of $800,000 funded by the Automation Projects Fund and an operating cost of $2.7 million funded by the Automation Operations Fund. The project funded the migration of 12 key functions for ADOA-ASET into a vendor-hosted "cloud" network. Cloud computing is a term used to describe when information is stored in a vendor-hosted remote location, while the user of that information remains on site. Key functions include a content management system for state agency websites and email services.

ADOA is currently requesting a review of the $335,500 from the Automations Projects Fund to fund an increased development cost for this project. The revised budget will extend the migration of 12 key functions to the cloud for all state agencies currently using ADOA network servers. These functions do not run on the recently updated State Data Center mainframe. By migrating these functions from ADOA servers to the cloud, ADOA expects to eliminate the need for these servers and reduce internal support resources needed to provide these services.

Further Review
The FY 2014 General Appropriation Act appropriated $11.5 million to ADOA for ASET Projects. This Committee has previously given a favorable review to $10.4 million of this amount. Following the current request to review an additional $335,500, $829,500 for ASET projects will remain to be reviewed by JLBC at a later date, following the necessary PIJ and ITAC approvals, as follows:

- State Data Center $384,500
- Web Portal Transition $445,000

RS/RP:kp

Janice K. Brewer
Governor

Kathy Peckardt
Interim Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007

(602) 542-1500

RECEIVED
NOV 25 2014
JOINT BUDGET COMMITTEE

November 24, 2014

The Honorable Don Shooter, Chairman
Joint Legislative Budget Committee
Arizona State Senate
1700 West Washington Street
Phoenix, AZ 85007

The Honorable John Kavanagh, Vice-Chairman
Joint Legislative Budget Committee
Arizona House of Representatives
1700 West Washington Street
Phoenix, AZ 85007

Dear Senator Shooter and Representative Kavanagh:

In accordance with Arizona Revised Statutes § 41-714, The Arizona Department of Administration (ADOA) is submitting this revised request for review of fiscal year 2014 and 2015 Automation Projects Fund projects. This request replaces our previous request dated November 12, 2014. Monies to support the expenditure plan have already been appropriated to the Automation Projects Fund.

The attached document contains a detailed explanation of each proposed project. We will be happy to meet with your staff to provide further explanation as appropriate.

Sincerely,

Kathy Peckardt

Kathy Peckardt
Interim Director

cc: Richard Stavneak, Director, JLBC
Andrew D. Smith, Fiscal Analyst, JLBC
Rebecca Perrera, Fiscal Analyst, JLBC
John Arnold, Director, OSPB
Will Palmisano, Fiscal Analyst, OSPB
Aaron Sandeen, Deputy Director and State CIO
Jeff Grant, Deputy Director
Paul Shannon, Assistant Director, ADOA
Clark Partridge, Comptroller, ADOA
Mike Smarik, Assistant Director, ADOA

Attachment

Janice K. Brewer
Governor

Brian C. McNeil
Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007

(602) 542-1500

October 20, 2014

Mr. Brian C. McNeil, Director
Arizona Department of Administration
100 N. 15th Ave.
Phoenix, AZ 85007

Dear Brian:

In response to the ***Amended*** Project Investment Justification (PIJ) for the **"Shared Services Platform"** project, my staff has reviewed your proposal to migrate all State agency customers using ADOA Exchange services to the cloud.

The original PIJ implied funding is available from the Automation Projects Fund in the amount of $800.0 thousand, and from the Automation Operations Fund in the amount of $2,720.7 thousand, for a total five-year life cycle cost for the project of $3,520.7 thousand. The amended PIJ implies additional funding is available from the Automation Projects Fund in the amount of $150.0 thousand, and from the Automation Operations Fund in the amount of $185.5 thousand, for a total five-year life cycle cost for the project of $3,856.2 thousand.

This is the Arizona Strategic Enterprise Technology Office's **Approval with Conditions** of the ***Amended*** technology project as follows.

1. As a result of further planning and implementation efforts, should there be significant changes in the proposed costs, technology approach, scope of work, or schedule, ADOA-ASET must amend the PIJ to reflect the changes and submit the updated PIJ to the ADOA-ASET Strategic Oversight team for review, and approval as necessary.
2. ADOA-ASET must ensure that appropriate levels of security controls are in place prior to the migration of any service offerings that may involve sensitive, confidential or Personally Identifiable Information (PII) data to the cloud.

You may proceed to secure additional approvals as required from the Joint Legislative Budget Committee, the Office of Strategic Planning and Budgeting and the State Procurement Office.

Best Wishes,

Aaron V. Sandeen
State CIO and Deputy Director
Arizona Strategic Enterprise Technology (ASET) Office

jc

Analyst: Jeffrey Crane **PIJ Summary - ASET** Project Number: AD14008_A2

Agency Name & Address	*Contact Name & Phone*
Arizona Department of Administration 100 N. 15th Ave. Phoenix, AZ 85007	David Nale 602-542-2411 David.Nale@azdoa.gov
Project and Investment Justification Name	*Date Submitted*
Shared Services Platform	November 22, 2013 (original date) *October 1, 2014* (prior amendment) ***October 20, 2014*** (current amendment)

Project Overview

Problem Description

In Fiscal Year 2014 (FY14), a number of transformation initiatives were prioritized by Governor Janice K. Brewer, proposed in her budget, and subsequently codified into law. Included in the initiatives are projects designed to ensure the continuity of mission-critical systems that the Arizona Department of Administration (ADOA) operates on behalf of its customers and its own business operations. The State Data Center (SDC) currently hosts more than one hundred customers and processes billions of dollars' worth of transactions each year on behalf of the State. While the Arizona Strategic Enterprise Technology Office within ADOA (ADOA-ASET) completed a number of FY13 projects intended to improve the resiliency of the SDC, that level of investment cannot be sustained. Demands on current in-house computing resources as well as ADOA-ASET staff continue to increase as customer needs grow and change. Over time, the need to maintain every service offering ever provided to its customers, regardless of how many are currently utilizing an offering, has resulted in an unsupportable demand on ADOA-ASET resources, which can lead to poor customer experience, diminished service capabilities, overburdened resources, and an increased risk of failures.

Solution

In the pursuit of alternate solutions that can provide the shared services, scalability and business continuity needed to meet the expected level of growth across the enterprise, ADOA-ASET has adopted a 'Cloud First' strategy. In support of that strategy, ADOA-ASET is proposing to migrate 12 key service functions into a vendor-hosted 'cloud' computer network. Cloud computing has already proven itself to be a safe, secure, reliable, and effective resource for providing ADOA services such as MS Lync, Project Pro for MS Office 365, and Clarity v13. The 'Cloud First' approach is expected to allow ADOA-ASET to replace currently overburdened and/or outdated infrastructure with expandable hardware and software resources that are professionally managed and maintained. By utilizing cloud services to provide these functions, ADOA-ASET will be able to better support customer needs, while also reducing risk and establishing a more sustainable cost model.

The MS SQL license renewal sub-project, originally in scope, has been addressed as a separate project (AD14015). The original scope of work, as part of this PIJ, was to renew the licenses in a like-for-like renewal. It was determined a standard renewal would be insufficient to meet the needs of ADOA and the implemented Amazon Web Services (AWS) cloud-based environment. With the change in license type to support the expansion of the ADOA environment, it was decided to represent that scope of work as its own PIJ (AD14015), and the MS SQL scope from this PIJ be removed.

Additional time is being requested to complete the remaining scope of work of the project due to resource availability.

In addition to moving all ADOA Exchange users to the cloud environment, as proposed in the original PIJ, ADOA-ASET is planning to migrate all State agency customers currently utilizing ADOA Exchange services to the cloud as well.

Measurements and Deliverables

The proposed project will utilize vendor-hosted services to replace 12 current ADOA-ASET application functions with comparable or enhanced services in a cloud computing environment. Services to be migrated have been organized into the following three (3) major phases:

Phase 1 - expected to be complete by the end of quarter three FY14 (Q3FY14)

1. Content Management System (Drupal)
2. Email Newsletter (SES – eNewsletter Pro subscription email service)
3. MySQL Databases

Phase 2 - expected to be complete by the end of quarter one FY15 (Q1FY15)

4. Windows SharePoint Services
5. Microsoft (MS) Dynamics Customer Relationship Management (CRM) System
6. Exchange On-Premise to MS Office 365 Exchange 2013
7. Clarity v12 to v13 (Project Portfolio Management System)
8. Document Management System (Shared DMS - ICM ViewCenter enterprise version)

Phase 3 - expected to be complete by the end of quarter two FY15 (Q2FY15)

9. CA Service Management (including Service Desk Manager, IT Asset Management, and Client Automation components)
10. Windows Web Hosting (WWH internet hosting service for State agency websites)
11. MS SQL Server Databases
12. Document Management System (Dedicated DMS - ICM ViewCenter ADOA Risk Management version)

Pending additional detailed planning, the anticipated order in which these services will be migrated has been determined based on priority and complexity, and also to ensure that all implementation costs will be incurred by the end of FY14. While the project is expected to finish by the end of calendar year 2014, work required in FY15 will be completed by resources on staff, and therefore those costs are not reflected in the PIJ financials.

Development costs for each sub-project have been estimated based on capacity requirements and research done to date into up-front vendor charges to implement and migrate each service offering. Given that efforts to fully scope supporting requirements and costs are still in process, contingency has been incorporated. In addition to hosting services to be acquired from Microsoft, CA, and Amazon, professional services will also be acquired from Microsoft, CA, and Statêra, to assist internal resources with the CMS, CRM, and DMS, CA Clarity, and MS Exchange migrations respectively. Operational costs reflect ongoing vendor-hosting and licensing fees for five (5) fiscal years, however ADOA-ASET is expecting those to be offset by revenues generated through customer use of these services.

The costs associated with the MS SQL scope of work will no longer be expended, however the remaining scope of work project costs have come in higher than originally proposed resulting in no change to existing PIJ costs.

While this expansion will require the acquisition of additional user licensing, there are sufficient Licensing & Maintenance costs in the original PIJ to cover this expense. Additional professional services, to be provided by the current vendor (Statêra), will be needed to support the migration, with an additional $150,000 reflected in PIJ development costs. Total costs reflect the need for additional staff augmentation resources to provide ongoing operational support for the cloud environment.

Benefits

By moving 12 key services into the cloud environment, ADOA-ASET will be able to reduce the current demand for SDC computing resources, while also allowing in-house staff resources to focus on core competencies needed to support business operations on behalf of the State. Most of these application functions will benefit from the greater availability of services, reduced on-premise hosting costs, and reduced demand on internal resources as a result of the move into a cloud environment. Additional benefits include:

- **No upfront infrastructure investment:** In contrast to the State's current acquisition investment model, resources in the cloud environment are paid for as they are consumed.
- **Ongoing cost:** Economies of scale enable cloud computing vendors to offer lower prices and multiple pricing models that allow customers to optimize costs for both variable and stable workloads, thereby driving down ongoing costs.
- **Flexible capacity and agility:** ADOA-ASET will be able to self-provision resources that may be needed at any point, in much smaller increments, without the lag time typically associated with procuring traditional IT infrastructure.
- **Focus on applications, not operations:** By supporting the re-allocation of IT resources toward new, more innovative efforts, cloud computing allows limited staff resources to focus on tasks that increase productivity, improve the customer experience and promote momentum for the enterprise.

The benefits of the MS SQL licensing scope will not be realized as part of this project. The remaining benefits of this project will still be met.

With the migration of all ADOA and State Agency Exchange users to the cloud environment, ADOA-ASET will be able to eliminate the need to maintain the on-site Exchange environment.

Project Management

The ADOA-ASET Project Manager will work with ADOA-ASET subject matter experts and vendor resources to complete the project deliverables.

Enterprise Architecture

Compliant.

Original Summary of Proposed Costs

All Figures in Thousands ($000)						
Cost Description	2014	2015	2016	2017	2018	Total
Development Costs	800.0	0.0	0.0	0.0	0.0	800.0
Operational Costs	92.9	657.0	657.0	657.0	657.0	2,720.7
Total Project Costs	892.9	657.0	657.0	657.0	657.0	3,520.7

Amendment #1 Summary of Proposed Costs as of October 1, 2014 (No Change)

All Figures in Thousands ($000)						
Cost Description	2014	2015	2016	2017	2018	Total
Development Costs	800.0	0.0	0.0	0.0	0.0	800.0
Operational Costs	92.9	657.0	657.0	657.0	657.0	2,720.7
Total Project Costs	892.9	657.0	657.0	657.0	657.0	3,520.7

Amendment #2 Summary of Proposed Costs as of October 20, 2014

All Figures in Thousands ($000)						
Cost Description	2014	2015	2016	2017	2018	Total
Development Costs	800.0	150.0	0.0	0.0	0.0	950.0
Operational Costs	92.9	842.5	657.0	657.0	657.0	2,906.2
Total Project Costs	892.9	992.5	657.0	657.0	657.0	3,856.2

Recommendation: **Approval with Conditions**

1. As a result of further planning and implementation efforts, should there be significant changes in the proposed costs, technology approach, scope of work, or schedule, ADOA-ASET must amend the PIJ to reflect the changes and submit the updated PIJ to the ADOA-ASET Strategic Oversight team for review, and approval as necessary.
2. ADOA-ASET must ensure that appropriate levels of security controls are in place prior to the migration of any service offerings that may involve sensitive, confidential or Personally Identifiable Information (PII) data.

1D

STATE OF ARIZONA

Joint Legislative Budget Committee

1716 WEST ADAMS
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http://www.azleg.gov/jlbc.htm

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Rebecca Perrera, Fiscal Analyst RP

SUBJECT: Arizona Department of Administration - Review Report on Public Safety Broadband

Request

Pursuant to an FY 2015 General Appropriation Act footnote, the Arizona Department of Administration (ADOA) has submitted for review its annual report on expenditures for the State and Local Implementation Grant program (SLIGP).

Recommendation

The Committee has at least the following 2 options:

1. A favorable review of the department's report.

2. An unfavorable review of the department's submission

Through September 2014, ADOA expected to spend $824,000 of the $2.9 million received for the SLIGP. However, ADOA's actual spending was significantly less, at $379,600. ADOA's FY 2015 plans include continuing education and outreach through meetings with local public safety agencies, tribes, and non-public safety stakeholders. ADOA will also work with the First Responders Network Authority (FirstNet) and the City of Phoenix Police Department to test the capabilities of the National Public Safety Broadband Network (NPSBN) during the 2015 Super Bowl, and demonstrate the capabilities to stakeholders.

Analysis

Background

Following September 11, 2001, the National 9/11 Commission recommended the establishment of a nationwide, interoperable public safety communications network to provide solutions to communications challenges facing first responders.

(Continued)

In response, Congress passed legislation in 2012 creating the NPSBN initiative, administered by FirstNet, in an effort to build a nationwide, standards-based, high-speed data network by reserving a part of the electromagnetic spectrum specifically for public safety, the 700 MHz broadband spectrum, or the "D Block."

More than $7 billion has been allocated for the NPSBN initiative, with a majority of funding being raised through the sale of rights to transmit signals over specific bands of the electromagnetic spectrum that were surrendered by television broadcasters during the transition from analog to digital television. Part of the $7 billion allocated for this initiative includes a grant program for state and local governments, the SLIGP. Approximately $118 million in formula-based grants were available to assist regional, state, local, and tribal government entities in preparing for the implementation of the NPSBN initiative. This initial funding is not intended to purchase new equipment, but for planning, education, and outreach.

Arizona was awarded $2.9 million through the SLIGP formula in August 2013. One requirement of the grant is that Arizona and local governments additionally contribute at least $745,200 in in-kind contributions to the project. The ADOA's Strategic Enterprise Technology office (ASET) manages the Arizona FirstNet Program (AZNET), which is responsible for implementing SLIGP. Last year ADOA reported that the $2.9 million grant will be spent in 2 phases over 3 years, each approximately $1.5 million. The first phase will be dedicated to education and outreach, while the second phase will be devoted to gathering relevant data.

In addition, ADOA-ASET had reported that the grant includes $2.2 million for 6 FTE Positions, including 3 FTE Positions for program contract staff, and an additional 3 FTE Positions working part-time as vendors and contractors for the project. In addition, $449,000 would be spent on travel, $213,000 would be spent on program support services and web development, and $104,000 would be spent on equipment and supplies.

Expenditures

Through September 30, 2014, AZNET's grant budget was $824,200, or 28% of the total grant award. However, actual spending has been significantly lower than the budget. To date, AZNET has spent $379,600, or 46%, of its budget, which accounts for 13% of the overall award amount. Approximately, $2.5 million remains available from the grant. AZNET attributes its limited spending to lower than expected meeting costs and general cost management efforts such as leveraging the state's website conversion project to implement the FirstNet website.

AZNET has identified 850 first responder agencies in more than 1,400 locations throughout the state, in addition to various secondary agencies that support first responders, such as transportation, public works, and public health agencies. During the first phase of the grant, AZNET's strategy is to conduct approximately 145 on-site outreach meetings to educate these stakeholders. To date, AZNET's progress consists of conducting outreach and presentations including:

- Meetings with 5 regional wireless cooperatives.
- Briefings to all 15 counties with over 300 attendees representing 220 local, counties, and state agencies.
- Briefings with 3 tribal groups and 10 public safety associations.
- Presentations to 4 of the 5 Regional Advisory Councils of the Arizona Department of Homeland Security.
- Presentation to the Public Safety Answering Point System Managers.
- Conducting 8 vendor reviews.
- Participation at 18 public safety and public service events, conferences, and meetings.

(Continued)

In addition, AZNET has arranged for the City of Phoenix to use the "D Block" spectrum during Super Bowl 2015 events on a trial basis. Currently, at major public events, the City of Phoenix primarily uses commercial data services, which often experience severe network congestion. AZNET will work with FirstNet to establish temporary, localized access to the "D Block" spectrum, which will simulate the National Public Safety Broadband Network. As part of its outreach phase, AZNET will coordinate demonstration viewings to interested stakeholders.

In FY 2015, AZNET plans to continue its education and outreach efforts including briefing local jurisdictions, developing and implementing a tribal version of the county briefings, and developing and implementing a non-public safety stakeholder program.

RS/RP:kp

Janice K. Brewer
Governor

Kathy Peckardt
Interim Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

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JOINT BUDGET COMMITTEE

October 31, 2014

The Honorable Don Shooter, Chairman
Joint Legislative Budget Committee
Arizona State Senate
1700 West Washington Street
Phoenix, Arizona 85007

The Honorable John Kavanagh, Vice Chairman
Joint Legislative Budget Committee
Arizona House of Representatives
1700 West Washington Street
Phoenix, Arizona 85007

Dear Senator Shooter and Representative Kavanagh:

At the Joint Legislative Budget Committee (JLBC) meeting on October 29, 2013, the Arizona Department of Administration (ADOA) was asked to provide a quarterly status report on a three year, $2.91 million grant, under the State and Local Implementation Grant Program (SLIGP), and to provide an annual update at year end. Additionally, Laws 2014, chapter 18 requires that "On or before October 1, 2014 ADOA must submit a report for review of the expenditures to date and progress of implementation for any monies received from the State and Local Implementation Grant Program associated with the National Public Safety Broadband Network Initiative. The JLBC may require ADOA to submit more frequent reports as necessary for further review." JLBC staff and ADOA agreed that this quarterly report should follow fiscal quarter reporting convention, so we are submitting this under an October 31st due date accordingly.

In August 2014, as requested, ADOA provided a comprehensive, FY 2014, year-end report which included extensive background on the SLIGP and the FirstNet program, detailed information on FY14 activities, accomplishments and findings, annual budget and actual expenditures, as well as preview of FY15 strategies. This FY14 report is a useful reference for review of this Q1 FY15 summary of activities and budget expenditures and is attached for ease of reference.

Should you have any questions, please contact me at 602-542-1500 or Michael Sherman, the Broadband Planning and Public Safety Communications Programs Manager, at 602-364-4794.

Sincerely,

Kathy Peckardt

Kathy Peckardt
Interim Director

Attachments: FY15 Q1 FirstNet Budget Report
FY14 Annual SLIGP Year-end Report

cc: Richard Stavneak, Director, JLBC
Rebecca Perrera, Fiscal Analyst, JLBC
John Arnold, Director, OSPB
Will Palmisano, Budget Analyst, OSPB
Aaron V. Sandeen, ADOA Deputy Director & State CIO
Phil Manfredi, ADOA-ASET Assistant Director & Deputy State CIO
Michael C. Sherman, ADOA-ASET Executive Manager

Arizona Department of Administration
Arizona FirstNet Program
Q1 FY15 Status Report

BACKGROUND:

The Nationwide Public Safety Broadband Network (NPSBN) is a federal wireless broadband network dedicated to public safety. The NPSBN program is administered by the First Responders Network Authority (FirstNet), an independent authority within the U.S. Department of Commerce's National Telecommunications and Information Administration (NTIA). FirstNet is comprised of members of the public and private sectors, representing public safety as well as state and local government finance and information technology interests. Approximately $7 billion was originally allocated for the NPSBN program using funds from FCC radio frequency spectrum auctions.

This funding includes approximately $118 million in grants (State and Local Implementation Grant Program or SLIGP) to each state and six territories to assist regional, state, local, and tribal government entities prepare for the implementation of the NPSBN. The Arizona FirstNet Program is managed by the Arizona Department of Administration's Arizona Strategic Enterprise Technology (ADOA-ASET) division using primarily contract personnel to support the state's obligations under SLIGP. The state was awarded a total of $2.91 million in grant funds in August 2013 for a three year program cycle. This initial funding is allocated for education and outreach, planning, and data collection only, not for equipment or operations.

To date, the Arizona program has focused primarily on education and outreach among local public safety agencies, tribes and local governments in preparation for the initial State Consultation by federal FirstNet staff which is expected in late FY15.

This report summarizes the Q1 FY15 activities according to the FY15 strategies set forth in the attached FY14 year-end report. A detailed budget and actual expenditure report – cumulative from grant inception through Q1 FY15 as well as for this most recent quarter - is summarized in the Financial Information section and detailed in an attached spreadsheet.

FY15 STRATEGIES

The FY15 plan calls for focus on the following strategies:

- State and local public safety association briefings.
- Coordinating trial use of FirstNet radio frequency spectrum by Arizona agencies as requested.
- Development and implementation of Tribal version of County Level briefings led by the Arizona Department of Homeland Security.
- Preparation for the initial federal FirstNet State Consultation, including analysis of County Level briefing results.
- Development and implementation of a non-public safety stakeholders (e.g. business management, finance, information technology, etc.) program.
- Sub-county level meetings.
- 911 Public Safety Answering Point Systems Administrator briefings.
- Alternative governance model development.

Q1 FY15 ACTIVITIES

The highlighted activities for Q1 FY15 are:

- Arranged for the Phoenix Police Threat Mitigation Unit Video Surveillance Team to use FirstNet radio frequency spectrum during Super Bowl 2015 events including the Pro Bowl, the NFL Experience and the Super Bowl game. We also arranged the short-term use of the New Jersey Office of Homeland Security and Preparedness' (NJOHSP) equipment that enables high-capacity wireless video surveillance. The Threat Mitigation unit deploys temporary cameras and networking equipment at major public events such as NASCAR races, the Waste Management Phoenix Open and the Rock and Roll Marathon for active monitoring and evidentiary purposes. This system relies primarily on commercial wireless data services and often experiences severe network congestion where there is a high concentration of commercial users. This temporary use of spectrum and equipment will solve this problem at the Super Bowl related events where the Threat Mitigation Unit is deployed, and will demonstrate the future capabilities of the proposed Nationwide Public Safety Broadband Network. The Arizona FirstNet program will coordinate demonstration viewings for various interested parties during the trial.
- Completed the five remaining County-level Education and Outreach meetings - attended by 280 public safety stakeholders.

- Implemented of the 9-1-1 Public Safety Answering Point (PSAP) program including presentations to four of eight planned PSAP System Managers at regularly scheduled quarterly meetings conducted by the State 9-1-1 Administration Office of the Broadband Planning and Public Safety Communications Department.
- Provided presentations to four of the five Regional Advisory Councils of the Arizona Department of Homeland Security.
- Briefed to ten public safety associations and three tribal groups. The final tribal plan will be completed in November for review by the Arizona Department of Homeland Security.

FINANCIAL INFORMATION

A table of the budgeted and actual financial performance for the FirstNet program including breakouts of federal funds, and state and local in-kind contributions is included as an attachment to this report titled "FirstNet Budget Report – October 31, 2014". This table includes sections titled "Q1 FY15 Quarterly FirstNet Budget Report", which summarizes results for the past quarter, and "Q1 FY15 Cumulative FirstNet Budget Report (Five Quarters Q1 FY14 Through Q1 FY15)" which summarizes result for the grant inception-to-date.

Budget Categories

Categories included in this report are defined as follows:

- *Personnel/Employee Related Expenses*: Allocation of existing ADOA management and administrative personnel costs. No incremental FTE were hired for this program.
- *Travel:* Arizona and out-of-state travel for Arizona FirstNet program staff and local public safety representatives funded entirely by federal grant funds.
- *Supplies*: Collateral materials and related costs funded entirely by federal grant funds.
- *Contract Staff*: Dedicated contract positions funded entirely by federal grant funds.
- *Other:* Comprised of the following two elements following to federal reporting requirements:
  - Temporary or project related sub-contractors and meeting expenses.
  - In-kind contributions of time from local public safety and public service representatives attending FirstNet briefings and events, and other contributions of time. This subcategory will comprise the majority of the in-kind contribution match requirement over the course of the grant cycle.

Also, for the purposes of in-kind contribution reporting in the attached "Q1 FY15 FirstNet Budget Reports", State in-kind is defined as only Personnel/Employee Related Expense from ADOA sources and Local in-kind is defined as allocations from local and tribal sources external to ADOA. This delineation provides a clear representation of the State funded in-kind contributions.

The grant requires a cumulative 20% in-kind match of federal dollars from State, tribal and local Arizona sources.

Budget and Actuals

Cumulative

The cumulative overall budget, including federal funds and in-kind contributions for five quarters of the grant cycle including Q1 FY15 was $1,071,912 or 29% of the entire grant award. Of this total, $824,223 was federal funds and $247,689 was total State and Local in-kind contributions.

Total actual spending for this period was significantly lower than budget at $530,772 or 50% of budget. Federal grant expenditures were $379,642 or 46% of budget. Total in-kind contributions were $151,130 or 61% of plan. Of this in-kind total, State contributions were $87,437 or 61% of plan while Local in-kind contributions were $63,693 or 55% of plan.

Q1 FY15

For the quarter Q1 FY15, the overall budget, including federal funds and in-kind contributions was $263,010 or 7% of the entire grant award. Of this total, $207,687 was federal funds and $55,323 was total State and Local in-kind contributions. Total actual spending for this period was $211,125 or 80% of budget. Federal grant expenditures were $152,679 or 58% of budget. Total in-kind contributions were $58,446 or 106% of plan. Of this in-kind total State contributions were $26,448 or 100% of plan, while Local in-kind contributions were $31,998 or 111% of plan.

Various factors contributed to this cumulative and quarterly under-variance including:

- Lower than expected meeting costs.

- Leverage of the State website conversion project to implement the FirstNet website.
- General cost management efforts by the Arizona FirstNet Program.

The percentage of total in-kind contributions on a cumulative basis was 28% or 5 percentage points above plan and 8 percentage points above grant requirements. This over-variance is due primarily to the federal policy that allows costs associated with grant application development activities incurred prior to the grant award to be counted as in-kind. This ratio will track to the 20% grant requirement over time. Further, we expect Local in-kind contributions to comprise the majority of total in-kind matching funds. For Q1 FY15, Local in-kind contributions represent 55% of total in-kind.

Q1 FY15 Quarterly FirstNet Budget Report

Cost Category	Federal Budget	Federal Actual	Federal Variance $'s	Federal Variance %	Total In-Kind Budget	Total In-Kind Actual	Total In-Kind Variance $'s	Total In-Kind Variance %
Personnel	$ -	$ -	$ -		$ 20,305	$ 12,923	$ (7,382)	64%
Employee Related Expenses	$ -	$ -	$ -		$ 6,092	$ 1,975	$ (4,117)	32%
Travel	$ 31,557	$ 16,315	$ (15,242)	52%	$ -	$ -	$ -	
Equipment	$ -	$ -	$ -		$ -	$ -	$ -	
Supplies	$ 4,966	$ 22,272	$ 17,306	448%	$ -	$ -	$ -	
Contract Staff	$ 153,273	$ 114,092	$ (39,181)	74%	$ -	$ -	$ -	
Other	$ 17,891	$ -	$ (17,891)	0%	$ 28,926	$ 43,548	$ 14,622	151%
TOTAL	**$ 207,687**	**$ 152,679**	**$ (55,008)**	**74%**	**$ 55,323**	**$ 58,446**	**$ 3,123**	**106%**

Cost Category	State In-Kind Budget	State In-Kind Actual	State In-Kind Variance $'s	State In-Kind Variance %	Local In-Kind Budget	Local In-Kind Actual	Local In-Kind Variance $'s	Local In-Kind Variance %
Personnel	$ 20,305	$12,923	$ (7,382)	64%	$ -	$ -	$ -	
Employee Related Expenses	$ 6,092	$1,975	$ (4,117)	32%	$ -	$ -	$ -	
Travel	$ -	$ -	$ -		$ -	$ -	$ -	
Equipment	$ -	$ -	$ -		$ -	$ -	$ -	
Supplies	$ -	$ -	$ -		$ -	$ -	$ -	
Contract Staff	$ -	$ -	$ -		$ -	$ -	$ -	
Other	$ -	$ 11,550	$ 11,550		$ 28,926	$ 31,998	$ 3,072	111%
TOTAL	**$ 26,397**	**$ 26,448**	**$ 51**	**100%**	**$ 28,926**	**$ 31,998**	**$ 3,072**	**111%**

Total Federal & In-Kind	**$ 263,010**	**$ 211,125**	**$ (51,885)**	**80%**

In-Kind Match %	Federal	Total State & Local In-Kind	State % of Grant	State % of In-kind	Local % of Grant	Local % of In-kind
Grant Cycle Target	80%	20%				
Q5 Budget	79%	21%	10%	48%	11%	52%
Actual	72%	28%	13%	45%	15%	55%

Q1 FY15 Cumulative FirstNet Budget Report (Five Quarters Q1 FY14 Through Q1 FY15)

Cost Category	Federal Budget	Federal Actual	Federal Variance $'s	Federal Variance %	Total In-Kind Budget	Total In-Kind Actual	Total In-Kind Variance $'s	Total In-Kind Variance %
Personnel	$ -	$ -	$ -		$ 101,525	$ 58,375	$ (43,150)	57%
Employee Related Expenses	$ -	$ -	$ -		$ 30,458	$ 17,512	$ (12,946)	57%
Travel	$ 94,671	$ 29,443	$ (65,228)	31%	$ -	$ -	$ -	
Equipment	$ -	$ -	$ -		$ -	$ -	$ -	
Supplies	$ 14,897	$ 30,444	$ 15,547	204%	$ -	$ -	$ -	
Contract Staff	$ 643,091	$ 319,755	$ (323,336)	50%	$ -	$ -	$ -	
Other	$ 71,564		$ (71,564)	0%	$ 115,705	$ 75,243	$ (40,462)	65%
TOTAL	**$ 824,223**	**$ 379,642**	**$ (444,581)**	**46%**	**$ 247,688**	**$ 151,130**	**$ (96,558)**	**61%**

Cost Category	State In-Kind Budget	State In-Kind Actual	State In-Kind Variance $'s	State In-Kind Variance %	Local In-Kind Budget	Local In-Kind Actual	Local In-Kind Variance $'s	Local In-Kind Variance %
Personnel	$ 101,525	$ 58,375	$ (43,150)	57%	$ -	$ -	$ -	
Employee Related Expenses	$ 30,458	$ 17,512	$ (12,946)	57%	$ -	$ -	$ -	
Travel	$ -	$ -	$ -		$ -	$ -	$ -	
Equipment	$ -	$ -	$ -		$ -	$ -	$ -	
Supplies	$ -	$ -	$ -		$ -	$ -	$ -	
Contract Staff	$ -	$ -	$ -		$ -	$ -	$ -	
Other	$ -	$ 11,550	$ 11,550		$ 115,705	$ 63,693	$ (52,012)	55%
TOTAL	**$ 131,983**	**$ 87,437**	**$ (44,546)**	**66%**	**$ 115,705**	**$ 63,693**	**$ (52,012)**	**55%**

Total Federal & In-Kind	**$ 1,071,911**	**$ 530,772**	**$ (541,139)**	**50%**

In-Kind Match %	Federal	Total State & Local In-Kind	State % of Grant	State % of In-kind	Local % of Grant	Local % of In-kind
Grant Cycle Target	80%	20%				
Q5 Cumulative Budget	77%	23%	12%	53%	11%	47%
Actual	72%	28%	16%	58%	12%	42%

2A

STATE OF ARIZONA

Joint Legislative Budget Committee

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http://www.azleg.gov/jlbc.htm

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Matt Gress, Fiscal Analyst

SUBJECT: Attorney General - Review of Allocation of Settlement Monies - State v. McKesson Corporation

Request

Pursuant to A.R.S. § 44-1531.02, the Office of the Attorney General (AG) must submit an expenditure plan for Committee review of legal settlement monies that are deposited into the Consumer Remediation Subaccount of the Consumer Restitution and Remediation (CPR) Revolving Fund prior to spending those monies.

This request is for review of a $5.8 million allocation from an $8.8 million legal settlement with the McKesson Corporation (McKesson). Of that amount, $4.1 million will be used to fund programs targeting prescription drug education, misuse, and abuse. Another $1.2 million will be used to enhance law enforcement efforts to prevent and prosecute prescription drug pricing, marketing offenses and other deceptive acts, and the remaining $578,700 will be used for program administration.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review of the $5.8 million allocation plan.

2. An unfavorable review of the allocation plan.

Analysis

In September 2012, Arizona sued McKesson for artificially raising the reported average wholesale price (AWP) of hundreds of brand-name drugs. As a result of McKesson's alleged misconduct, the Arizona Health Care Cost Containment System (AHCCCS), as well as other third-party payers and consumers, paid higher prices for prescription drugs. McKesson denied wrongdoing but reached a settlement with Arizona and agreed to pay $8.8 million in damages to the state. Several other states and the federal government sued McKesson for similar reasons and also reached separate legal settlements with the company.

(Continued)

Of the $8.8 million McKesson paid to the AG, $1.0 million was deposited into the Restitution Subaccount to directly compensate those Arizona consumers and third party payers who purchased drugs at inflated prices but did not recover funds pursuant to earlier class action lawsuits. As part of the Restitution Subaccount, these monies do not require legislative appropriation or further Committee review. The AG reports that it plans to hire a claims administrator to help the AG identify entities entitled to these restitution monies.

Another $2.0 million from the settlement was deposited into the Consumer Protection-Consumer Fraud (CPCF) Revolving Fund. Statute permits funds in the CPCF Revolving Fund to be used for direct consumer fraud activities as well as general operating expenses of the AG's office. Of the $5.3 million appropriated from the CPCF Revolving Fund in FY 2015, $1.8 million went to non-consumer fraud activities. The AG has no immediate plan for how it will spend the $2.0 million from the McKesson Settlement.

The remaining $5.8 million of the legal settlement was deposited into the Remediation Subaccount and is allocated in the AG's expenditure plan *(see Table 1 for more information)*. The AG believes its plan complies with the following provisions of the legal settlement:

1) To educate consumers about prescription drug pricing and ways to reduce their prescription drug spending. The AG plan allocates approximately $4.1 million of the total $5.8 million expenditure plan to community-based programs related to prescription drugs. Of the $4.1 million, half will be allocated to programs that provide prescription drug education and payment assistance, and the other half will fund programs that mitigate prescription drug misuse and abuse. The AG will award these funds through a competitive grant process in early 2015 to non-profit organizations and local government agencies. The AG will distribute the funds over a 27-month funding cycle.

2) To enhance law enforcement efforts to prevent and prosecute prescription drug price manipulation or other deceptive acts related to the pricing or marketing of merchandise. The AG plan allocates approximately $1.2 million to AG law enforcement efforts in these areas.

The AG allocates the remaining $578,700 to administer the program and hire a consultant with expertise in public health and the prescription drug field to develop grant requirements and provide recommendations on the distribution of these monies.

Table 1

Attorney General McKesson Settlement Expenditure Plan
Remediation Subaccount subject to JLBC review

	Amount	Recipient	Goals
	2,025,500	Non-profit or governmental agency	Provide prescription drug education and payment assistance
	2,025,500	Non-profit or governmental agency	Prevent prescription drug misuse and abuse
	1,157,400	AG	Enhance AG's law enforcement efforts to prevent and prosecute prescription drug price manipulation
	$ 578,700	AG	Administrative expenditures
Subtotal	**$5,787,100** 1/		
		Other Components of the McKesson Settlement	
	$2,000,000	AG	Consumer Fraud
	$1,000,000	Individuals/Companies	Restitution
Total	**$8,787,100**		

1/ Includes interest income.

RS/MG:kp

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JOINT BUDGET COMMITTEE

OFFICE OF THE ARIZONA ATTORNEY GENERAL

PUBLIC ADVOCACY & CIVIL RIGHTS DIVISION
CONSUMER PROTECTION & ADVOCACY SECTION

TOM HORNE
ATTORNEY GENERAL

DENA BENJAMIN
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DIRECT PHONE NO. (602) 542-7717
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November 21, 2014

The Honorable Don Shooter, Chairman
Joint Legislative Budget Committee
Arizona State Senate
1700 West Washington Street
Phoenix, AZ 85007

The Honorable John Kavanagh, Co-Chairman
Joint Legislative Budget Committee
Arizona House of Representatives
1700 West Washington Street
Phoenix, AZ 85007

Re: *State of Arizona v. McKesson Corporation*

Dear Senator Shooter and Representative Kavanagh:

Pursuant to A.R.S. § 44-1531.02(C), the Attorney General's Office respectfully submits the enclosed expenditure plan for review. As a result of a December, 2013 settlement with the McKesson Corporation, the Attorney General secured approximately $5.7 million in remediation funds which have been deposited into the consumer remediation subaccount of the consumer restitution and remediation revolving fund established by A.R.S. § 44-1531.02. According to the court order, the McKesson funds may be used to support programs addressing prescription drug activity and enhancing law enforcement efforts to prevent and prosecute deceptive pricing and marketing acts or practices. The enclosed McKesson Settlement Expenditure Plan allocates the funds in compliance with the court order. For reference, copies of the court order and settlement agreement, as well as the complaint, are attached.

If you have any questions, please feel free to contact me.

Sincerely,

Dena Benjamin
Section Chief Counsel
Consumer Protection and Advocacy Section

cc: The Honorable Chad Campbell
The Honorable Anna Tovar
Richard S. Stavneak
Vicki Salazar
Matthew Gress (via e-mail and U.S. mail)
Bob Hull
Art Harding

Enclosures

Doc #4228217

OFFICE OF THE ARIZONA ATTORNEY GENERAL

PUBLIC ADVOCACY DIVISION

CONSUMER PROTECTION & ADVOCACY SECTION

MCKESSON SETTLEMENT EXPENDITURE PLAN

OCTOBER 2014

This plan is submitted to the Joint Legislative Budget Committee, for review at its next meeting. It outlines the expenditure of $5.7 million in McKesson settlement funds, secured by the Arizona Office of the Attorney General.

The McKesson enforcement action

In December 2013, a consumer protection enforcement settlement was reached between the Arizona Attorney General and McKesson Corporation (Case # CV-2012-013707) to resolve allegations that McKesson violated Arizona's Consumer Fraud Act by artificially inflating the prices of more than 400 brand-name prescription drugs, costing consumers millions of dollars. The terms of the court order approving the settlement require that $5.7 million of the funds be used for any of the following purposes:

- to educate consumers about prescription drug pricing and ways to reduce their prescription drug spending.
- to enhance law enforcement efforts to prevent and prosecute prescription drug price manipulation or other unfair or deceptive acts or practices related to the pricing or marketing of merchandise including prescription drugs.
- other programs intended to rectify violations or alleged violations of consumer protection laws as alleged in the complaint.

The court order designated a separate $1 million of the McKesson settlement to be used for direct restitution payments to consumers harmed by McKesson's alleged violations and that is currently in process. Any unexpended funds shall be distributed to the consumer protection-consumer fraud revolving fund established by A.R.S. 44-1531.01.

Community Assessment and Response

After internal discussion with the lead attorney on the case and preliminary dialogue with potential stakeholders on issues of greatest importance to the community regarding prescription drugs and deceptive pricing or marketing practices, it was learned that prescription drug education, payment assistance and misuse and abuse were critical public health issues in need of attention and funding opportunities. Due to this feedback and the AGO's collaboration with the AZ Partnership for a Drug Free America on the dangers of prescription drug abuse, these topics were addressed in a community needs assessment that was distributed to at least 45 public and private nonprofit organizations to ensure broad statewide representation. Recipients included representatives from all county health departments, the Board of Pharmacy, AZ Department of Education, AZ Department of Weights and Measures, AZ Department of Health Services, the Public Health Assn., the AZ Criminal Justice Commission, the Assn. of Community Health Centers, the Center for Rural Health, AHCCCS, the Governor's office, various medical professional boards, substance abuse coalitions and the Alliance of AZ Nonprofits.

The assessment sought feedback on the best use of the funds for programs and/or services that focus on one or more of the following issue areas:

- prescription drug education
- prescription drug payment assistance
- prescription drug abuse and misuse
- deceptive pricing practices
- other programs intended to rectify violations or alleged violations of consumer protection laws as alleged in the Complaint.

Stakeholders were asked to prioritize the issue areas based on need in their community, and for evidence-based or informed program types with the goal to increase capacity, fill a gap in services and provide the largest benefit to people in need in Arizona.

Following the receipt of assessment responses the AGO convened a stakeholders meeting on October 2, 2014 to bring respondents and others together to discuss the assessment results and obtain additional comments. The AGO notified the Arizona Legislature of the meeting through JLBC staff. The AGO received written and/or verbal comments from eleven organizations. The plan was developed according to the priority issue areas identified by the community stakeholders.

Expenditure Plan

The AGO will distribute the McKesson settlement funds through a competitive solicitation process that complies with Arizona law. The funds will be used to support evidence-based or informed programs throughout the state that target populations most in need, over a twenty seven (27) month funding cycle. As summarized in the chart below, 35% will be targeted to prescription drug education and payment assistance, 35% to prescription drug misuse and abuse and 20% to AGO law enforcement activity for prosecution of deceptive pricing offenses. The consent judgment allows for an amount to be used to enhance law enforcement efforts to prevent and prosecute prescription drug price manipulation or other unfair or deceptive acts or practices related to the pricing or marketing of merchandise including prescription drugs. As interest income is accrued it will be allocated to the contract or grant awarded programs.

Description	% of Total	Expenditures	Summary
Beginning Cash			$5,760,798.00
Interest Income			26,286.00
Total Funds Available			**5,787,084.00**
Grant/Contract Awards			
• Prescription Drug Misuse/Abuse	35%	2,025,479.00	
• Prescription Drug Education and Payment Assistance	35%	2,025,479.00	
AGO Law Enforcement – to prosecute deceptive pricing offenses	20%	1,157,416.00	
Sub-total			5,208,374.00
Program Administration			
• Operations	07%	405,095.00	
• Program Design & Monitoring	03%	173,615.00	
Sub-total			578,710.00

It is anticipated that the funds will be awarded to private nonprofits and county or municipal government agencies for community-based programs, in early 2015. The AGO plans to hire a consultant(s) with expertise in public health and the prescription drug field who will be responsible for developing contract or grant requirements, providing recommendations on the distribution of funds, and program monitoring. Administrative costs, including the consultant(s), are not expected to exceed 10% of the total settlement amount throughout the start-up and close-out of the programs. This is less than the 12% cap imposed by A.R.S. §41-191.08, which governs the Attorney General's operation of the victim services fund. An AGO settlement program coordinator is in place to oversee the funding process and effective implementation of the funds and programs, to ensure compliance with the court order.

2B

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE

DON SHOOTER
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JOHN McCOMISH
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1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 926-5491

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http://www.azleg.gov/jlbc.htm

HOUSE OF REPRESENTATIVES

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DAVID GOWAN, SR.
ADAM KWASMAN
DEBBIE LESKO
STEFANIE MACH
JUSTIN OLSON
MICHELLE UGENTI

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director

FROM: Matt Gress, Fiscal Analyst

SUBJECT: Attorney General - Review of Quarterly Reports on Legal Settlements

Request

The FY 2015 General Appropriation Act (Laws 2014, Chapter 18) requires the Attorney General (AG) to submit to the Joint Legislative Budget Committee for review quarterly reports on the receipts to and disbursements from the Consumer Protection - Consumer Fraud (CPCF) Revolving Fund, the Consumer Restitution and Remediation Revolving Fund, and the Antitrust Enforcement Revolving Fund, as well as deposits made to the General Fund.

The intent of the General Appropriation Act provision is to review the AG's allocation of legal settlements among the various funds. In the first quarter of FY 2015, the AG deposited $4.0 million to the CPCF Revolving Fund, $264,800 to the Restitution Subaccount, and $7,800 to the Remediation Subaccount.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review.

2. An unfavorable review.

The AG has deposited their settlement funds consistent with legislative intent.

Analysis

The review of the quarterly reports is intended to provide legislative oversight of how the AG has allocated legal settlement proceeds among the 5 possible funds/subaccounts (*see Attachment A*). With the

(Continued)

exception of $7,800 that was deposited into the Remediation Subaccount, none of the deposits will require further Committee review. The AG's allocation of legal settlement proceeds appear to comply with legislative intent (*see Table 1 for more detail on the amount of deposits to each fund*). The remainder of the memo provides a summary of the legal settlements that resulted in deposits of more than $250,000 and background on the AG's different funds related to consumer activities.

Table 1

FY 2015 Legal Settlement Deposits 1/
July 1, 2014 - September 30, 2014

	Revenues	**Fund Balance**
CPCF Revolving Fund	$3,951,000	$14,120,200 2/
State of Arizona vs. GlaxoSmithKline, LLC	*3,140,100*	
State of Arizona vs. Wyeth Pharmaceuticals, Inc.	*721,200*	
Consumer Restitution Subaccount	264,800	2,181,700
State of Arizona vs. Maurice J. Chelliah, et al. 3/	*150,000*	
Consumer Remediation Subaccount	7,800	5,787,100
Antitrust Enforcement Revolving Fund	0	240,300
General Fund	0	N/A 4/
Total	**$4,223,600**	**$22,329,300**

1/ The total receipts for each fund may include interest income on the total proceeds awarded.
2/ The fund balance includes $2,091,300 in funds which are restricted by legal settlement.
3/ This deposit is derived from a legal settlement that, in aggregate, totals more than $250,000. To date, there has been $610,000 collected from this legal settlement.
4/ Not applicable.

Case Background

The AG deposited proceeds from 2 cases listed in *Table 1* into the CPCF Revolving Fund.

The *GlaxoSmithKline* case is the largest receipt reported by the AG. The AG sued GlaxoSmithKline, LLC, as did several other states, for engaging in deceptive practices in connection with marketing an asthma drug, Advair, and antidepressant drugs Paxil and Wellbutrin. GlaxoSmithKline denied wrongdoing but reached a settlement agreement with the AG. The settlement agreement required GlaxoSmithKline to pay $3,140,100 to the state. The AG deposited these monies into the CPCF Revolving Fund, which may be used for any purpose permitted by statute.

In the *Wyeth Pharmaceuticals* case, which was also a multi-state settlement, the AG alleged that the pharmaceutical company misrepresented the benefits of Rapamune, a drug used to prevent organ rejection after kidney transplant surgery. Like GlaxoSmithKline, the company also agreed to no wrongdoing but reached a settlement agreement with the AG for $721,200, which was deposited into the CPCF Revolving Fund for use as permitted by statute.

The AG deposited the proceeds from the *Chelliah* case listed in *Table 1* into the Consumer Restitution Subaccount. The *Chelliah* case is an ongoing legal settlement that was reached after the AG's office sued Maurice J. Chelliah, et al., who operated a business opportunity telemarketing scheme that defrauded thousands of consumers nationwide. The most recent deposit related to this legal settlement was $150,000, which went into the Restitution Subaccount and will be distributed to consumers who purchased websites or marketing packages from Chelliah or his associates.

RS/MG:kp
Attachment

Attachment A

Fund Structure Background

Laws 2013, Chapter 143 revised the AG's procedures for reporting on the distribution and allocation of legal settlements. Prior to this legislation, the General Appropriation Act required the Committee to review the AG's proposed allocations of any non-criminal legal settlements exceeding $100,000. Many of these settlements were typically deposited into the CPCF Revolving Fund. Chapter 143 retained the CPCF Revolving Fund, but established a new Consumer Restitution and Remediation Revolving Fund with 2 new subaccounts. With this legislation, the AG may now deposit consumer fraud-related recoveries into 1 of 4 funds/subaccounts:

1. The main <u>CPCF Revolving Fund</u>, which derives its revenue from any investigative or court costs, attorney fees or civil penalties recovered by the AG as a result of enforcement of either state or federal consumer fraud statutes. The monies, subject to legislative appropriation, are used for operations of the Consumer Protection Division, and can also be used for other operating expenses. Committee review of expenditures from this fund is not required.
2. The Consumer <u>Restitution Subaccount</u> of the Consumer Restitution and Remediation Revolving Fund. The AG is to deposit legal settlement proceeds into this subaccount to compensate specific, identifiable entities, including the state, for economic loss resulting from violations of consumer protection laws. This subaccount is not subject to legislative appropriation. Committee review of expenditures from this subaccount is not required.
3. The Consumer <u>Remediation Subaccount</u> of the Consumer Restitution and Remediation Revolving Fund. This subaccount consists of monies collected as a result of a settlement to rectify violations of consumer protection laws, other than monies collected for the benefit of specific, identifiable entities. Monies in this subaccount up to $3,500,000 are continuously appropriated. Any amount of money collected over that amount is subject to legislative appropriation. The AG must submit an expenditure plan for Committee review before expending any monies in this subaccount.
4. The <u>General Fund</u>. Chapter 143 directs any monies resulting from compromises or settlements, excluding restitution and reimbursement funds or attorney fees, into the General Fund.

The AG must also report deposits into the Antitrust Enforcement Revolving Fund. This fund consists of monies recovered by the state as a result of antitrust, restraint of trade, or price-fixing activity enforcement. The monies are to be used to cover the AG's antitrust enforcement costs. If the settlement exceeds the cost of enforcement, then the remainder is transferred to the General Fund unless the recovery was on behalf of a special fund or political subdivision, in which case the remaining monies would go to those entities.

TOM HORNE
ATTORNEY GENERAL

OFFICE OF THE ARIZONA ATTORNEY GENERAL

BUSINESS & FINANCE DIVISION

VICKI SALAZAR
DIRECTOR

October 15, 2014

RECEIVED
OCT 16 2014
JOINT BUDGET COMMITTEE

The Honorable Jan Brewer
Governor of the State of Arizona
State Capitol Complex
1700 West Washington
Phoenix, Arizona 85007-2890

Dear Governor Brewer:

Pursuant to A.R.S. § 41-191.02 (B), enclosed is the accounting of the receipts and disbursements from the Antitrust Enforcement Revolving Fund for the period ended September 30, 2014.

Please let me know if you need additional information.

Sincerely,

Vicki Salazar

Vicki Salazar
Director, Business & Finance Division

Copies with enclosure to:

The Honorable Andy Biggs, Senate President
Arizona State Senate

The Honorable Andy Tobin, Speaker of the House
House of Representatives

Brian C. McNeil, Director
Department of Administration

1275 WEST WASHINGTON PHOENIX, AZ 85007 • PHONE (602) 542-8046 • FAX (602) 542-5940

Department: ATTORNEY GENERAL - DEPARTMENT OF LAW
Fund: ANTITRUST ENFORCEMENT REVOLVING FUND
Cost Center: CONSUMER PROTECTION & ADVOCACY SECTION
Period: JULY 1, 2014 THROUGH SEPTEMBER 30, 2014
A.R.S. Citation: § 41-191.02
Fund Number: 2016

DESCRIPTION:			AMOUNT
SOURCE OF REVENUE	BEGINNING BALANCE, JULY 1, 2014		$ 290,064
Money recovered as a result of the enforcement of state or federal antitrust statutes.	REVENUES		
	Other Fines Forfeitures and Penalties	-	
	Transfers In	-	
	TOTAL REVENUES		-
PURPOSE OF FUND	EXPENDITURES		
To offset costs incurred in the enforcement of state and federal antitrust statutes, but may not be used to employ or compensate attorneys.	Personal Services	$ 17,955	
	Employee Related Expenses	6,860	
	Professional & Outside Services	-	
	Travel - In-State	105	
	Travel - Out-of-State	-	
	Aid to Others	-	
	Other Operating Expenses	5,392	
	Capital Outlay	-	
	Capital Equipment	-	
	Non-Capital Equipment	-	
	Fund Sweep	-	
	Operating Transfers Out	3,750	
	TOTAL EXPENDITURES		34,062
	FUND BALANCE, SEPTEMBER 30, 2014		256,002
	OUTSTANDING ENCUMBRANCES		15,656
	FUND BALANCE NET OF ENCUMBRANCES , SEPTEMBER 30, 2014		$ 240,346

(A): Fund Balance, June 30, 2014 before 13th Month FY2014		$ 290,147
Adjustments to Expenditures/Operating Transfers out 13th Month FY14	(83)	
Total adjustments 13th month FY2014		(83)
Adjusted Ending Balance, June 30, 2014		$ 290,064

TOM HORNE
ATTORNEY GENERAL

OFFICE OF THE ARIZONA ATTORNEY GENERAL
BUSINESS & FINANCE DIVISION

VICKI SALAZAR
DIRECTOR

RECEIVED
OCT 16 2014
JOINT BUDGET COMMITTEE

October 15, 2014

The Honorable Andy Tobin
Speaker of the House
Arizona House of Representatives
State Capitol Complex
1700 West Washington
Phoenix, Arizona 85007-2890

The Honorable Andy Biggs
Senate President
Arizona State Senate
State Capitol Complex
1700 West Washington
Phoenix, Arizona 85007-2890

Dear Mr. Speaker and Mr. Biggs:

Pursuant to A.R.S. § 44-1531.01(D), enclosed is the accounting of the receipts and disbursements from the Consumer Protection Revolving Fund for the period ended September 30, 2014.

Please let me know if you need additional information.

Sincerely,

Vicki Salazar

Vicki Salazar
Director, Business & Finance Division

Copies with enclosure to:

The Honorable Jan Brewer, Governor
State of Arizona

Ken Bennett, Secretary of State
Office of the Secretary of State

Richard Stavneak, Director
Joint Legislative Budget Committee

Brian C. McNeil
Department of Administration

1275 WEST WASHINGTON PHOENIX, AZ 85007 • PHONE (602) 542-8046 • FAX (602) 542-5940

Department: ATTORNEY GENERAL - DEPARTMENT OF LAW
Fund: CONSUMER PROTECTION REVOLVING FUND
Cost Center: CONSUMER PROTECTION & ADVOCACY SECTION
Period: JULY 1, 2014 THROUGH SEPTEMBER 30, 2014
A.R.S. Citation: § 44-1531.01
Fund Number: 2014

DESCRIPTION:				Amount
SOURCE OF REVENUE	**BEGINNING BALANCE, JULY 1, 2014**	See (A) below		$ 11,427,953
	REVENUES			
Civil penalties imposed on violations of consumer fraud statutes; recovery of costs or attorneys fees.	Other Fines Forfeitures and Penalties		$ 3,951,046	
	Interest		-	
	Transfers In		-	
	TOTAL REVENUES			3,951,046
PURPOSE OF FUND	**EXPENDITURES**			
Consumer fraud education and investigative and enforcement operations of the Consumer Protection & Advocacy Section, including costs and expenses associated with the tobacco master settlement agreement arbitration.	Personal Services		545,306	
	Employee Related Expenses		241,278	
	Professional & Outside Services		46,321	
	Travel - In-State		9,664	
	Travel - Out-of-State		2,290	
	Aid to Others		-	
	Other Operating Expenses		83,948	
	Capital Outlay		-	
	Capital Equipment		-	
	Non-Capital Equipment		13,924	
	Operating Transfers Out		44,550	
	TOTAL EXPENDITURES			987,281
	FUND BALANCE, SEPTEMBER 30,2014	See (B) below		14,391,718
	OUTSTANDING ENCUMBRANCES			271,489
	FUND BALANCE NET OF ENCUMBRANCES, SEPTEMBER 30, 2014			$ 14,120,229

(A): Fund Balance, June 30, 2014 before 13th Month FY2014		$ 11,572,791
Adjustments to Revenue/Operating Transfers In 13th Month FY2014	3,657	
Adjustments to Expenditures/Operating Transfers out 13th Month FY14	(148,496)	
Outstanding Encumbrances liquidated 13th Month FY14	-	
Outstanding Encumbrances to be liquidated in FY2015	-	
Total adjustments 13th month FY2014		(144,839)
Adjusted Ending Balance, June 30, 2014		$ 11,427,953

(B): Fund Balance includes $2,091,331 in funds which are restricted by settlement.

OFFICE OF THE ATTORNEY GENERAL
BUSINESS & FINANCE DIVISION
CONSUMER PROTECTION REVOLVING FUND
REVENUE
FY2015

	Amount
Total Revenue beginning 7/1/14	-
Deposits - 1st Quarter FY2015	
Legal Settlement Deposits greater than or equal to $250,000	
STATE OF ARIZONA, ex rel. THOMAS C. HORNE, Attorney General, Plaintiff, vs. GLAXOSMITHKLINE LLC, Defendant --- Case No. C20143053. This settlement resolves allegations that GlaxoSmithKline, LLC engaged in deceptive and/or unfair acts and practices in connection with the advertisement or sale of Advair, an asthma drug, as well as antidepressant drugs Paxil and Wellbutrin, in violation of the Arizona Consumer Fraud Act. The Company's alleged conduct is described more fully in the attached Press Release. As a result of this settlement, the Attorney General obtained $3,140,126 to be deposited into the Consumer Protection-Consumer Fraud Revolving Fund and used for purposes set forth in statute. In addition, the settlement prohibits GlaxoSmithKline from engaging in conduct that gave rise to this enforcement action in the future, and requires the Company to maintain its Patient First Program through at least March 2019.	3,140,126
STATE OF ARIZONA, ex rel. THOMAS C. HORNE, Attorney General, Plaintiff, vs. WYETH PHARMACEUTICALS INC. Defendant --- Case No. C20144229. This settlement resolves allegations that Wyeth Pharmaceutical, Inc., a subsidiary of Pfizer, Inc., engaged in deceptive and/or unfair acts and practices in connection with the advertisement or sale of Rapamune, a kidney transplant drug, in violation of the Arizona Consumer Fraud Act. The Company's alleged conduct is described more fully in the attached Press Release. As a result of this settlement, the Attorney General obtained $721,169 to be deposited into the Consumer Protection-Consumer Fraud Revolving Fund and used for purposes set forth in statute. In addition, the settlement prohibits Pfizer from engaging in conduct that gave rise to this enforcement action in the future.	721,169
Legal Settlement Deposits less than $250,000	89,751
Total Deposits - 1st Quarter FY2015	3,951,046
Total Revenue 7/1/14 - 9/30/14	3,951,046

TOM HORNE
ATTORNEY GENERAL

OFFICE OF THE ARIZONA ATTORNEY GENERAL
BUSINESS & FINANCE DIVISION

VICKI SALAZAR
DIRECTOR

RECEIVED
OCT 16 2014
JOINT BUDGET COMMITTEE

October 15, 2014

The Honorable Andy Tobin
Speaker of the House
Arizona House of Representatives
State Capitol Complex
1700 West Washington
Phoenix, Arizona 85007-2890

The Honorable Andy Biggs
Senate President
Arizona State Senate
State Capitol Complex
1700 West Washington
Phoenix, Arizona 85007-2890

Dear Mr. Speaker and Mr. Biggs:

Pursuant to A.R.S. § 44-1531.02(D), enclosed is the accounting of the receipts and disbursements from the Consumer Restitution and Remediation Revolving Fund by Subaccount for the period ended September 30, 2014.

Please let me know if you need additional information.

Sincerely,

Vicki Salazar

Vicki Salazar
Director, Business & Finance Division

Copies with enclosure to:

The Honorable Jan Brewer, Governor
State of Arizona

Ken Bennett, Secretary of State
Office of the Secretary of State

Richard Stavneak, Director
Joint Legislative Budget Committee

Brian C. McNeil
Department of Administration

Department: ATTORNEY GENERAL - DEPARTMENT OF LAW
Fund: CONSUMER RESTITUTION & REMEDIATION REVOLVING FUND
Sub Account: RESTITUTION
Cost Center: CONSUMER PROTECTION & ADVOCACY SECTION
Period: JULY 1, 2014 THROUGH SEPTEMBER 30, 2014
A.R.S. Citation: § 44-1531.02
Fund Number: 2573

DESCRIPTION:				**AMOUNT**
SOURCE OF REVENUE	**BEGINNING BALANCE, JULY 1, 2014**	(See (A) below)		**$ 1,918,447**
Monies collected from lawsuits intended to compensate a specific, identifiable person, including the state, for economic loss resulting from violations of consumer protection laws.	**REVENUES**			
	Other Fines Forfeitures and Penalties		$ 264,786	
	Transfers In		-	
	TOTAL REVENUES			**264,786**
PURPOSE OF FUND	**EXPENDITURES**			
Monies to be distributed to specific, identifiable persons as directed by a court order.	Personal Services		-	
	Employee Related Expenses		-	
	Professional & Outside Services		-	
	Travel - In-State		-	
	Travel - Out-of-State		-	
	Aid to Others		-	
	Other Operating Expenses		1,506	
	Capital Outlay		-	
	Capital Equipment		-	
	Non-Capital Equipment		-	
	Operating Transfers Out		-	
	TOTAL EXPENDITURES			**1,506**
	FUND BALANCE, SEPTEMBER 30, 2014			**2,181,727**
	OUTSTANDING ENCUMBRANCES			-
	FUND BALANCE NET OF ENCUMBRANCES, SEPTEMBER 30, 2014			**$ 2,181,727**

(A): Fund Balance, June 30, 2014 before 13th Month FY2014		$ 1,457,650
Adjustments to Revenue/Operating Transfers In 13th Month FY2014	460,797	
Total adjustments 13th month FY2014		460,797
Adjusted Ending Balance, June 30, 2014		$ 1,918,447

Department: ATTORNEY GENERAL - DEPARTMENT OF LAW
Fund: CONSUMER RESTITUTION & REMEDIATION REVOLVING FUND
Sub Account: REMEDIATION
Cost Center: CONSUMER PROTECTION & ADVOCACY SECTION
Period: JULY 1, 2014 THROUGH SEPTEMBER 30, 2014
A.R.S. Citation: § 44-1531.02
Fund Number: 2573

DESCRIPTION:				AMOUNT
SOURCE OF REVENUE	**BEGINNING BALANCE, JULY 1, 2014**	(See (A) below)		**$ 5,779,348**
Monies collected as the result of an order of a court, or as a result of a settlement or compromise, to rectify violations or alleged violations of consumer protection laws.	**REVENUES**			
	Other Fines Forfeitures and Penalties		$ -	
	Interest		7,747	
	Transfers In		-	
	TOTAL REVENUES			**7,747**
PURPOSE OF FUND	**EXPENDITURES**			
Consumer fraud education programs and operating expenses incurred in administrating or implementing programs.	Personal Services		-	
	Employee Related Expenses		-	
	Professional & Outside Services		-	
	Travel - In-State		-	
	Travel - Out-of-State		-	
	Aid to Others		-	
	Other Operating Expenses		-	
	Capital Outlay		-	
	Capital Equipment		-	
	Non-Capital Equipment		-	
	Operating Transfers Out		-	
	TOTAL EXPENDITURES			-
	FUND BALANCE, SEPTEMBER 30, 2014			**5,787,095**
	OUTSTANDING ENCUMBRANCES			-
	FUND BALANCE NET OF ENCUMBRANCES, SEPTEMBER 30, 2014			**$ 5,787,095**

(A):	Fund Balance, June 30, 2014 before 13th Month FY2014		$ 5,776,240
	Adjustment Rounding	1	
	Adjustments to Revenue/Operating Transfers In 13th Month FY2014	3,107	
	Total adjustments 13th month FY2014		3,108
	Adjusted Ending Balance, June 30, 2014		$ 5,779,348

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JOINT BUDGET COMMITTEE

OFFICE OF THE ATTORNEY GENERAL
BUSINESS & FINANCE DIVISION
CONSUMER RESTITUTION & REMEDIATION REVOLVING FUND
RESTITUTION SUBACCOUNT
REVENUE
FY2015

	AY14	AY15	Total
Total Revenue beginning 7/1/14	-	-	-
<u>Deposits - 1st Quarter FY2015</u>			
Legal Settlement Deposits greater than or equal to $250,000			
STATE OF ARIZONA, *ex rel.* THOMAS C. HORNE, Attorney General, Plaintiff, vs. MAURICE J. CHELLIAH ask Butch Chelliah, et al, Defendants. --- Case No.: CV2012-009716. This judgment was entered in a lawsuit that the Attorney General filed against Maurice J. Chelliah and several others alleging that Defendants engaged in deceptive and/or unfair acts and practices in connection with the advertisement or sale of business opportunities, in violation of the Arizona Consumer Fraud Act, the Telephone Solicitation Statute and Arizona's civil racketeering laws. The Defendants' alleged conduct is described more fully in the attached Press Release. As a result of the judgment, Meritus Payment Solutions, which was named as a relief defendant, paid $426,849 to be deposited into the consumer restitution sub-account of the Consumer Restitution-Consumer Remediation Revolving Fund. Those funds will be combined with funds obtained from other defendants and distributed as restitution to affected consumers. These other defendants account for the $183,171 difference between the $426,849 payments and the reported total payments of $610,020. Litigation is ongoing against the remaining defendants but the vast majority of settlement funds have been received at this time.	460,020	150,000	610,020
Legal Settlement Deposits less than $250,000		112,180	112,180
Interest Income	777	2,606	3,383
Total Deposits - 1st Quarter FY2015	460,797	264,786	725,583
Total Revenue 7/1/14 - 9/30/14	460,797	264,786	725,583

3A

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE
SENATE

DON SHOOTER
CHAIRMAN 2014
OLIVIA CAJERO BEDFORD
GAIL GRIFFIN
JOHN McCOMISH
AL MELVIN
LYNNE PANCRAZI
ANNA TOVAR
STEVEN B. YARBROUGH

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PHOENIX, ARIZONA 85007

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DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Jon Stall, Senior Fiscal Analyst JS

SUBJECT: ADOA/DOR - Review of Data Capture Project (Automation Projects Fund)

Request

Pursuant to A.R.S. § 41-714, the Arizona Department of Administration (ADOA) has requested that the Committee review \$1.7 million in proposed FY 2015 expenditures from the Automation Projects Fund (APF) to improve the Arizona Department of Revenue's (DOR) ability to capture and analyze more tax return data electronically. The request includes a \$565,800 contingency.

For additional information regarding the Automation Projects Fund, please refer to agenda item 1C.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review.

2. An unfavorable review.

This project has received relevant approvals from the Information Technology Authorization Committee (ITAC) and Arizona Strategic Enterprise Technology (ASET) Staff. The JLBC Staff recommends that the Committee consider adopting the ITAC provision as part of its review:

A. Should any additional expense be required to implement the project beyond what has been proposed, DOR must amend the project investment justification and submit it to ADOA's Arizona Strategic Enterprise Technology Office and ITAC, if requested for review and approval prior to further expenditure of funds.

(Continued)

The JLBC Staff also recommends the following provisions:

B. Committee review is only for $1,134,200 of the expenditure plan. Prior to spending of the project's contingency funding of $565,800, DOR must submit an expenditure plan of funding activity to the Committee for review.

C. DOR is to report to JLBC by February 3, 2015 as to whether these automation changes will permit publication of fiscal year income tax credit data within 90 days after the end of the fiscal year.

Analysis

Background

DOR's Taxpayer Accounting System (TAS) is the state's primary system for storing and tracking information on individual income tax collections. Currently, DOR's Taxpayer Accounting System (TAS) captures data from individual income tax returns but does not allow timely analysis of tax expenditures such as credits, subtractions, exemptions and deductions.

DOR annually publishes reports on tax expenditures using returns and other data sources. The tax expenditure data is delayed by several tax years and is incomplete. Most tax credit information is only available for tax year 2012. In addition, exemption, subtraction and deduction data (such as the deduction for mortgage interest) is even more delayed and speculative, with information based on tax year 2008. The lack of timeliness and accuracy of tax expenditure data limits the ability of Executive and Legislative Staff to analyze recent trends in individual income tax collections.

Of the 3.2 million individual income tax returns processed through TAS in FY 2014, 2.9 million (90%) were filed electronically and 0.3 million (10%) were filed as traditional paper returns. While DOR collects tax expenditure data from the 90% of returns filed electronically, there has been limited computer programming to aggregate the data. Tracking tax expenditure data from the 10% of returns that are filed on paper requires research staff to key amounts into spreadsheets from paper copies or scanned images of the return. Due to the high workload associated with each paper return, it is not currently possible to track actual usage of most tax expenditures from paper returns.

Current Proposal

The FY 2015 General Appropriation Act (Laws 2014, Chapter 18) deposited $1.7 million into the APF from the General Fund for a project to improve DOR's accuracy and timeliness of reporting income tax credits and the agency's ability to determine fiscal impacts of recent reductions in long-term capital gains subject to income tax.

The current request would enable DOR to more quickly analyze information from electronic individual income tax returns that are currently stored in TAS, including information on tax credits, other tax expenditures and reductions in long-term capital gains revenue taxed. The request will also now allow DOR Staff to store and analyze tax expenditure information from paper returns in TAS. The requested expenditure amount of $1.7 million in FY 2015 would consist of 4 categories, as follows:

• Computer Programming and Imaging Services	$1,105,000
• Computer Storage Hardware	$20,700
• License and Maintenance Fees (Year 1)	$8,500
• Contingency	$565,800

(Continued)

The primary component of the project includes $1,105,000 to fund 13,000 hours of computer programming that would enable tax expenditures data from electronic and paper individual income tax returns to be analyzed in a more timely and complete manner. The request also includes funding to electronically store 40,000 additional scanned images of tax credit forms from paper returns each year. DOR would still need to input the paper return data into TAS.

Of the $1.7 million appropriation for the project, $565,800 is planned as a contingency cost. JLBC Staff recommends that, prior to spending the contingency funding, DOR must submit an expenditure plan of funding activity to the Committee for review.

DOR reports that automation improvements to TAS may have a net positive $2.3 million General Fund impact. DOR expects that capturing more return data in the system will increase audit revenues by $2.1 million annually. The system improvements will reduce the amount of audit leads that would not recover any taxes (from 4,800 to 2,300 audits) and allow for shifting of staff resources to audits that would have a revenue impact. The agency additionally estimates that the project will reduce operating costs to the Audit and Records Management Divisions by $(247,400), as a result of saving microfilm, paper and staff time previously associated with maintaining paper returns.

RS/JS:kp

Janice K. Brewer
Governor

Kathy Peckardt
Interim Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007

(602) 542-1500

November 24, 2014

The Honorable Don Shooter, Chairman
Joint Legislative Budget Committee
Arizona State Senate
1700 West Washington Street
Phoenix, AZ 85007

The Honorable John Kavanagh, Vice-Chairman
Joint Legislative Budget Committee
Arizona House of Representatives
1700 West Washington Street
Phoenix, AZ 85007

Dear Senator Shooter and Representative Kavanagh:

In accordance with Arizona Revised Statutes § 41-714, The Arizona Department of Administration (ADOA) is submitting this revised request for review of fiscal year 2014 and 2015 Automation Projects Fund projects. This request replaces our previous request dated November 12, 2014. Monies to support the expenditure plan have already been appropriated to the Automation Projects Fund.

The attached document contains a detailed explanation of each proposed project. We will be happy to meet with your staff to provide further explanation as appropriate.

Sincerely,

Kathy Peckardt

Kathy Peckardt
Interim Director

cc: Richard Stavneak, Director, JLBC
Andrew D. Smith, Fiscal Analyst, JLBC
Rebecca Perrera, Fiscal Analyst, JLBC
John Arnold, Director, OSPB
Will Palmisano, Fiscal Analyst, OSPB
Aaron Sandeen, Deputy Director and State CIO
Jeff Grant, Deputy Director
Paul Shannon, Assistant Director, ADOA
Clark Partridge, Comptroller, ADOA
Mike Smarik, Assistant Director, ADOA

Attachment

Janice K. Brewer
Governor

Brian C. McNeil
Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007
(602) 542-1500

September 24, 2014

Mr. David Raber, Director
Arizona Department of Revenue
1600 West Monroe Street
Phoenix, Arizona 85007

Dear David:

The Information Technology Authorization Committee (ITAC) met September 24, 2014 to consider the **"Data Capture"** project.

The ITAC voted in the affirmative for **Approval with Conditions** of this technology project as follows:

1. Should any additional expense be required to implement the project beyond what has been proposed, the Arizona Department of Revenue (ADOR) must amend the PIJ and submit it to ADOA-ASET and the Information Technology Authorization Committee (ITAC), if requested for review and approval prior to further expenditure of funds. Upon the expenditure of non-contingency funding, the ADOR will report back to ITAC regarding how remaining funds will be allocated.

You may proceed to secure additional approvals as required from the Joint Legislative Budget Committee, the Office of Strategic Planning and Budgeting, and the State Procurement Office.

Best Wishes,

Aaron V. Sandeen
State CIO and Deputy Director
Arizona Strategic Enterprise Technology (ASET) Office

ADOA-ASET
Arizona Strategic Enterprise Technology

Project Investment Justification

Version 01.01

A Statewide Standard Document for Information Technology Projects

Project Title:
Data Capture

Agency Name:	Department of Revenue
Date:	09/16/2014
Agency Contact Name:	Janice Swim
Agency Contact Phone:	(602) 716-6249
Agency Contact Email:	jswim@azdor.gov

Hover for Instructions

I. Management Summary*

This project will capture data on page two of the individual income tax returns and data on AZ Form 301 (Nonrefundable Individual Tax Credits and Recapture). This information will be uploaded from e-filing and 2D barcode tax returns into the Tax Administration System (TAS). The individual income tax returns which are mailed to the ADOR would be keyed by Processing Administration staff. The project will require scanning all pages of the paper forms 140, 140A, 140NR, 140PY, 140X and related documents. It would also require the data entry screens to be revised to reflect the additional data being captured. Once the data is captured it will need to have a place in TAS to reside, therefore requiring additional fields and display screens to be added to the system. Also, current reports which are generated by TAS would need to be modified to include the additional data.

II. Project Investment Justification (PIJ) Type*

[ ] Yes [X] No Is this document being provided for a Pre-PIJ / Assessment phase?

Identify any cost to be incurred during the Assessment phase.	
Based on research done to date, provide a high-level estimate or range of development costs anticipated for the full PIJ.	$0

Explain:

[ ] Yes [X] No Will a Request for Proposal (RFP) be issued as part of the Pre-PIJ or PIJ?

III. Business Case

A. *Business Problem**

ADOR is required to provide statistical data to the Governor's Office and the Legislature detailing the approximate costs in lost revenue for all state tax expenditures. This information includes deductions, subtractions, exclusions, exemptions, allowances and credits. It also includes the impact of the reduction in long-term capital gains subject to income tax. Currently, page 2 information on an individual income tax return is not captured in TAS which stores this data. Since the data is not captured in TAS the process of developing audit leads for individual income tax audit and providing statistics for the department's annual report to the Governor's Office is a manual process.

Individual Income Tax has four basic audit programs. Program #1 is Match Merge, where differences between the Federal individual income tax return and the Arizona State individual income tax return are compared line-by-line. Staff manually look for differences in entries such as federal adjusted gross income (FAGI), filing status, tax credits, and so on. Once the comparisons have been completed the returns considered as audit leads are those with an added tax greater than $100. Program #2 is non-filers, where staff checks social security numbers (SSN) on Federal returns against social security numbers on Arizona returns. The staff also considers SSN transpositions, flip-flops (where the Federal SSN1 filed as Arizona SSN2 and Federal SSN2 filed as Arizona SSN1) and other SSN differences. Those leads where SSNs don't match are considered candidates for a non-filer audit. Program #3 is CP2000 audits. The Internal Revenue Service (IRS) will check for differences on filed returns, comparing what the taxpayer reports and what is reported on supporting documents such as W-2s, 1099s, 1098s, etc. If there is a difference, the IRS can perform a CP2000 audit. The department receives 6 CP2000 cycles for each tax year from the IRS and a summary 7th cycle at the end of the year. The department uses these reports to compare against the Arizona returns. Program #4 is RAR audits. These audits come from IRS closed examination case records but do not include appealed cases. These cases are sent to the department monthly and used to compare against the Arizona return in order to decide wether an audit is worth pursuing.

Capturing page 2 data from paper returns would help the department compare dependents on the Federal return vs. dependents on the Arizona return, exemption differences (over 65, blind, dependents, parents) as well as specific addition/subtraction differences.

In addition, information on AZ Form 301 is not captured in TAS. The Office of Economic Research & Analysis (OERA) researches individual income tax credits. Currently, OERA has to provide the department's warehouse with a list of 2D barcode and paper returns with credits to be pulled and copied. The warehouse copies the first page of the 140, 140NR, 140PY, both pages of the 301 and any other credit forms attached to the return. Then the data from the copies provided by the warehouse is keyed into credit tracking spreadsheets for analysis.

Capturing data from 301 would eliminate the manual process of updating the spreadsheet and having the warehouse copy this form. If all of the return was scanned OERA would be able to view the returns electronically thereby eliminating the need to have these forms pulled and copied by warehouse staff. It would also allow for a timelier turnaround time for analyzing credits on individual income tax returns.

*B. Proposed Business Solution**

The proposed solution is to continue to scan page one and two of the individual income tax returns and add the scanning of AZ Form 301 for paper returns using the current vendor. Scanning of the individual income tax returns means that the paper document is imaged so it can be displayed on a monitor for the data entry staff to be able to read and key the information into the data processing system; no data is electronically captured by the scanning process. In the future, the department intends to explore the possibility of enhancing this process to include an electronic data capture system. Referred to as optical character recognition (OCR) this converts scanned or photographed images of typewritten or printed text into machine-encoded/computer-readable text. For the current project, Processing Administration staff would key the information from the scanned documents for page 2 and AZ Form 301.

For 2D barcode and Me-Efile returns, data from page 2 and form 301 would be captured and uploaded into TAS. The data reported on the additional credit forms will be available through the vendor batch viewer. The other remaining data which is not uploaded to TAS but received by 2D barcode and Me-Efile returns will also be made available to OERA.

The IT Division would update the current input screens used by Processing Administration to key the data to be captured. In some instances new input screens may need to be developed. Also some new fields may need to be created in TAS to store the data. IT Staff would need to update and/or develop new screens for displaying the data. IT would also need to modify the current reports generated by TAS to include the additional information.

C. *Quantified Benefits**

- [X] Service enhancement
- [X] Increased revenue
- [X] Cost reduction
- [X] Problem avoidance
- [X] Risk avoidance

Explain: Benefits of capturing individual income tax data from page 2 and AZ Form 301 from the returns would be as follows:

The total benefit to the Audit and OERA teams for increased data capture is an estimated $2,273,414. The additional data will give Audit the ability to further refine the current Match Merge program and create possible new automated audit programs for areas currently being manually worked. The Audit and OERA benefits can be divided into two categories:

Decreased Costs

With additional data capture, Audit would generate cost savings associated with printing microfilmed copies of tax returns for the Match Merge, Revenue Agents' Reports (RAR), and Federal Income Adjustments (CP2000). If Individual Income tax return data was available in an electronic format, the microfilmed copies would not be required. Audit would be able to further refine the Match Merge program to account for each data element of the tax return. Currently for the paper filed returns, only totals from each section of the tax return are used in the Match Merge program. This required the printing of the microfilmed returns for the auditors to be able to review and process these audit leads. On average, over the two fiscal years (FY11 and FY12), 24,690 audits were processed that required the paper return to be printed from microfilm. This is using an estimated 40% paper filed returns for the three major audit programs (based upon tax year 2008 audits issued). With an average cost to print a microfilmed return at approximately $6.25, by not having to print returns, this works out to a cost savings of $154,313 per year. The OERA averaged 4,500 printed returns in tax year 2012. Eliminating the need to print those returns would result in cost savings of approximately $28,125 per year.

If all tax return data was available electronically, then the department as a whole could look at reducing the retention schedules for stored paper tax returns, microfilm and fiche records. This would ultimately result in additional savings to the department. For Individual Income Tax, the Records Management Center currently has over 26,000 boxes that cost the department an average of $2.50 per box per year or a total of $65,000 per year.

The total cost savings related to microfilming would be approximately $247,438 per year.

Increased Revenue

In addition to cost reduction, the true value of capturing more data for Audit is the ability to better produce leads. According to Audit data, the increase in revenue would be over $2.09 million. This is detailed as follows:

With more data, audit would achieve further refinements to the audit selection programs, increase audit leads created, and reduce auditors work resulting in no additional tax due. For the same two fiscal years (FY11 and FY12), an average of 63,978 audit leads were created. Of that number, 4,810 resulted in no additional tax due. This is approximately 7.5% of all audit leads. The remaining 59,168 audits generated collection revenue of $23,972,516 or $405.16 per audit. If the no change percentage could be reduced to 4% or 2,560 leads, this would result in an increase in assessments of 2,250 with associated additional revenue of $912,000.

In addition, refinements made to the Match Merge selection program could eliminate audit leads that are not worthy of review. For the same two fiscal years (FY11 and FY12), an average of 3,860 leads were created that required auditor review and which were subsequently determined to be not worth pursuing. Eliminating these bad audit leads would allow auditors' to use their time to pursue worthwhile audits. It is estimated that lost revenue associated with these leads would be the equivalent of one and one-half auditors' average production in a fiscal year. Based upon the average collections per auditor of $785,984, this works out to lost revenue of $1,178,976.

IV. Technology Approach

A. *Proposed Technology Solution**

The proposed technology solution is to scan the entire individual income tax return and have Processing Administration staff enter the "page two" and "AZ Form 301" information into TAS. This would require IT staff to develop and modify the current input screens for the individual income tax returns. This would also include the addition of various business rules to be identified and programmed into the logic of the data entry system. These rules would either not allow the return to process or make an adjustment to the return and generate a billing. IT staff would also need to develop and modify the display screens in TAS. ADOR would also need to purchase additional SAN storage in the amount of $20,688.12 with yearly maintenance fees of $8,472. See attached quote. Storage needs are based on a calculation of 40,000 additional documents to be scanned per year and stored for at least five years. The average document requires 400 kilobytes. The smallest increment of storage that can be purchased from the State's contracted vendor is 12 terabytes.

In addition to displaying data in TAS, the department would also need to modify the Me-Efile viewer to display images of the returns filed by 2D barcode and modify reports that are currently generated from this information.

B. Technology Environment

Currently, only page 1 and 2 of the individual income tax returns are scanned and only page 1 is entered by Processing Administration and displayed in TAS. AZ Form 301 is not keyed or displayed in TAS.

TAS is an Oracle based application and database located in the State data center that supports individual, withholding, transaction privilege and corporate tax types. TAS is used to process 5.6 million tax documents and facilitates the collection of $13+ billion in annual tax revenues. This is a very complex application with more than 320 modules of logic, which use over 6,000,000 lines of custom code built by Accenture. It is a web based application that is built with multiple layers of software. Oracle is the primary technology of the TAS application. The application uses supported versions of Oracle 11g database, Oracle 11g Forms, Oracle 11g Reports and Oracle WebLogic application server. This application integrates with the Agency's Remittance, Cashier, Modernized E-File, AZFSET and other applications.

C. Selection Process

The selection process was mandated by the ADOR's Strategic Plan and included an analysis of security risks. Our technology is currently based in Oracle and our primary tax application is a customized solution that is designed for securing taxpayer data.

Under Laws 2014, Chapter 18 HB2703 Sec. 123 – Automation Projects fund; fiscal year 2014-2015; appropriations, "B. The sum of $1,700,000 is appropriated to the department of administration from the automation projects fund established by section 41-714, Arizona Revised Statutes, in fiscal year 2014-2015 to increase the accuracy and timeliness of reporting income tax credits and to determine the impact of the reduction in long-term capital gains subject to income tax, as required by Laws 2012, chapter 343." In addition, A.R.S. § 42-1005 titled "Powers and duties of director" provides that "on or before November 15 of each year issue a written report to the governor and legislature detailing the approximate costs in lost revenue for all state tax expenditures in effect at the time of the report. For the purpose of this paragraph, "tax expenditure" means any tax provision in state law which exempts, in whole or in part, any persons, income goods, services or property from the impact of established taxes including deductions, subtractions, exclusions, exemptions, allowances and credits."(emphasis added).

As noted above, the legislature mandated through statute to automate the process and provide an analysis of capital gains and credits in the ADOR's Annual Report.

V. Project Approach

A. Project Schedule*

Project Start Date: 10/1/2014 **Project End Date:** 6/30/2015

B. Project Milestones

Major Milestones	Start Date	Finish Date
Business Requirements (use cases)	10/1/2014	10/31/2014
Initial Discovery	10/1/2014	10/31/2014

Project Charter	10/1/2014	10/31/2014
Technology Architecture	10/1/2014	10/31/2014
Software Development	10/1/2014	10/31/2014
Testing of Software	11/1/2014	11/30/2014
Training of staff	12/1/2014	12/31/2014
User Acceptance - Application	12/1/2014	12/31/2014
Deploy Software to Systems	12/31/2014	12/31/2014
Reporting	1/1/2015	6/30/2015
User Acceptance – Reporting	5/1/2015	5/31/2015
Release Project Resources	6/30/2015	6/30/2015
Project Closeout	6/15/2015	6/30/2015

VI. Roles and Responsibilities

A. *Project Roles and Responsibilities*

Role	Responsibilities
Business Owner and Sponsor Lynette Nowlan Assistant Director, ADOR Processing Administration Division	▪ Ultimate decision-maker and tie-breaker ▪ Provide project oversight and guidance ▪ Review/approve project elements ▪ Commits department resources ▪ Approves resource allocation strategies, and significant changes to resource allocation ▪ Resolves conflicts and issues ▪ Provides direction to the Analyst ▪ Review deliverables
ADOR Project Manager	▪ Manages projects in accordance to the appropriate methodology or framework ▪ Communicate and coordinate with IT Developers ▪ Manage the project progress of IT Developers ▪ Serves as SME to the sponsor(s) ▪ Receive direction and guidance from the sponsors ▪ Provides regular updates to sponsors ▪ Provide overall project direction ▪ Direct/lead team members toward project objectives ▪ Market projects to agency staff/units
ADOR Audit, Process Administration, Technology Divisions Subject Matter Experts	▪ Complete Assigned Tasks ▪ Lend expertise and guidance as needed ▪ Understand the user needs and business processes of their area ▪ Act as consumer advocate in representing their area ▪ Communicate project goals, status and progress throughout the project to personnel in their area ▪ Review and approve deliverables ▪ Provide knowledge and recommendations ▪ Helps identify and remove barriers

Role	Responsibilities
	▪ Assure quality of deliverables that will meet the project goals and objectives ▪ Identify risks and issues and help in resolutions ▪ Information Security
ADOR Information Technology Divisions	▪ Identify risks and issues and help in resolutions ▪ Equipment Acquisition ▪ Information Security ▪ Requirements Documentation ▪ Work with identified ADOR resources to complete required Hardware and/or Software installation and configuration ▪ Testing ▪ Training

B. *Project Manager Certification*

	Project Management Professional (PMP) Certified
X	State of Arizona Certified
	Project Management Certification not required

C. *Full-Time Employee (FTE) Project Hours*

Total Full-Time Employee Hours	7,500
Total Full-Time Employee Cost	$575,000

VII. Risk Matrix, Areas of Impact, Itemized List, PIJ Financials

Project Investment Justification.xlsx

3B

STATE OF ARIZONA

Joint Legislative Budget Committee

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 926-5491

FAX (602) 926-5416

http://www.azleg.gov/jlbc.htm

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Jon Stall, Senior Fiscal Analyst JS

SUBJECT: Department of Revenue - Review of Tax Data Analysis Expenditure Plan

Request

The FY 2015 General Appropriation Act (Laws 2014, Chapter 18) requires Committee review prior to any monies being expended from the Department of Revenue's (DOR) $100,000 appropriation for improving the agency's analysis of tax data.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review.

2. An unfavorable review.

Analysis

Background

Agenda item 3A includes a deposit of $1.7 million from the General Fund to the Automation Projects Fund for a project to improve DOR's accuracy and timeliness of reporting income tax expenditures. The $100,000 expenditure plan for this agenda item includes staffing for analyzing data that would result from automation improvements under agenda item 3A.

Current Proposal

The FY 2015 General Appropriation Act appropriated $100,000 of General Fund money to DOR to improve analysis of tax data in conjunction with automation improvements. Of the agency's $100,000 expenditure plan, $99,000 would fund 2 staff positions. Hired staff would work in DOR's Office of Economic Research and Analysis (OERA) located at the agency's main Phoenix office.

(Continued)

The added staff will assist the agency in preparing more frequent reports of credit use activity. Automation improvements will make it possible for new DOR staff to report annual tax credit use within several months of the end of a fiscal year. Information reported would represent the most recent actual use of credits.

RS/JS:kp

STATE OF ARIZONA

Department of Revenue

Janice K. Brewer
Governor

David Raber
Director

RECEIVED
NOV 12 2014
JOINT BUDGET COMMITTEE

November 12, 2014

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

Dear Mr. Stavneak,

Pursuant to Laws 2014, Chapter 18, Section 85, the Department of Revenue is submitting its Expenditure Plan for the $100,000 FY 2015 General Fund Appropriation for Capital Gains Tax Reduction Imaging.

The General Appropriations Act included $1.7 million in Automation Projects Fund money appropriated to the Department for two information technology projects. Included was $647,000 for system upgrades required to store and track data resulting from adding a second page to individual income tax return forms, and $1,059,000 to improve the Department's timeliness and accuracy in reporting tax credits.

The $100,000 ongoing General Fund Appropriation will be used to fund 2.0 FTE in the Office of Economic Research and Analysis, a subdivision of the Director's Office. These 2.0 FTE will primarily be responsible for processing, handling, and analyzing all data resulting from these system improvements. The cost breakdown of the $100,000 is as follows:

FTE	Title	Grade	Annual PS	Annual ERE	Annual Total
1.0	Economist I	18	$33,280	$13,312	$46,592
1.0	Economist II	20	$37,440	$14,976	$52,416
				Total - 2.0 FTE:	$99,008

The remaining $992 will be spent on required other operating expenses, or to increase the hiring salary(s).

I hope this information has been helpful. If you have any questions regarding this information, please contact Michael Moan at 602-716-6885.

Regards,

David Raber
Director

3C

STATE OF ARIZONA

Joint Legislative Budget Committee

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

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http://www.azleg.gov/jlbc.htm

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Jeremy Gunderson, Fiscal Analyst

SUBJECT: ADOA/DOR - Review of Electronic Tobacco Tax Filing System Project (Automation Projects Fund)

Request

Pursuant to A.R.S. § 41-714, the Arizona Department of Administration (ADOA) has requested that the Committee review $1.0 million in proposed FY 2015 expenditures from the Automation Projects Fund for an electronic tobacco tax licensing system at the Arizona Department of Revenue (DOR). The electronic licensing system would have a total cost of up to $1.4 million, consisting of $1.0 million from the Automation Projects Fund and up to $400,000 from the existing DOR operating budget.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review.

2. An unfavorable review.

The project has received relevant approval from the Information Technology Authorization Committee (ITAC) and the Arizona Strategic Enterprise Technology (ASET) staff. The JLBC Staff recommends that the Committee consider adopting the ITAC provision as part of its review:

A. Prior to moving any state data into the vendor provided solution, DOR must specify the selected solution's compliance with the Arizona Baseline Security Controls needed to provide a moderate level of protection for any Personally Identifiable Information data to be stored offsite. DOR and/or the vendor must explain any controls that cannot be met and if there are plans to address future compliance.

(Continued)

B. As a result of the procurement process, should the final costs exceed the estimated costs by 10% or more, or should there be significant changes to the proposed technology, scope of work or implementation schedule, DOR must amend the PIJ to reflect the changes and submit it to ADOA-ASET and ITAC, for review and approval prior to further expenditure of funds.

The JLBC Staff also recommends the following provision:

C. A favorable review by the Committee does not constitute endorsement of General Fund appropriations to fund any increase in DOR operating costs due to the new licensing system.

Analysis

Background

In 1998, 46 states, including Arizona, entered into a Master Settlement Agreement (MSA) with major tobacco companies stipulating that the participating tobacco companies would make annual payments to pay for some of the states' Medicaid costs as a result of tobacco use. Arizona has received over $1 billion since the inception of the MSA, and receives approximately $100 million annually. As a result of Proposition 204, these monies are dedicated entirely to the Arizona Health Care Cost Containment System (AHCCCS).

As part of the MSA, Arizona enacted A.R.S. § 44-7101, also referred to as the Escrow Statute. The Escrow Statute requires non-participating manufacturers (NPMs) (tobacco manufacturers not subject to the MSA) to put monies into an Escrow Account to negate any market advantage NPMs might gain as a result of not paying the annual MSA payment. NPMs must certify to the Attorney General that Escrow Statute payments are made. The MSA requires the state to enforce the Escrow Statute, ensuring that NPMs are paying their share into the Escrow account.

Current Proposal

ADOA is requesting a favorable review of $1.0 million in proposed FY 2015 expenditures from the Automation Projects Fund to purchase an electronic tobacco tax filing system from an outside vendor. Including an additional $400,000 from the DOR operating budget, the total project cost is estimated to be up to $1.4 million. DOR expects future operating costs to be $400,000 to $600,000 annually in terms of licensing fees and other expenses. The electronic filing system would begin operation in FY 2016.

The new tobacco tax filing system will ensure that Arizona is compliant with the MSA by creating an accurate and timely stream of tax data to ensure that payments are made as required by the Escrow Statute. Under the current system, Arizona is unable to perform many of the auditing functions that would show compliance with the MSA, putting Arizona at risk of a reduction to the annual payments.

After reviewing tobacco tax filing systems in other states, DOR developed a Request for Proposal (RFP) for a commercial off the shelf filing system provided by an outside vendor. DOR currently processes paper submissions of tobacco tax returns by manually entering information from a scanned image of the returns into a Microsoft Access database. The new system will allow tobacco distributors to perform the following functions online: file returns, complete license applications, order tobacco stamps, and make payments. It will also allow enable DOR to more easily perform various auditing functions.

Along with ensuring the continued $100.0 million annual MSA payment, DOR also expects to achieve savings in staff costs by eliminating its current manual process. In addition, DOR states that it also will be able to perform more audits on tobacco tax filers as a result of the reduction in hours spent by staff auditors manually inputting data into the previous system. These potential General Fund savings and added revenues have not been factored into DOR's $400,000 to $600,000 annual operating cost estimates.

RS/JG:kp

Janice K. Brewer
Governor

Kathy Peckardt
Interim Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007

(602) 542-1500

November 24, 2014

RECEIVED
NOV 25 2014
JOINT BUDGET COMMITTEE

The Honorable Don Shooter, Chairman
Joint Legislative Budget Committee
Arizona State Senate
1700 West Washington Street
Phoenix, AZ 85007

The Honorable John Kavanagh, Vice-Chairman
Joint Legislative Budget Committee
Arizona House of Representatives
1700 West Washington Street
Phoenix, AZ 85007

Dear Senator Shooter and Representative Kavanagh:

In accordance with Arizona Revised Statutes § 41-714, The Arizona Department of Administration (ADOA) is submitting this revised request for review of fiscal year 2014 and 2015 Automation Projects Fund projects. This request replaces our previous request dated November 12, 2014. Monies to support the expenditure plan have already been appropriated to the Automation Projects Fund.

The attached document contains a detailed explanation of each proposed project. We will be happy to meet with your staff to provide further explanation as appropriate.

Sincerely,

Kathy Peckardt

Kathy Peckardt
Interim Director

cc: Richard Stavneak, Director, JLBC
Andrew D. Smith, Fiscal Analyst, JLBC
Rebecca Perrera, Fiscal Analyst, JLBC
John Arnold, Director, OSPB
Will Palmisano, Fiscal Analyst, OSPB
Aaron Sandeen, Deputy Director and State CIO
Jeff Grant, Deputy Director
Paul Shannon, Assistant Director, ADOA
Clark Partridge, Comptroller, ADOA
Mike Smarik, Assistant Director, ADOA

Attachment

Janice K. Brewer
Governor

Kathy Peckardt
Interim Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007

(602) 542-1500

December 9, 2014

Mr. David Raber, Director
Arizona Department of Revenue
1600 West Monroe Street
Phoenix, Arizona 85007

Dear David:

The Information Technology Authorization Committee (ITAC) met December 9, 2014 to consider the ***"Electronic Tobacco Tax Filing System"*** project.

The ITAC voted in the affirmative for **Approval with Conditions** of this technology project as follows:

1. ADOR shall notify ADOA-ASET once procurement rules allow the release of additional information regarding the project, at which point ADOA-ASET will formally distribute the PIJ Summary to the ITAC, Joint Legislative Budget Committee, Office of Strategic Planning and Budgeting, and State Procurement Office.

2. Prior to moving any State data into the vendor provided solution, the ADOR must specify the selected solution's compliance with the Arizona Baseline Security Controls needed to provide a moderate level of protection for any Personally Identifiable Information (PII) data to be stored offsite. The ADOR and/or the vendor must explain any controls that cannot be met and if there are plans to address future compliance.

3. As a result of the procurement process, should the final costs exceed the estimated costs by 10% or more, or should there be significant changes to the proposed technology, scope of work or implementation schedule, the ADOR must amend the PIJ to reflect the changes and submit it to ADOA-ASET and the Information Technology Authorization Committee (ITAC), for review and approval prior to further expenditure of funds.

You may proceed to secure additional approvals as required from the Joint Legislative Budget Committee, the Office of Strategic Planning and Budgeting, and the State Procurement Office.

Best Wishes,

Aaron V. Sandeen
State CIO and Deputy Director
Arizona Strategic Enterprise Technology (ASET) Office

el

cc: Carole Martin, ADOR
Tom Johnson, ADOR
Janice Swim, ADOR
Fawn Medesha, ADOR
Monique Gregory, ADOR
Andrew Smith, JLBC
John Arnold, OSPB
Barbara Corella, ADOA-SPO
Phil Manfredi, ADOA-ASET
Robert Phelps, ADOA-ASET
Clark Lathrum, ADOA-ASET

ASET# RV15003

ADOA - ASET
Arizona Strategic Enterprise Technology

Project Investment Justification

Version 01.01

A Statewide Standard Document for Information Technology Projects

Project Title:

ELECTRONIC TOBACCO TAX FILING SYSTEM

Agency Name:	Department of Revenue
Date:	11/24/14
Agency Contact Name:	Janice Swim
Agency Contact Phone:	(602) 716-6249
Agency Contact Email:	jswim@azdor.gov

Hover for Instructions

I. Management Summary*

The Arizona Department of Revenue (ADOR) has a need to acquire and deploy tax processing and revenue accounting system for luxury tax that has the capability of processing tobacco tax returns, inventory tracking, issue billings, Preventing All Cigarette Trafficking (PACT) reports etc. The system is required by ARS §42-3053(B) and (C). The application would provide MSA tracking functionality and allow for electronic filing of tobacco returns and schedules. It would also have the ability to post and accept electronic transfers of funds related to the purchase of tobacco tax stamps.

II. Project Investment Justification (PIJ) Type*

☐ Yes ☒ No Is this document being provided for a Pre-PIJ / Assessment phase?

The funding needs for this project have been provided in FY15 budget for the Department of Revenue.

Identify any cost to be incurred during the Assessment phase.	
Based on research done to date, provide a high-level estimate or range of development costs anticipated for the full PIJ.	

Explain:
Click here to enter text.

☐ Yes ☒ No Will a Request for Proposal (RFP) be issued as part of the Pre-PIJ or PIJ?

III. Business Case

A. *Business Problem**

The State of Arizona, in a combined effort of the Arizona Department of Revenue (ADOR) and Arizona Attorney General's Office (AGO), is obligated to ensure that the provisions of the tobacco manufacturers' Master Settlement Agreement (MSA) are being adequately met in order to receive the annual $100 million payment from the Participating Manufacturers (PMs). Recent PM challenges against states, including Arizona, made claims of inadequate enforcement efforts which may have resulted in downward adjustments to this annual payment (PMs were the original and subsequent signatories to the MSA). On March 13, 2013 ("2013 Settlement"), an arbitration panel approved a settlement between the PMs and 19 States/Territories (including Arizona) to resolve a dispute concerning the 2003 Non-Participating Manufacturer (NPM) adjustment. Under the terms of the 2013 Settlement, the next year that will come under diligent enforcement scrutiny is 2015, when the escrow payment is due for calendar year 2014 tobacco sales.

In addition to the day-to-day responsibilities of administering and enforcing the luxury tax laws, pursuant to ADOR's interpretation of the MSA statutes (Exhibit A), ADOR is also required to perform the following duties:

- Design, receive, and process monthly reports from tobacco distributors that include specified NPM and Roll-Your-Own tobacco ("RYO") sales information;

- License tobacco distributors and suspend or revoke such licenses for violations of luxury tax laws, the MSA, and other state laws governing tobacco products;
- Process refund requests from licensed tobacco distributors for cigarettes that have been "delisted" from the AGO directory and thus not permitted for sale in Arizona;
- Seize and destroy contraband cigarettes and seize other tobacco products that are not compliant with MSA, tobacco enforcement, or luxury tax laws;
- Imposing civil penalties on distributors violating luxury tax or MSA provisions;
- Receive filings of annual certifications by tobacco product manufacturers;
- Publish and maintain a list of all tobacco distributors; and
- Receive MSA reports containing documentation of cigarettes and RYO product sales.

The terms of the 2013 Settlement requires ADOR to do more than what was originally required under the MSA. The Division's MSA-related obligations now include:

- Review monthly tobacco reports for accuracy and completeness;
- Conduct MSA compliance audits to support the integrity of NPM sales;
- Conduct nonresident distributor audits;
- Track all NPM sales including tribal sales, and determine the amount of taxes paid for, broken out by PM/NPM.
- Within the limits of federal law protecting tribal sovereignty, exercise diligent enforcement in tracking and enforcing tax laws and the MSA with on-reservation retailers; and
- Refer noncompliant NPMs to AGO for escrow enforcement.

Complicating the Division's ability to enforce both MSA requirements and tobacco tax enforcement, ADOR does not have an adequate return processing, billing and collection system in place for tobacco tax (the limited data we do collect is currently tracked on a Microsoft Access Database developed in the late 1990s. It was written in Access 1997 and has gone through numerous conversions which can compromise the integrity of the data. The database also fails to perform any of the following critical functions required of the ADOR for both effective MSA and luxury tax enforcement:

- track delinquent returns and missing returns;
- accounts receivables and accounts payable;
- identify incomplete returns, calculate interest and penalties, and issue billing notices license renewals;
- calculate accurate discounts for rebates/refunds;
- track any NPM data from the MSA-related schedules attached to the returns (Process Administration only keys page 1 data);
- suspend returns based on criteria and compare reported versus calculated discrepancies;
- track sales of NPM product on and off the reservations;
- track tobacco products, brands and manufacturers;
- track cigarette stamp inventory;
- track retail sales of tobacco products on and off the reservation;
- track daily deposits of distributor payments and reconcile the Luxury Tax Unit's monthly income statements;
- track non-compliant manufacturers; audit inventory, audit leads and inquiries;
- provide case management for an effective collection function;
- match manufacturer invoices and distributor invoices;

- track out-of-state export sales, and U.S. Government sales;
- track distributor-to-distributor sales;
- track federal PACT Act reports

ADOR collected over $300 million in tobacco taxes during FY2013, yet payments for the tobacco stamp purchases are not processed through the Tax Administration System (TAS) or any standalone processing system. Furthermore, the Division, which is also responsible for tobacco stamp inventory and revenue accounting, uses a manual inventory process to perform its required tracking of stamps from receipt at the loading docks to the point-of-sale. The tobacco stamp revenue accounting system is manual, labor intensive and contains several redundancies (to allow for the proper separation of duties) which create inefficiencies. Since these processes are manual, they are subject to human error, and take a greater amount of time and effort to ensure that inventory is properly controlled and tobacco tax revenues are collected, distributed, and accurately reported. The State is obligated under the MSA and 2013 Settlement to ensure that the integrity of the NPM sales data is not compromised or risk a downward adjustment in MSA monies received.

Of the additional duties ADOR is assuming after the 2013 Settlement, one that poses a significant challenge in light of the problems already identified is the requirement that the State track all on-reservation cigarette and RYO sales and diligently enforce laws governing such sales and tobacco products. The few Inter-Governmental Agreements that ADOR currently holds with tribes provides for extremely limited power to inspect the on-reservation businesses, provided that the agency obtains prior permission from the tribal authorities and conducts the inspections jointly with such authorities; to date, ADOR has not successfully obtained permission to exercise this authority. Given the steep downward adjustments PMs can make to their annual payments based on the State's failure to exercise diligent enforcement, the Department has initiated efforts to encourage tribal nations to enter into Inter-Governmental Agreements with the Department that will allow for improved monitoring.

This effort to close the distributor-to-retailer information gap and improve the quality of data submitted would allow the ADOR, and the AGO to demonstrate diligent enforcement to the PMs while avoiding any equal protection challenges from the regulated community by having the law be generally applicable (*i.e.*, not targeted to tribal retailers). Moreover, it allows the State to advance a unique solution to the problem faced by all state signatories to the 2013 Settlement—and, indeed, state signatories to the original MSA—in terms of enforcing state laws while respecting tribal sovereignty. Nevertheless, the effort will require an investment through additional resources to: (a) establish and implement a tobacco retailer licensing system; (b) process and review additional retail sales data filed through the new system; and (c) address any legal disputes, questions, or appeals regarding the new system.

*B. Proposed Business Solution**

The proposed solution is to acquire and deploy a Commercial off the Shelf (COTS) tobacco tax processing and revenue accounting system to eliminate the manual process and, more importantly, ensure the integrity of the NPM data and that the State's payments under the MSA cannot be reduced by the NPM adjustment.

The anticipated solution should include all required upgrades, security systems, data archiving, system back-up and recovery, resolving hardware/software communication issues, end of day backup, training for distributors, and 24X7 help desk support.

The Department established a committee to review proposals submitted in response to its Request for Proposal (RFP). The committee assessed the proposals and, where appropriate, submitted follow-up inquiries to the vendors. After considering numerous factors, the Department selected an approach to meet the needs of the Audit Division and the Attorney General Office for effective and efficient administration of the tobacco tax program.

The Department anticipates project success, primarily due to the expectation of acquiring and deploying a robust and highly configurable COTS application that will meet the Department's needs and requirements, as outlined in the RFP.

C. *Quantified Benefits**

- [X] Service enhancement
- [X] Increased revenue
- [X] Cost reduction
- [X] Problem avoidance
- [X] Risk avoidance

Explain: Benefits of an automated tobacco tax processing and revenue accounting system would be:

Improvement	**Description**
Compliance with MSA 2013	Auditors will be able to conduct the necessary reviews to comply with MSA 2013. -5 auditors
Continued receipt of MSA funds in the amount of $100 million annually	
Accelerated delivery of information	Information will be provided electronically – 1 mailroom clerk. Approx. salary savings would be $5,000 per year
Automate manual tasks	Mailroom clerk is required to open and separate mail related to tobacco tax. The returns are sent to Processing Administration and all other mail related to tobacco is sent to the Audit Division. Data entry operators input the returns in a database. One auditor reviews the data entry and makes all corrections as necessary. Another auditor reconciles and tracks all purchases of tobacco stamps. 1 mailroom clerk, 2-3 data entry operators and 2 auditors will result in salary savings of approximately $30,000 per year.
Increased productivity	Eliminate manual input and review of returns, no longer necessary to input stamp purchases in an Excel spreadsheet to reconcile. 2-3 data entry operators and 2 auditors will result in salary savings of approximately $30,000 per year.

Increased accuracy	Auditor from Audit Division would no longer have to review data entry input and make corrects to the current database. – 1 auditor
Increased audit review	All tobacco tax auditors – 5 auditors
Increased customer confidence	
Increased ability to respond to changes in taxpayers history	Data will be more readily available to query and review – 5 auditors
Improved employee satisfaction	Reduce the amount of redundant work. 5 auditors, 1 mailroom clerk and 2-3 data entry operators

The Audit Division predicts that this system will enable audit staff to conduct more audits related to Tobacco Tax by eliminating the current manual tasks associated with the filing of tobacco tax returns.

IV. Technology Approach

*A. Proposed Technology Solution**

The envisioned solution will have a vendor provide an on-line application which would impact the Department's website that allows tobacco distributors to file returns, complete license applications, order tobacco stamps and process payments via the use of credit cards on-line. The vendor would also provide an interface from the current cashier system (INOVAH) used by ADOR to post tobacco tax payments to the system.

In addition the vendor would be required to create a file that can be interfaced with State of Arizona's financial system to transfer financial data, such as deposits and the distribution of tobacco funds.

The application would also be accessible by the Attorney General's Office (AGO). AGO will be able to review the taxpayer's returns and create their own reports as necessary.

B. Technology Environment

Currently, tobacco tax returns and schedules are filed using paper forms which can be downloaded from the ADOR's website. The returns are scanned and a portion of the information provided on these forms is entered into an Access database which was created in 2001. Auditors in the Luxury Tax Unit review the returns and schedules submitted by the taxpayer. Copies of the scanned returns are forwarded to the AGO for review to ensure that escrow requirements are met.

The envisioned new system will interface with the Department's website and INOVAH cashier system to provide tobacco distributors the ability to file returns, complete license applications, order tobacco stamps and complete payments. In addition, taxpayers would be able to upload returns, and filings and to order tobacco stamps online.

The Department Anticipates an application based on an n-tier architecture, which would provide a mechanism for a clear separation of user interface control and data presentation from application logic.

C. Selection Process

The ADOR Audit staff contacted various states which provide electronic filing of tobacco tax returns and inquired as to whether or not these systems were purchases by a vendor or built in-house. Audit staff also, contacted the tobacco distributors and conducted a survey to determine which states had better electronic filing systems than other states. In addition, ADOR staff visited other states with electronic tobacco tax filing system to have a better understanding how this types of systems. Therefore, based on the research conducted it was decided to submit a Request for Proposal (RFP) to obtain an outside vendor to provide an electronic tobacco tax filing system. ADOR issued solicitation number ADSP014-00004252 and received and reviewed the various responses. After reviewing the proposals submitted in response to the RFP, the Department completed their evaluation and selected an approach that could be suitable for both the Audit Division and Attorney General's Office.

V. Project Approach

A. Project Schedule*

Project Start Date: 9/19/2014 **Project End Date:** 7/1/2015

B. Project Milestones

Major Milestones	Start Date	Finish Date
RFP Process	9/19/14	12/31/14
Technology Procurement	12/19/14	1/6/15
Project Preparation – Develop Business Profiles	1/6/15	1/17/15
Installation of Software	1/6/15	1/17/15
Base Configuration – Implementation Specifications	1/20/15	3/9/15
Development	3/9/15	5/5/15
Conversion of Data	2/6/15	5/20/15
Testing of Software	3/1/15	5/20/15
Training of staff	4/1/15	5/15/15
User Acceptance	5/30/15	6/30/15
Release Project Resources	6/30/15	7/1/15
Project Closeout	6/30/15	7/1/15

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE
SENATE

DON SHOOTER
CHAIRMAN 2014
OLIVIA CAJERO BEDFORD
GAIL GRIFFIN
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HOUSE OF
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JUSTIN OLSON
MICHELLE UGENTI

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Josh Hope, Fiscal Analyst JH

SUBJECT: JLBC Staff - Consider Approval of Index for School Facilities Board Construction Costs

Request

A.R.S. § 15-2041D.3c requires that the cost-per-square-foot factors used in the School Facilities Board (SFB) new school construction financing "shall be adjusted annually for construction market considerations based on an index identified or developed by the Joint Legislative Budget Committee (JLBC) as necessary but not less than once each year."

Recommendation

The Committee has at least the following 3 options:

1. Approve the SFB Staff request for a 4.6% adjustment in the cost-per-square-foot factors. This is based on the Arcadis 20 city nationwide average of $142.95 per square foot construction cost for K-6 elementary schools, which is 4.6% higher than SFB's current formula amount. This 4.6% adjustment would also be applied to grade levels 7-8 and 9-12.

2. Approve a 2.95% adjustment in the cost-per-square-foot factors, based on the most recent available 1-year change in the Rider Levett Bucknall (RLB) Phoenix construction cost index.

3. Approve a 0% adjustment in the cost-per-square-foot factors. The adjustment is based on longitudinal inflation data, by measuring the change in the RLB Phoenix construction cost index since the last JLBC cost-per-square-foot adjustment in November 2008. The Committee adopted this option last year.

(Continued)

Table 1 lists the cost-per-square-foot amounts for the three options.

Table 1

Cost-Per-Square-Foot Amounts for Each Option

	K-6	7-8	9-12
Option 1 - SFB Staff Request - Arcadis 20 City Average (4.6%)	$142.95	$150.91	$174.74
Option 2 - Phoenix Construction Cost Index's (1 Year Change, 2.95%)	$140.69	$148.53	$171.98
Option 3 - Longitudinal Phoenix Construction Index (Current Amount; 0%)	$136.66	$144.27	$167.05

Analysis

Background Information

The original Students FIRST legislation (Laws 1998, 5th Special Session, Chapter 1) established funding amounts per-square-foot of space for new construction (e.g., $90 per-square-foot for grades K-6). Current statute requires that SFB use the cost-per-square-foot in effect at the time a new construction project is approved, except that SFB may adjust the formula based on geographic or site conditions as defined in statute.

The Committee has used a variety of different indices to establish the per-square-foot amounts. In November 2008, the Committee approved a 1.98% adjustment in construction costs. Since that time, the Committee has approved a 0% adjustment in construction costs in each year. Statute requires that the Committee adjust the cost-per-square-foot amounts at least once per year. The last adjustment occurred 1 year ago at the December 2013 meeting.

Three Options

SFB Staff is requesting an increase in the new school construction cost per square foot factors by 4.6%. This option is based on the Arcadis 20 city average of $142.95 per square foot construction cost for a K-6 elementary school, which is 4.6% higher than SFB's current $136.66 per square foot formula amount for K-6 construction. The 20 city average is comprised of data from major metropolitan areas across the country. Increasing the school construction index by 4.6% for K-6 elementary schools would make the cost-per-square-foot factors equivalent to the nationwide average. This 4.6% adjustment would also be applied to school construction index for grade levels 7-8 and 9-12.

The second option is based on the most recent RLB measurement of the change in all construction costs in the Phoenix area for the past year, from July 2013 through July 2014, which would be an increase of 2.95%.

The third option is to set the inflation adjustment based on a longitudinal measurement of construction costs since the last time the Committee adopted an adjustment. As noted previously, JLBC approved a 1.98% adjustment in November 2008. Construction costs, however, subsequently declined during the recession and may have only partially recovered. Based on the most current RLB data, construction costs in the Phoenix area have decreased by (3.44)% since January 2009. This longitudinal approach was previously used by the Committee at the December 2013 meeting, with an adjustment of 0%.

(Continued)

Fiscal Impact
SFB Staff has recently estimated that 2 school districts may now qualify for new construction projects totaling $25.0 million, including land costs. SFB Staff's recommended cost per square foot factors increase would increase that cost by approximately $1.0 million. The second option would result in approximately $640,000 in additional costs. The third option would result in no increase. Any additional long-term costs would depend on future SFB new construction approvals.

RS/JH:kp

State of Arizona
School Facilities Board

Governor of Arizona Janice K. Brewer	Executive Director Dean T. Gray

November 17, 2014

The Honorable Don Shooter, Chairman
Joint Legislative Budget Committee
1716 West Adams
Phoenix, Arizona 85007

RECEIVED
NOV 17 2014
JOINT BUDGET COMMITTEE

And

The Honorable John Kavanagh, Chairman
Joint Legislative Budget Committee

Dear Senator Shooter and Representative Kavanagh:

A.R.S. §15-2041.D.3(c) states in part "...The cost per square foot shall be adjusted annually for construction market considerations based on an index identified or developed by the joint legislative budget committee as necessary but no less than once each year." To assist the JLBC, the School Facilities Board has prepared the following information.

The current new school construction cost index was established in 2008. Current market conditions, as noted below, would not provide sufficient funds to build a school to the Minimum School Facility Adequacy Guideline requirements.

For the past few years, the SFB has used analysis developed by the project management firm Arcadis (formerly known as PinnacleOne) and Rider Levett Bucknall or RLB (formerly Rider-Hunt), an international construction consulting group, in support of the annual requests for inflation adjustments.

The last Arcadis analysis shows an increase of 2.4% in K-6 construction costs, reflecting an average cost per square foot of $151.28 in the greater Phoenix area for the year ending December 2013 compared to December 2012. The Arcadis report shows a 1.98% increase to $142.95 per square foot from $140.18 using a 20 city average for the year ending December 2013 compared to December 2012.

The RLB analysis shows a current cost of between $140.00 and $200.00 per square foot for elementary school construction and between $170.00 and $240.00 per square foot for high school construction. (Please note that the RLB analysis accounts for only construction bid costs. Costs for design, permitting, furniture, etc. need to be added to the cost per square foot. These additional costs add approximately 20% to the construction cost). See attachments. Please also note that the current construction cost index for K-6 is $136.66 (established in 2008).

To become effective in FY 2016, the SFB is requesting the Joint Legislative Budget Committee increase the new school construction cost index by 4.6%. This requested increase is based on the

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Arcadis 20 city average of $142.95 per square foot construction cost for a K-6 elementary school and the SFB's current $136.66 per square foot formula amount for construction.

The current market conditions for construction materials have begun to stabilize and remain at or just slightly higher than the December 2013 request. The major difference in the market today is the availability of a qualified work force. Today, contractors are struggling to put enough "journeymen" type workers in the field. During the recession, when Arizona's new home construction was at a trickle, the construction workers either moved to areas where construction work was still available or changed occupations. Today, unfortunately, Arizona's construction industry, while growing, is still not attracting enough qualified workers. The lack of an available work force is keeping labor rates high.

Table One below shows the impact on the formula cost per square foot when the requested 4.6% increase is added to the current formula.

Table One

Grade Level	Current Amount	Adjusted Amount
K-6	$136.66	$142.95
7-8	$144.27	$150.91
9-12	$167.05	$174.74

The SFB believes that these amounts adequately reflect FY 2015 inflation and market conditions.

<u>Fiscal Impact</u>

The SFB assumes the fiscal impact in FY16, as a result of the requested 4.6% increase, will be approximately $681,000 (based on the potential to award three new schools). Staff is currently reviewing school district capital plans and estimate there will be between three andfive school districts that will be over capacity in FY16 and will need to be awarded additional square footage to meet their capacity need projections.

If you or your staff has any questions regarding this information and request, please contact me at 602-542-6143 or dgray@azsfb.gov.

Sincerely,

Dean T. Gray

Attachments//

cc: Scott Smith, Chief of Staff, Governor's Office
John Arnold, Director, OSPB
Michael Williams, OSPB
Josh Hope, JLBC staff

ARCADIS

Infrastructure · Water · Environment · Buildings

Phoenix Elementary School Building Cost ($) /SF from FY 1998 through 2013

Fiscal Year (FY) July -June	1 Inflation Rate of Increase/Decrease (Arcadis)	2 $/SF of K through 6 in Greater Phoenix	3 ENR 20 city average Rate of Increase	4 $/SF of K through 6 in 20 city average	5 Inflation Rate of Increase (Marshall Swift)	6 $/SF of K through 6 in Greater Phoenix	7 Inflation Rate of Increase (JLBC Adopted)	8 $/SF of K through 6 in Greater Phoenix	9 $/SF of K through 6 by Rider Hunt in Greater Phoenix	10 Rate of Increase
1998		$90.00		$90.00		$90.00	0.00%	$90.00	$90.00	
1999	1.92%	$91.73	1.92%	$91.73	0.00%	$90.00	3.10%	$92.79		
2000	2.40%	$93.93	2.40%	$93.93	3.10%	$92.79	5.00%	$97.43		
2001	0.99%	$94.86	0.99%	$94.86	5.00%	$97.43	0.60%	$98.01		
2002	1.37%	$96.16	1.37%	$96.16	0.60%	$98.01	0.00%	$98.01		
2003	1.93%	$98.01	1.96%	$98.04	4.80%	$102.72	4.20%	$102.13	$120.00	
2004	7.88%	$105.74	7.85%	$105.74	1.70%	$104.46	1.40%	$103.56	$120.00	0%
2005	5.55%	$111.60	5.55%	$111.60	8.70%	$113.55	12.85%	$116.87	$120.00	0%
2006	17.30%	$130.91	3.90%	$115.96	6.40%	$120.82	12.20%	$131.13	$150.00	25%
2007	2.66%	$134.39	2.68%	$119.06	3.00%	$124.45	2.20%	$134.01	$155.00	3%
2008	8.04%	$145.19	3.70%	$123.47	Not Available	Not Available			$160.00	5.39%
2009	2.18%	$148.36	4.99%	$129.63	Not Available	Not Available			$158.95	-0.65%
2010	-2.88%	$144.09	1.87%	$132.05	Not Available	Not Available			$154.34	-2.90%
2011	0.62%	$144.98	3.66%	$136.89	Not Available	Not Available			$157.24	1.88%
2012	1.89%	$147.73	2.40%	$140.18	Not Available	Not Available			$161.00	2.39%
2013	2.40%	$151.28	1.98%	$142.95					$165.64	2.88%

Notes:

1 Inflation rate per year was derived using the ENR formula for computing the BCI index, and adjusted to Phoenix market. For FY 2005-2006, the inflation rate was based on the Association of General Contractors Inflation report for the Phoenix market.

FY 2011-2012, All economic indicators rose for the fiscal year, unemployment rate in Phoenix area went down from 9.40% to 8.30% but still more than twice as much from the 2007 levels. Housing start went up indicating recovery in the residential construction industry. Non residential construction also went up by 9.00% .

Architectural billings rose but has been facing some headwinds on new facilities such as commercial and industrial facilities. Recovery has been slow and there is risk that economy will take a hit on expiring tax cuts.

FY 2012-2013, The unemployment rate continue to improve but on slower phase. It only gained 0.30 % for the last 3 quarters. Residential construction is rapidly growing and has been the busy sector especially in the multi housing area. Government construction spending has been slow nationally due to budget constraints. The value of construction starts has been going up since the start of the year.

2 The base construction cost for FY1998 is $90/sf and was used as a base for all indices shown.

3 Column 3 is the 20 City Average BCI Inflation Rate computed by ENR.

4 Column 9 & 10, Rider Hunt Inflation Index.

INDICATIVE CONSTRUCTION COSTS

The data in the chart below represents estimates of current building costs in each respective market. Costs may vary as a consequence of factors such as site conditions, climatic conditions, standards of specification, market conditions, etc. Values represent hard construction costs based on U.S. dollars per square foot of gross floor area.

LOCATION	OFFICES				RETAIL SHOPPING				HOTELS				HOSPITAL	
	PRIME		SECONDARY		CENTER		STRIP		5 STAR		3 STAR		GENERAL	
	LOW	HIGH	LOW	HIGH	LOW	HIGH	LOW	HIGH	LOW	HIGH	LOW	HIGH	LOW	HIGH
Boston	200	280	175	245	120	210	90	145	350	400	160	250	375	550
Chicago	230	380	120	180	115	210	80	130	250	450	120	210	310	580
Denver	140	225	100	150	80	130	65	125	185	280	105	165	335	385
Honolulu	250	460	210	345	160	430	150	375	445	645	280	470	410	660
Las Vegas	140	285	105	190	115	480	65	145	325	465	120	225	285	455
Los Angeles	180	290	120	195	110	240	80	140	250	400	170	245	375	525
New York	205	350	180	270	140	250	115	160	320	475	185	265	460	600
Phoenix	130	230	100	160	105	165	70	125	230	380	110	160	290	420
Portland	165	220	115	170	110	220	90	130	175	265	130	170	350	460
San Francisco	195	310	140	220	120	240	110	165	265	420	190	270	325	585
Seattle	165	205	115	160	115	200	95	135	185	275	140	180	320	435
Washington DC	175	240	130	185	95	190	75	135	230	375	150	260	350	500

LOCATION	INDUSTRIAL		PARKING				RESIDENTIAL				EDUCATION					
	WAREHOUSE		GROUND		BASEMENT		MULTI-FAMILY		SINGLE FAMILY		ELEMENTARY		HIGH SCHOOL		UNIVERSITY	
	LOW	HIGH	LOW	HIGH	LOW	HIGH	LOW	HIGH	LOW	HIGH	LOW	HIGH	LOW	HIGH	LOW	HIGH
Boston	70	100	60	90	80	110	135	220	165	325	220	300	240	350	275	400
Chicago	70	130	65	110	90	130	130	210	120	325	190	350	190	370	250	375
Denver	65	110	40	70	60	95	70	190	65	355	125	150	145	215	185	305
Honolulu	120	195	85	125	120	230	165	385	245	660	390	410	350	530	385	625
Las Vegas	50	100	50	65	60	150	70	400	90	350	180	315	200	455	235	455
Los Angeles	75	140	75	95	95	140	135	230	130	300	235	395	310	430	300	470
New York	90	130	65	105	85	125	140	250	175	350	190	340	220	375	275	400
Phoenix	55	100	40	65	60	100	80	185	100	350	150	200	170	240	210	375
Portland	75	130	70	90	90	130	110	195	110	260	220	275	230	290	260	390
San Francisco	80	140	75	100	95	145	145	250	145	320	295	400	310	460	325	480
Seattle	75	110	65	85	85	125	120	235	100	235	205	250	230	300	265	395
Washington DC	70	100	55	80	75	100	100	165	120	250	180	250	220	275	250	375

TORONTO-BASED CRSP COST CONSULTANTS JOINS RIDER LEVETT BUCKNALL

RLB | CRSP Cost Consultants

We are pleased to announce that, as of September 2, 2014, Toronto-based CRSP Cost Consultants has joined Rider Levett Bucknall. With roots dating back to 1969, CRSP Cost Consultants is a fully integrated, multi-disciplinary cost consultancy firm that is now doing business as RLB | CRSP Cost Consultants.

By joining together, we can now offer an expanded range of services and broader sector expertise to our clients across North America and worldwide.

For additional information on our service offerings, please visit www.rlb.com.

JOE PENDLEBURY PQS, MRICS
SENIOR VICE PRESIDENT

Joe Pendlebury is a Senior Vice President of Rider Levett Bucknall's North American practice and is responsible for leading the Toronto office.

Mr. Pendlebury is a Professional Quantity Surveyor with nearly 30 years of national and international project experience. He has extensive knowledge and expertise in all phases of the construction process and has worked on both public and private developments across a variety of sectors ranging from transportation, hospitality, cultural and higher education to healthcare, sports and energy.

Currently, Mr. Pendlebury is the treasurer of the Canadian Association of Consulting Quantity Surveyors and is a member and past president of

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STATE OF ARIZONA

Joint Legislative Budget Committee

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

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http://www.azleg.gov/jlbc.htm

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Steve Schimpp, Deputy Director SS

SUBJECT: Arizona Department of Education - Review of Transwestern Settlement

Request

Pursuant to A.R.S. § 15-915B, the Arizona Department of Education (ADE) requests a favorable review of its plan to provide 26 school districts in 7 counties with $2,953,900 in corrected Basic State Aid funding due to a recent settlement in the Arizona Tax Court regarding property taxes paid in prior years by the Transwestern Pipeline Company.

Recommendation

The JLBC Staff recommends that the Committee give a favorable review of the request, as it conforms to statutory requirements regarding state aid corrections required as a result of Arizona Tax Court rulings.

Analysis

Subject to review by the JLBC, A.R.S. § 15-915B requires the Superintendent of Public Instruction to reimburse school districts for K-12 "local share" taxes that they must refund to a taxpayer due to an Arizona Tax Court ruling that reduces the taxpayer's assessed property value for prior fiscal years. In this regard, the Arizona Tax Court ruled on June 9, 2014 that the Net Assessed Value (NAV) of property owned by the Transwestern Pipeline Company was set too high for Tax Years 2011 through 2014 and should be reduced retrospectively to levels prescribed by the court.

The ruling has the effect under A.R.S. § 15-915B of requiring the state to reimburse 26 school districts in 7 counties for K-12 Qualifying Tax Rate (QTR) and State Equalization Tax Rate (SETR) taxes that they must now refund to the Transwestern Pipeline Company for the affected tax years. Those taxes equal $2,953,900 for all years and school districts collectively *(see Attachment 1)*. Breakdowns by school district and county appear in *Attachments 1* and *2*.

The computed $2,953,900 refund total does not include settlement-related interest costs or monies to reimburse the affected school districts for taxes paid by the Transwestern Pipeline Company for items other than the QTR and SETR, such as for overrides and bond debt service, as those costs are not addressed in A.R.S. § 15-915B.

RS/SSc:kp

State of Arizona
Department of Education

RECEIVED
DEC 0 2 2014
JOINT BUDGET COMMITTEE

TO: Senator Don Shooter, Chairman
Joint Legislative Budget Committee

CC: Richard Stavneak, Director of Joint Legislative Budget Committee
Steve Schimpp, Analyst, Joint Legislative Budget Committee

FROM: Lyle Friesen, Deputy Associate Superintendent of School Finance

DATE: 11/26/2014

SUBJECT: Correction of State Aid (A.R.S. §15-915)

Settlement has been reached in the Transwestern Pipeline Lawsuit (TX2013-000241). Pursuant to A.R.S §15-915(B), a review of state aid adjustments by the JLBC is required.

> A.R.S. §15-915 B: *Subject to the review by the joint legislative budget committee, the superintendent of public instruction shall adjust state aid for a school district in the current year if the governing board of a school district requests the recalculation of state aid for a prior year due to a change in assessed valuation that occurred as the result of a judgment in accordance with section 42-16213.*

School Finance has received requests for correction of state aid from the governing boards of 38 of 39 school districts impacted by the lawsuit. The change in net assessed valuation, for the 38 school districts requesting correction to state aid totals $2,953,881 for fiscal years 2011 through 2014 (See attached District Summary and County Summary reports).

If you have any further questions, I may be reached at 602-542-8250 or by e-mail at Lyle.Friesen@azed.gov.

County Summary
Transwestern Pipeline Company LLC (TX2013-000241)
Basic State Aid Corrections Pursuant to A.R.S §15-915(B)
Fiscal years: 2011, 2012, 2013, 2014
Tax Year: 2010, 2011, 2012, 2013

County	2011	2012	2013	2014	Total
Apache	106,045	61,274	133,953	86,916	388,188
Coconino	161,343	75,982	149,520	96,416	483,261
Maricopa	212,378	48,590	107,983	70,083	439,035
Mohave	136,213	93,395	175,907	92,833	498,348
Navajo	96,117	57,508	123,884	80,270	357,779
Pinal	112,806	23,172	55,811	36,234	228,024
Yavapai	247,661	72,535	155,616	83,436	559,248
Total:	1,072,562	432,456	902,673	546,190	2,953,881

District Summary
Transwestern Pipeline Company LLC (TX2013-000241)
Basic State Aid Corrections Pursuant to A.R.S §15-915(B)
Fiscal Years: 2011, 2012, 2013, 2014
Tax Years: 2010, 2011, 2012, 2013

	Total Annual State Aid Correction:	1,072,562	432,456	902,673	546,190	
	Total State Aid Correction:					**2,953,881**
				Fiscal Year		
Name	County	2011	2012	2013	2014	Total
Ganado Unified School District	Apache	79,845	38,383	83,592	54,214	256,035
Window Rock Unified District	Apache	26,199	22,891	50,361	32,702	132,153
Coconino Association for Vocation Industry and Technology	Coconino	4,984	1,880	3,316	1,973	12,153
Flagstaff Unified District	Coconino	124,066	54,428	104,164	67,292	349,950
Maine Consolidated School District	Coconino	8,866	7,633	16,311	10,534	43,344
Williams Unified District	Coconino	23,427	12,041	25,729	16,617	77,814
Buckeye Elementary District	Maricopa	13,777	2,885	6,201	4,010	26,872
Buckeye Union High School District	Maricopa	58,525	12,254	28,761	19,170	118,710
Deer Valley Unified District	Maricopa	53,477	11,197	24,895	15,566	105,135
Dysart Unified District	Maricopa	24,671	5,166	11,098	7,181	48,116
Liberty Elementary District	Maricopa	15,644	3,276	7,438	5,105	31,462
Mobile Elementary District	Maricopa	-	3,184	6,840	4,426	14,449
Palo Verde Elementary District	Maricopa	4,447	931	2,000	1,294	8,673
Peoria Unified School District	Maricopa	24,447	5,119	10,997	7,116	47,678
West-MEC - Western Maricopa Education Center	Maricopa	3,602	910	1,871	1,114	7,497
Wickenburg Unified District	Maricopa	13,788	3,670	7,884	5,101	30,442
Colorado River Union High School District	Mohave	28,808	16,683	36,379	24,311	106,180
Kingman Unified School District	Mohave	32,216	33,904	73,741	24,632	164,493
Mohave Valley Elementary District	Mohave	28,808	16,683	36,379	24,311	106,180
Peach Springs Unified District	Mohave	44,502	25,173	27,538	18,430	115,643
Western Arizona Vocational District #50	Mohave	1,879	951	1,870	1,151	5,851
Holbrook Unified District	Navajo	58,476	34,827	75,408	48,969	217,680
Northeast Arizona Technological Institute of Vocational Education	Navajo	1,796	869	1,715	1,025	5,405
Northern Arizona Vocational Institute of Technology	Navajo	1,567	790	1,540	921	4,817
Winslow Unified District	Navajo	34,278	21,022	45,221	29,356	129,877
Casa Grande Elementary District	Pinal	19,932	4,105	8,834	5,736	38,607

District Summary
Transwestern Pipeline Company LLC (TX2013-000241)
Basic State Aid Corrections Pursuant to A.R.S §15-915(B)
Fiscal Years: 2011, 2012, 2013, 2014
Tax Years: 2010, 2011, 2012, 2013

Name	County	2011	2012	2013	2014	Total
Casa Grande Union High School District	Pinal	33,392	6,878	15,756	11,554	67,580
Central Arizona Valley Institute of Technology	Pinal	1,874	323	703	421	3,322
Coolidge Unified District	Pinal	24,393	5,024	12,983	7,020	49,421
Maricopa Unified School District	Pinal	19,755	4,069	10,612	5,685	40,121
Stanfield Elementary District	Pinal	13,460	2,772	6,922	5,819	28,974
Ash Fork Joint Unified District	Yavapai	32,749	18,405	42,575	27,070	120,799
Canon Elementary District	Yavapai	36,071	7,623	16,470	10,856	71,019
Chino Valley Unified District	Yavapai	51,001	10,778	23,295	15,349	100,423
Humboldt Unified District	Yavapai	48,153	10,176	21,987	14,492	94,808
Mayer Unified School District	Yavapai	46,469	9,820	21,479	13,985	91,754
Mountain Institute Joint Technology Education District	Yavapai	4,001	1,362	2,732	1,684	9,778
Seligman Unified District	Yavapai	29,216	14,372	27,078	-	70,667

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STATE OF ARIZONA

Joint Legislative Budget Committee

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DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Steve Schimpp, Deputy Director SS

SUBJECT: State Board of Education - Review Changes to Achievement Testing Program

Request

The State Board of Education (SBE) requests committee review of changes to the Achievement Testing program that will increase program costs, as required by a General Appropriation Act footnote.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review.

2. An unfavorable review.

Analysis

Background
A.R.S. § 15-741A2 requires the SBE to adopt and implement a K-12 Achievement Testing program to measure pupil achievement in state board adopted academic standards in reading, writing and mathematics. A related General Appropriation Act footnote requires the SBE to submit to the Committee for review the estimated fiscal impact of any changes to the Achievement Testing program that will increase program costs. On November 3, 2014 the SBE adopted a new statewide assessment that will cost more than the current Arizona Instrument to Measure Standards (AIMS). As a result, the SBE is seeking Committee review of the adopted testing program changes.

The new assessment is called "Arizona's Measurement of Educational Readiness to Inform Teaching" (AzMERIT). *Table 1* shows key differences between AzMERIT and AIMS:

(Continued)

Table 1

AIMS versus AzMERIT

	AIMS	AzMERIT
Subjects Tested	Writing, Reading and Math	English Language Arts & Math
Grades Tested	Grade 2 – High School	Grade 3 – High School
Type 1/	Norm & Criterion Referenced	Criterion Referenced 2/
Mode	Paper and Pencil	Computer or Paper & Pencil
Standards	"AIMS"	Arizona College and Career Ready
Graduation Exam	Yes	No 3/
End of course (high school)	No	Yes
AIMS Science	Yes	Yes
Cost	\$14.2 M (FY 14)	\$19.0 M (FY 15 Est)
Vendor	Pearson	American Institutes for Research

1/ Norm referenced tests measure student performance relative to that of other students in a norm group (such as all 6th Graders nationwide), whereas criterion referenced tests measure performance relative to established academic standards or other set criteria.

2/ AzMERIT is not technically "norm referenced," but still can compare the academic performance of Arizona students to that of students in other states because of the multi-state use of identical test questions. Laws 2013, Chapter 20 eliminated annual norm referenced testing in Arizona.

3/ 3rd graders must still pass reading exam to reach 4th Grade

Cost Breakdown for AzMERIT

A cost breakdown for the new contract appears in *Appendix A*. It assumes that 85,000 students in each elementary grade (Grades 3-8) and 77,000 students in each high school grade (Grades 9-11) will take AzMERIT in FY 2015, with 2% annual growth thereafter. It also assumes that 50% of students will take the more expensive paper based tests ("PBT") in FY 2015, but with a 7% annual increase in the proportion taking the less expensive computer based tests ("CBT") annually in subsequent years.

In "Year 1" (FY 2015), the contract cost is approximately \$21 per student for the CBT for both elementary and high school grades and \$31 per pupil for the PBT (again all grades). Per pupil costs are virtually unchanged (slightly lower) in "Years 2 & 3" of the contract (FY 2016 and FY 2017, respectively). Total estimated contract costs, however, are expected to decrease slightly in FY 2016 and FY 2017, as the proportion of students taking the less expensive CBT is assumed to increase from 50% in FY 2015 to 57% in FY 2016 and 64% in FY 2017. Contract costs will be higher than shown in *Appendix A* if greater than budgeted percentages of students take the PBT rather than CBT, and vice versa.

Appendix A also provides a cost breakdown by "major task area." This breakdown includes a total of \$7.9 million for test administration, \$4.6 million for test and item development, \$3.6 million for scoring, \$1.5 million for program management, \$1.0 million for psychometric services, and \$0.4 million for reporting.

Estimated Achievement Testing Costs Under AzMERIT

The new AzMERIT contract assumes that AzMERIT testing will cost approximately \$19.0 million, \$18.5 million and \$18.4 million in FY 2015, FY 2016 and FY 2017, respectively *(see Appendix A)*. This does not include non-AzMERIT costs related to achievement testing, such as for AIMS retests for high school students who still must pass AIMS in order to graduate (current juniors and seniors), an alternate exam for special needs students, statewide science exams for grades 4, 8 and high school, statewide Arizona English Language Learner Assessment (AZELLA) testing for English Learners, and related program staff and administration. When all costs are included (including costs currently funded through the English Learner Administration line item in ADE's budget), ADE currently estimates that Achievement Testing will cost approximately \$34.6 million in FY 2015 *(see Table 2)*.

(Continued)

Table 2

Estimated Achievement Testing Costs for FY 2015
($ in Millions)

Item	Estimated Cost
AzMERIT	$19.0 1/
AIMS Retests & Science Testing	4.5
AZELLA Testing	5.0
Alternative Special Needs Exams	1.8
Staff and Administration	4.3 2/
Grand Total Cost from All Sources	**$34.6**

1/ The AzMERIT contract assumes a $19.0 million cost. The actual cost will depend on the proportion of students taking computer versus paper and pencil tests, which is not yet known.
2/ Includes staff and administrative costs associated with AzMERIT, AIMS retests, AIMS science testing, and AZELLA testing, as well as total statewide English Language Learner (ELL) reclassification and monitoring costs for English Learner Administration.

Table 3 shows that an estimated $33.5 million in funding is expected to be available to cover the $34.6 million in costs shown in *Table 2*, which includes $8.8 million in federal funding (ADE's current estimate). This would result in a net $(1.1) million shortfall in Achievement Testing funding for FY 2015. ADE indicates that it has enough one-time carry forward monies from Proposition 301 to cover the estimated FY 2015 shortfall, so would not need supplemental funding in FY 2015 for AzMERIT testing.

Table 3

Estimated Achievement Testing Funding for FY 2015
($ in Millions)

Item	Estimated Funding
General Fund – Achievement Testing	$11.2
Proposition 301 – Achievement Testing	7.0 1/
General Fund – English Learner Administration	6.5
Federal Funds	8.8 2/
Grand Total Cost from All Sources	**$33.5**

1/ Current year appropriation. Prior year carry-forward monies also may be available.
2/ Includes $7.0 million in Title IV funding that is allocated between AzMERIT, AZELLA, AIMS (high school retests and science) and the administration associated with those assessments. Also includes $1.8 million of federal Individuals with Disabilities Education Act (IDEA) funding that is allocated for the alternative special needs assessment and associated staff and administration.

Spring 2015 Testing

Appendix B provides a detailed testing calendar for all statewide achievement testing (not just AzMERIT) for FY 2015. For AzMERIT, it shows that schools can administer CBTs any time between March 30 and May 8 (writing must be completed by April 24) and PBTs from April 13 - 24.

RS/SSc:kp

Arizona State Board of Education

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November 26, 2014

The Honorable Don Shooter
Chairman, Joint Legislative Budget Committee
1716 West Adams
Phoenix, Arizona 85007

Re: Achievement Testing Program

Dear Senator Shooter,

On November 3, 2014, the SBE fulfilled its statutory obligation under ARS § 15-741(A)(2) to adopt and implement a new statewide assessment to replace the AIMS reading, writing and mathematics tests. Pursuant to Laws 2014, Ch. 18, §24, the Arizona State Board of Education (SBE) is submitting, for your review, the estimated fiscal impact to the Achievement Testing Program.

Background

The SBE is responsible for prescribing the minimum course of study for public schools, adopting statewide academic standards, and selecting a statewide assessment to measure the Arizona academic standards. These SBE adopted measures are considered by governing boards and charter schools as they fulfill their local responsibility and exclusive authority under A.R.S. §§15-721 and 15-722 to prescribe curricula and textbooks, and adopt criteria for the promotion of students and any course of study or competency requirements greater than those required by the SBE.

Arizona's Instrument to Measure Standards (AIMS) was the State's achievement testing program for over a decade. AIMS assessments in English and mathematics were given to students in grades 3 through 8, and in grade 10 as the competency tests required for graduation from high school. Students in grade 3 are required to score better than "falls far below the 3rd grade level" on the reading portion of the statewide test in order to be promoted to grade 4 under Arizona's Move on When Reading law (A.R.S. §15-701A2a). AIMS Science is a separate assessment given in grades 4, 8, and high school.

Laws 2013, Ch. 20 included the repeal of statutes requiring a passing score on the high school AIMS be used as a high stakes high school graduation requirement, and requiring the administration of a nationally standardized norm referenced test.

High school students through the Class of 2016 are required to pass the AIMS math, reading and writing tests in order to graduate; and Arizona Department of Education (ADE) will make AIMS retests available through December 31, 2016 for students who do not pass all 3 AIMS subject tests. Beginning in 201 7, students will be able to graduate if they pass all required classes without having to also pass separate graduation tests. As was true under AIMS, non-high school students generally will not have to pass annual exams in order to be promoted to the next grade, except for grade 3 students subject to the Move On When Reading law.

AIMS high school retests required for high school graduation through 2016, alternative assessments for students with significant cognitive disabilities, and AIMS Science tests in grades 4, 8, are each under separate contract.

AzMERIT – Arizona's Measurement of Educational Readiness to Inform Teaching

Through the state procurement process, the SBE selected the American Institute of Research (AIR) to provide AzMERIT. The Arizona 3-8 assessment is a criterion referenced test in English language arts (ELA) and mathematics given to all students enrolled in the appropriate grade level each spring. Arizona high school ELA and mathematics assessments are end of course criterion referenced tests in the content areas to all students enrolled in those courses (fall, spring or summer).

AzMERIT will be overseen and controlled by Arizona, and will measure each child's mastery of the Arizona Standards. The new assessment will provide reliable and timely information to parents, teachers and policy makers to support Arizona schools as they help prepare our students for success in life, in career, and in college. The assessment will also provide meaningful comparisons to help us better understand how our students are performing relative to their peers across the country.

Fiscal Impact

In its final year (FY 2014), the AIMS contract cost the state $14,243,100. Based on the assumptions below, the estimated contract costs for AzMERIT are $18,999,271 (see Appendix A – the best and final cost proposal submitted by AIR). Increased costs for the new assessment as compared to AIMS are due in part to the heightened complexity in the items and responses and testing students at end of course in high school. Efficiencies will also be realized due to previous changes in the law and delivery of exams via computer.

Increased Complexity

In contrast to simpler AIMS items which utilized multiple choice/true or false responses, AzMERIT provides complex items requiring constructed responses, short answers as well as some multiple choice/true or false. These item types allow for a more in-depth understanding of how students are performing, creating opportunities for targeted intervention and support. This increased exam complexity is one factor which increases the costs of scoring the exams.

Increased Students

AIMS was administered in grades 3-8, and once in high school (in grade 10) on cumulative basis for ELA and mathematics. Additionally, the norm referenced test required through the spring of 2014 was imbedded in the AIMS tests and also administered in grade 2.

In high school, AzMERIT tests students at the end of six ELA and mathematics courses required for graduation – 9th, 10th and 11th grade ELA and Algebra 1, Geometry, and Algebra 2. Using estimates of 2014 high school enrollments, and appreciating that grade 2 students will no longer take the norm referenced test, it is estimated that an additional 72,000 students will participate in the testing program.

Computer Based Testing (CBT) vs. Paper Based Testing (PBT)

The exams must measure a student's mastery of the standards, not their computer literacy, and local education agencies will decide if they are ready to give, and their students are ready to take, AzMERIT on a computer. The final determination of the assessment format, CBT or PBT, to be administered at each school in spring 2015 is currently being determined by local school districts and charter schools.

Before the selection of the vendor, ADE estimated that 50% of all Arizona students would be administered the CBT in the spring 2015, and 33% of Arizona schools would to be able to be administer the CBT in the spring 2015. The Department and the Board are confident that the technology platform used to deliver AzMERIT will allow for easy school set-up, exceptional monitoring and security, greater access through a wide variety of supported hardware, and ultimately a faster statewide transition to CBT.

Efficiencies
AzMERIT provides a cost efficient mechanism to provide meaningful comparisons to other students across the country while negating the need for a separate norm referenced test. Additionally, removal of a high stakes graduation requirement will both help students more accurately understand if they are academically prepared for life and work after high school, while saving the costs associated with high stakes retesting requirements.

Finally, costs are also expected to decrease in future years as schools are able to transition to computer-based exams. As noted, the awarded contract estimates are based on assumptions regarding the number of schools who can administer CBT and PBT. The estimate will be refined by the end of 2014, as schools determine if they are technologically prepared to give the computer-based exam, which will impact the total cost to the state.

Both SBE and ADE staff are available to provide additional detail and answer any questions. Thank you for your timely consideration.

Sincerely,

Christine M. Thompson
Executive Director

Enclosure
C: John Huppenthal, Superintendent of Public Instruction
Representative John Kavanagh, Chairman
Richard Stavneak, Executive Director, JLBC
Steve Schimpp, Deputy Director, JLBC
John Arnold, Director, OSPB
Elizabeth Hansen, Analyst, OSPB
Dale Frost, Policy Advisor, Governor's Office
Stacey Morley, Director of Policy Development & Government Affairs, ADE

Offeror: American Institutes for Research

BEST AND FINAL OFFER COST PROPOSAL

COMPLETE THIS SHEET IF SUBMITTING A BID FOR ALL GRADES 3-8 AND HIGH SCHOOL EOC ASSESSMENTS

*****Any exceptions or deviations from this cost form may impact Offeror's susceptibility of award.*****

CBT and PBT in ELA/L and mathematics in Grades 3-8

AND

EOC CBT and PBT in ELA/L Grades 9, 10, and 11 & High School Algebra 1, Geometry, and Algebra 2

Total All Inclusive Cost Per Student and Total Cost

(Based on 85,000 students per grade in grades 3-8 completing ELA/L and mathematics assessments AND 77,000 students per grade in grades 9-11 completing one ELA/L and one mathematics assessments in Year 1; 2% annual growth in student population; and 7% annual increase in students administered CBT.)

Year 1			Year 2			Year 3		
AZ Students administered CBT/PBT	*Cost Per Student*	*Total Cost*	*AZ Students administered CBT/PBT*	*Cost Per Student*	*Total Cost*	*AZ Students administered CBT/PBT*	*Cost Per Student*	*Total Cost*
255,000 CBT Grades 3-8	20.30	5,176,500	**297,000 CBT** Grades 3-8	20.10	5,969,700	**339,600 CBT** Grades 3-8	20.10	6,825,960
255,000 PBT Grades 3-8	31.23	7,963,650	**223,200 PBT** Grades 3-8	30.53	6,814,296	**190,800 PBT** Grades 3-8	30.83	5,882,364
115,500 CBT HS EOC	19.90	2,298,450	**134,400 CBT** HS EOC	19.70	2,647,680	**153,600 CBT** HS EOC	19.70	3,025,920
115,500 PBT HS EOC	30.83	3,560,671	**101,100 PBT** HS EOC	30.15	3,047,670	**86,400 PBT** HS EOC	30.42	2,628,551
741,000 TOTAL CBT & PBT All grades	25.64	18,999,271	**755,700 TOTAL CBT & PBT** All grades	24.45	18,479,346	**770,400 TOTAL CBT & PBT** All grades	23.84	18,362,795

Notes:

- As specified, each annual administration for assessments in grades 9-11 includes a total of 77,000 students per grade level but the students may be distributed over multiple administration periods including the primary spring administration and summer and fall administrations to accommodate alternative schedules.
- The combination of ELA/L and mathematics assessments completed by individual students at a particular grade level will vary based on the courses in which they are enrolled.
- For purposes of this cost proposal, assume that each student in grades 9, 10, and 11 will complete one ELA/L and one mathematics EOC. In reality, some students may begin to take the EOC prior to grade 9 and complete the sequence of tests prior to grade 11.

Estimated All Inclusive Cost Per Student by Test for the 2014-2015 Administration to Reflect Anticipated Cost Differences Due to Format and Possible Design Differences

Test	*CBT*	*PBT*
ELA/L Grade 3	*11.38*	*18.31*
ELA/L Grade 4	*11.38*	*18.31*
ELA/L Grade 5	*11.38*	*18.31*
ELA/L Grade 6	*11.38*	*18.31*
ELA/L Grade 7	*11.38*	*18.31*
ELA/L Grade 8	*11.38*	*18.31*
ELA/L Grade 9	*11.18*	*18.11*
ELA/L Grade 10	*11.18*	*18.11*
ELA/L Grade 11	*11.18*	*18.11*
Mathematics Grade 3	*8.92*	*12.92*
Mathematics Grade 4	*8.92*	*12.92*
Mathematics Grade 5	*8.92*	*12.92*
Mathematics Grade 6	*8.92*	*12.92*
Mathematics Grade 7	*8.92*	*12.92*
Mathematics Grade 8	*8.92*	*12.92*
Algebra 1	*8.72*	*12.72*
Geometry	*8.72*	*12.72*
Algebra 2	*8.72*	*12.72*

Estimated Expenses by Major Task Areas

Evaluation of cost will be based on the total all inclusive cost per student and total cost as presented above. Itemize the following total estimated expenses by major task.

Task Area	*Year 1*	*Year 2*	*Year 3*
Program Management - C.8	1,460,740	1,410,190	1,220,136
PBT Test and Item Development - C.3	203,774	203,774	203,774
PBT Test Administration - C.4	3,840,819	3,649,062	3,344,497
PBT Test Scoring - C.5	2,192,760	2,033,684	1,709,606
CBT Test and Item Development - C.3	4,407,802	2,447,600	2,422,157
CBT Test Administration - C.4	4,044,382	4,303,323	4,737,323
CBT Test Scoring - C.5	1,418,650	2,019,072	2,497,962
Psychometric Services - C.6	1,001,789	1,228,385	828,385
Reporting - C.7	428,555	1,184,255	1,398,955
Support Services (administration and reporting) - C.4 and C.7	-	-	-

Detailed Assessment Testing Calendar for 2014-2015

Achievement Testing

AzMERIT

AzMERIT will be administered to students in Grades 3 through high school in English Language Arts and Mathematics at their grade level. Students taking high school level English Language Arts and Mathematics will take AzMERIT End-of-Course assessments that will test their proficiency in these subjects near the end of the course.

For both Computer-Based and Paper-Based testing:

- Day 1, Day 2, and Day 3 must be scheduled in order but do not have to be consecutive days.
- When two test sessions are scheduled on the same day, there must be a break between sessions.
- AzMERIT is untimed. The upper end of the suggested time for a testing session is the estimated time needed for at least 95% of students to complete the session. A test session must be completed by the end of the school day.

Spring 2015 Computer-Based Test Window – Grades 3-8 and High School End-of-Course

March 30 – May 8* (*Writing must be completed by April 24.)

- Day 1 (ELA Writing) must be scheduled no later than April 24 and must be completed by April 24.
- Last day of testing must be scheduled no later than May 6.
- All make up testing must be completed no later than May 8.
- Students in the same grade (gr 3 – 8) or taking the same EOC test within same school are **not** required to test on the same day.

Spring 2015 Paper-Based Test Window – Grades 3-8 and High School End-of-Course

April 13 – April 24

- Day 1 (ELA Writing) must be scheduled April 13 or April 14.
- Last day of testing must be scheduled no later than April 22.
- All make up testing must be completed no later than April 24.
- Students in the same grade (gr 3 – 8) or taking the same EOC test within same school **must** test on the same day.

Grade 3 – 8		
3 Testing Days	**Content Areas**	**Suggested Times**
Day 1	ELA – Writing	45-90 minutes
Day 2	ELA – Reading, Part 1 Mathematics, Part 1	45-75 minutes 60-85 minutes
Day 3	ELA – Reading, Part 2 Mathematics, Part 2	45-75 minutes 60-85 minutes

English Language Arts (ELA) - End-of-Course (EOC)		
2 or 3 Testing Days	**Content Areas**	**Suggested Times**
Day 1	ELA – Writing	45-90 minutes
Day 2	ELA – Reading, Part 1	45-75 minutes
Day 2 or Day 3	ELA – Reading, Part 2	45-75 minutes

Mathematics - End-of-Course (EOC)		
1 or 2 Testing Days	**Content Areas**	**Suggested Times**
Day 1	Mathematics, Part 1	50-85 minutes
Day 1 or Day 2	Mathematics, Part 2	45-75 minutes

DETAILED ASSESSMENT TESTING CALENDAR FOR 2014-2015

AIMS SCIENCE

AIMS Science will be administered to students in grades 4, 8, and HS.

Test Window	Level	Approximate Times	Participation Guidance
March 16 to April 24	Grades 4 and 8	2 hours	
	HS Grade 9 or Grade 10 Students may only test on AIMS HS Science once.	2 hours	Students in Grade 9 taking a life science course may test on AIMS HS Science. Students in Grade 10 test on AIMS HS Science unless they tested the previous year.

AIMS HS

AIMS HS tests must be administered on the exact dates shown in the tables below.

AIMS HS – Writing, Reading, Mathematics			
Test Dates	**Content Areas**	**Approximate Times**	**Participation Guidance**
Spring 2015			Students on track to graduate by December 31, 2016, are permitted to participate in the AIMS HS. Students who have an IEP or 504 plan participate in AIMS HS testing as determined by their IEP or 504 plan.
Monday, February 23	Writing	3 hours	
Tuesday, February 24	Reading	2 hours	
Wednesday, February 25	Mathematics	3-1/2 hours	

ALTERNATE ASSESSMENT

AIMS A SCIENCE

Test Window	Grades	Content Areas
February 15 – March 31	4, 8, and 10 only	Science

NCSC (NATIONAL CENTER AND STATE COLLABORATIVE)

Test Window	Grades	Content Areas
Approximately February – April specific dates to be TBD	3 – 8 and 11	ELA and Math

Detailed Assessment Testing Calendar for 2014-2015

English Language Proficiency Assessment

AZELLA

Placement Testing Window
2 weeks before the start of school through May 22

Reassessment Testing Window
February 9 – March 27

National Assessment

NAEP (National Assessment of Educational Progress)

Test Window	Grades	Content Areas	Grades	Scheduling Guidance
January 26 – March 6	4, 8, 12	Math, Reading, Science	4, 8, 12	At selected schools only.

International Assessment

TIMSS (Trends in International Mathematics and Science Survey)

Test Window	Content Areas	Grades	Scheduling Guidance
March 30 – May 29	Math, Science	4, 8, 12	At selected schools only.

7

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE
SENATE

DON SHOOTER
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HOUSE OF
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MICHELLE UGENTI

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Tom Ritland, Fiscal Analyst TR

SUBJECT: Department of Economic Security - Review of Transition Funding Expenditure Plan - Data Center

Request

Laws 2014, 2nd Special Session, Chapter 2 requires Committee review prior to any monies being expended from the Arizona Department of Administration's (ADOA) $25.0 million appropriation for the establishment of the Department of Child Safety (DCS) and the relocation of the Department of Economic Security (DES) Data Center. DES requests Committee review of $2.5 million for the next phase of the data center relocation.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review of the expenditure plan.

2. An unfavorable review of the expenditure plan.

Under either option, the JLBC Staff recommends the following provision:

A. DES is to notify the JLBC Staff prior to expending the $200,000 contingency.

The project has received relevant approvals from the Information Technology Authorization Committee (ITAC) and the Arizona Strategic Enterprise Technology (ASET) staff through the Project Investment Justification (PIJ) process. The JLBC Staff recommends that the Committee consider adopting the ITAC/ASET provision as part of its review:

(Continued)

A. Should final costs exceed the proposed costs by 10% or more, or should there be significant changes to the technology approach, scope of work, or schedule, DES must amend the PIJ to reflect the changes and submit an updated PIJ to ADOA-ASET, and to ITAC, for review and approval prior to further expenditure of funds.

Analysis

Background

The FY 2015 budget includes $25.0 million for one-time DCS transitional costs and costs associated with DES Data Center improvements. The $25.0 million appropriation does not have any specific dollar earmarks. In preparation for the May Special Session, however, the Executive suggested that $7.0 million of these monies may be directed toward DES Data Center relocation. The current Data Center is located on state property and has experienced flooding, power outages, leaks, asbestos, and failed air conditioning and fire suppression systems.

At its September 30, 2014 meeting, the Committee favorably reviewed a $500,000 expenditure plan for a planning phase of the data center relocation under the following provisions:

A. DES is to receive Information Technology Authorization Committee (ITAC) approval before spending any amount above the $500,000 planning monies.
B. DES is to submit more detailed information regarding the split between State and Federal funding for the Data Center relocation by October 31, 2014. The submission is to address how equipment purchase and leasing arrangements will affect federal financial participation.
C. The Committee's action does not constitute an endorsement of DES' full $7.0 million plan.

At its October 22, 2014 meeting, ITAC approved the next portion of the project to acquire the necessary hardware, software, and professional services to establish a new DES local area network infrastructure. The approval came with the standard provisions listed on page 1.

DES submitted the report detailing the split between State and Federal funding for the data center relocation. The split can be seen in *Attachment 1*, and shows that 11 different federal programs would contribute 21% of the cost of improvements; the state would contribute 79%. While the JLBC Staff finds the methodology for the Federal Fund allocation reasonable, it is pursuing with DES the possibility of leveraging more federal Long Term Care funding.

The report also addressed the question of whether leasing as opposed to purchasing equipment may increase federal participation. The report stated that the level of federal financial participation will be equivalent whether equipment is purchased or leased.

DES is nearing completion of the Planning Phase of the relocation, which cost $500,000. The Planning Phase assessed how all the Data Center systems, applications, and hardware connect to and utilize each other so the department can relocate and migrate all systems and applications with minimal risk.

DES is currently seeking approval for the second component of the relocation, the Implementation Phase, which is estimated to cost $2.3 million from the DCS transition appropriation and $600,000 from Federal Funds for a total cost of $2.9 million. DES is requesting review of $2.5 million instead of $2.3 million to account for any contingency expenditures. The department has secured rental space for the new Data Center location utilizing the ADOA statewide contract for new private data center space. DES will fund the ongoing cost of the lease with their operating budget rather than with the one-time DCS transition appropriation. The Implementation Phase will establish the network infrastructure in the new space, including routers, switches, firewalls, cabling, software, and services for installation and configuration. DES anticipates this phase to be completed by February 2015.

(Continued)

Future Costs
Once the new Data Center network is established, vendors will begin migrating all the department's applications, hardware, and systems incrementally to minimize the risk of a total shutdown. DES plans to rent a duplicate mainframe to test the transition of each system. DES estimates the application migration to take 6 months and require an additional $4.0 million from the DCS transition funding appropriation, but the department is not requesting Committee review of the $4.0 million at this time.

The total cost for the project is estimated to be $8.8 million. The split between state and federal spending is currently estimated to be $7.0 million and $1.8 million, respectively, based on their cost allocation report.

RS/TR:kp
Attachment

Attachment 1

Table 1								
			DES Data Center Federal Fund Allocation					
Fund Source	**Total Funds**		**Fed Applied**			**State Match Applied**		
Supplemental Nutrition Assistance Program	$ 1,476,000	17%	$ 693,000	8%	$	783,000	9%
AHCCCS Medical Assistance Only	1,122,000	13%	-	0%		1,122,000	13%
Title IV-E	825,000	9%	415,000	5%		410,000	5%
Title IV-D	830,000	9%	473,000	5%		357,000	4%
Unemployment Insurance Administration	578,000	7%	-	0%		578,000	7%
Long Term Care Capitation	1,078,000	12%	-	0%		1,078,000	12%
Temporary Assistance for Needy Families	1,191,000	14%	-	0%		1,191,000	14%
Social Services Block Grant Program	480,000	5%	-	0%		480,000	5%
Section 110	317,000	4%	249,000	3%		68,000	1%
Child Care Development Fund	90,000	1%	-	0%		90,000	1%
Other	813,000	9%	-	0%		813,000	9%
Total	**$ 8,800,000**		**$ 1,830,000**	**21%**	**$**	**6,970,000**	**79%**

DEPARTMENT OF ECONOMIC SECURITY
Your Partner For A Stronger Arizona

Janice K. Brewer
Governor

Clarence H. Carter
Director

NOV 26 2014

RECEIVED
NOV 26 2014
JOINT BUDGET COMMITTEE

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

Dear Mr. Stavneak:

The Department of Economic Security requests to be placed on the Joint Legislative Budget Committee's next agenda for review of expenditure plans for the DES Data Center Relocation as required in Laws 2014, Second Special Session, Chapter 2, Section 3:

> The sum of $25,000,000 is appropriated in fiscal year 2014 - 2015 from the state general fund to the Department of Administration for costs associated with the establishment of the Department of Child Safety and the relocation of the data center operated by the Department of Economic Security. Before any expenditure of this amount, the Department of Child Safety shall submit an expenditure plan for review by the Joint Legislative Budget Committee.

The Department plans to utilize this appropriation to relocate the data center through distinct phases. At its September 30, 2014 meeting, the Committee favorably reviewed the Department's request to expend $500,000 for the Planning Phase of the data center relocation. The Planning Phase for the network migration is nearing completion. In order to manage risk, the Department has also engaged Gartner Inc. to provide an independent verification and validation of the planned migration phases.

On October 22, 2014, The Department received an "Approval with Conditions" from the Information Technology Authorization Committee for the network migration phase of the project. As required by the Committee at its September meeting, the Department is now requesting approval to spend $2.5 million of the above appropriation to complete the Network Migration Phase which sets the stage for timely application migration and, ultimately, a successful data center move to the new state facility. Additional detail is provided below.

Network and Application Migration Phase:

Once the roadmap has been created, containing all the migration related tasks for each move event, a place to relocate must be established and its storage and network systems must be created in order to ensure minimal application downtime. Then, applications and servers are moved in bundles to maintain key dependencies. These moves are staggered to manage risk, and to focus troubleshooting in the event of unforeseen issues.

As in planning, implementation and migration will have the same distinct, but related components: network and application. The network must be in place before application migration can begin.

Network Migration (December 2014 to February 2015) -- The Arizona Department of Administration (ADOA) awarded the contract for data center space rental in September. Therefore, the Department is establishung a lease so that the state's networking vendor, AZNet, can begin implementing the networking migration plan. The cost of this lease will be funded by the Department's operating budget rather than the one-time appropriation above.

The project's next step is for AZNet to order the hardware, bandwidth, and services needed. For application migration to begin in February 2015, ordering and implementation lead-times require DES to issue a task order to AZNet in December 2014. DES anticipates a total cost of approximately $2.5 million.

Application Migration (March 2015 to TBD) – Once the new data center network is in place, the application migration vendors can begin sequentially migrating all of the Department's applications and systems. The final time frame for the application migration will be determined by the application migration plan but it is preliminarily anticipated to require twelve months as low risk applications will be moved and tested first to identify any problems. Once all low risk applications have been moved, the more complex applications will begin the process. The Department anticipates seeking approval to spend the remaining appropriation associated with this final phase of the data center relocation at a future Committee meeting.

If you have any questions, please contact Debra Peterson, Chief Financial Officer, at (602) 542-3786.

Sincerely,

for CHC

Clarence H. Carter
Director

CHC/dp
Enclosures (2)
cc: Members of the Joint Legislative Budget Committee
John Arnold, Director, Governor's Office of Strategic Planning and Budgeting

Janice K. Brewer
Governor

Brian C. McNeil
Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007

(602) 542-1500

October 20, 2014

Mr. Clarence H. Carter, Director
Arizona Department of Economic Security
1717 W. Jefferson
Phoenix, AZ 85007

Dear Clarence:

In response to the Project Investment Justification (PIJ) for the **"DES Data Center Relocation – Network Implementation"** project, my staff has reviewed your proposal to procure hardware and professional services to establish and connect the Department of Economic Security (DES) Data Center network to a new co-location multi-tenant data center facility.

The PIJ implies that funding is available from the Department of Child Safety (DCS) Transition – DES Data Center Relocation Fund in the amount of $2,304.8 thousand, and from various federal funds in the amount of $576.2 thousand, for a total five-year life cycle cost for the project of $2,881.0 thousand. Operational costs have not been included in the total costs for the project, as those are not expected to exceed current DES facilities and maintenance / support costs.

This is the Arizona Strategic Enterprise Technology Office's recommendation to the Information Technology Authorization Committee (ITAC) for **Approval with Conditions** of the technology project as follows:

1. Should final costs exceed the proposed costs by 10% or more, or should there be significant changes to the technology approach, scope of work, or implementation schedule, the Department of Economic Security (DES) must amend the PIJ to reflect the changes and submit it to ADOA-ASET, and to ITAC, for review and approval prior to further expenditure of funds.

The ITAC is scheduled to meet on October 22, 2014 to review this project. Should the ITAC approve the project, you may then proceed to secure additional approvals as required from the Joint Legislative Budget Committee, the Office of Strategic Planning and Budgeting, and the State Procurement Office.

Best Wishes,

Aaron V. Sandeen
State CIO and Deputy Director
Arizona Strategic Enterprise Technology (ASET) Office

jd

cc: Michael Dellner, DES
Kathleen Huse, DES
Kim Hartleroad, DES
John Peckert, DES
Andrew Smith, JLBC
John Arnold, OSPB
Barbara Corella, SPO
Phil Manfredi, ADOA-ASET
Chuck Revenew, ADOA-ASET
James Dean, ADOA-ASET

ASET# DE15003

Analyst: James Dean	**PIJ Summary - ASET**	Project Number: DE15003

Agency Name & Address	*Contact Information*
Arizona Department of Economic Security 1717 W. Jefferson Phoenix, AZ 85007	Kim Hartleroad 602-542-0592 KHartleroad@azdes.gov
Project and Investment Justification Name	*Date Submitted*
DES Data Center Relocation – Network Implementation	October 17, 2014

Project Overview

Problem Description

During the past few years, the Department of Economic Security (DES) data center has experienced a number of unexpected events related to facility failures that have caused disruption and complete outages of DES IT processing services. The DES data center has been impacted by three significant facility outages over the last 18 months, and the condition continues to deteriorate. These facility issues have included fire, flood, power outages, leaks, asbestos abatement, generator issues, and Halon deployments. The resultant outages have prevented DES field personnel from accessing application systems designed to provide services and benefits to the citizens of Arizona, and have impacted the productivity of approximately 10,000 DES employees.

Solution

The DES is proposing to procure the hardware and professional services needed to prepare for a planned relocation of the current DES data center to a new co-location data center site within the multi-tenant CenturyLink / IO facility. This project will establish a new DES local area network infrastructure, including the core switches, network connections and firewalls needed to support the handoff from the State AZNETII network, and to complete the build-out of the DES data center.

Major Deliverables and Outcomes

The DES will purchase new core switches supporting both the access layer and storage fabric that will be required for the eventual build-out of the new co-location facility. The proposed design is intended to ensure that all network paths are redundant, and that any dependencies on the existing DES data center can ultimately be removed.

Equipment to be purchased includes:

- Cisco Core/Top of Rack/Fiber Channel Switches
- Palo Alto Networks PA-5050 Firewalls
- F5 Big-IP Load Balancers and ancillary software
- Cisco Catalyst Switches for the DES Main Office
- BlueCat DNS/DHCP/IPAM Appliances and ancillary software

During the project, the DES will utilize professional services to establish network connectivity to the new co-location, multi-tenant data center. The proposed design will isolate DES network traffic by division through dedicated subnets, isolate the fiber channel storage network from the user network, and ensure that regulatory and statute requirements are met.

Benefits

The project will establish the network foundation required to support the planned move of the existing DES data center to the new co-location, multi-tenant site. Anticipated benefits from the eventual move of the data center include elimination of the infrastructure problems resulting from the age of the existing facility and associated service failures due to those conditions.

Project Management

The DES Division of Technology Services (DTS) will manage the overall project, and work with contracted resources to install and configure the new hardware. Staff training on the new environment will also be provided by the professional and outside services vendor.

Enterprise Architecture

Compliant

Summary of Proposed Costs

All Figures in Thousands ($000)						
Cost Description	*2015*	*2016*	*2017*	*2018*	*2019*	*Total*
Development Costs	2,465.2	0.0	0.0	0.0	0.0	2,465.2
Operational Costs	415.9	0.0	0.0	0.0	0.0	415.9
Total Project Costs	2,881.0	0.0	0.0	0.0	0.0	2,881.0

Recommendation: **Approval with Conditions**

1. Should final costs exceed the proposed costs by 10% or more, or should there be significant changes to the technology approach, scope of work, or implementation schedule, the Department of Economic Security (DES) must amend the PIJ to reflect the changes and submit it to ADOA-ASET, and to ITAC, for review and approval prior to further expenditure of funds.

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STATE OF ARIZONA

Joint Legislative Budget Committee

1716 WEST ADAMS
PHOENIX, ARIZONA 85007

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http://www.azleg.gov/jlbc.htm

DATE: December 10, 2014

TO: Senator Don Shooter, Chairman
Members, Joint Legislative Budget Committee

THRU: Richard Stavneak, Director RS

FROM: Jon Stall, Senior Fiscal Analyst

SUBJECT: AHCCCS/DHS/DES - Review of Revised Capitation Rate Changes

Request

Pursuant to footnotes in the FY 2015 General Appropriation Act, the Arizona Health Care Cost Containment System (AHCCCS), Department of Health Services (DHS) and Department of Economic Security (DES) are required to report capitation rate changes to the Committee for review prior to implementation. The agencies propose revisions to previously reviewed contract year (CYE) 2013 capitation rates. The proposed rate changes would reimburse Medicaid health insurers for costs of paying a federal health insurer fee in 2014.

Recommendation

The Committee has at least the following 2 options:

1. A favorable review.

2. An unfavorable review.

In the aggregate, the proposed rate changes are expected to save $(8.2) million from the General Fund compared to amounts included in the FY 2015 budget for health insurer fee costs. The AHCCCS adjustments are expected to save $(7.2) million while DHS adjustments would save $(1.4) million. Savings would be partially offset by a $0.4 million cost increase above the budgeted amount for DES' Developmentally Disabled (DD) program. This rate review excludes any impact to the FY 2015 budget from capitation rates previously reviewed at the JLBC meeting on September 30, 2014.

Analysis

The federal Affordable Care Act placed an $8 billion annual fee on the health insurance industry nationwide in 2014. The fee grows to $14.3 billion in 2018 and is indexed to inflation thereafter. The fee is allocated to qualifying health insurers, including most of the state's Medicaid health insurers, based on their respective market share of premium revenue in the previous year.

(Continued)

Insurers were required to pay the 2014 fee to the Internal Revenue Service by September 30, 2014. Of the 1,109,000 Medicaid capitation enrollees in September 2013, about 724,000 (65%) were covered by a health insurer subject to the fee.

The federal Centers for Medicare and Medicaid Services (CMS) require that Medicaid capitation rates reimburse insurers for all costs of doing business, including costs from fees or taxes paid as a result of insuring Medicaid enrollees. In order to reimburse Medicaid health insurers for the fee paid for 2014, the agencies plan to use CMS' approved methodology of retroactively increasing capitation rates for the final month of CYE 2013 (September 1 to September 30, 2013), paid in December 2014. While the fee started in 2014, it is based on 2013 market share data. As a result, the fee can be applied against the 2013 capitation rate.

Capitation rates have not previously included costs of the health insurer fee as CMS had yet to approve an actuarially sound method for this calculation. Estimates of the fee cost were separately included in the FY 2015 budget and represented 1.24% of estimated capitation and reinsurance costs.

The table below compares the General Fund amounts included in the FY 2015 budget for the health insurer fee to costs associated with the proposed capitation rate revision. The General Fund impact of capitation rate revisions to fund the first year of the health insurer fee is $(8.2) million less than included in the FY 2015 budget.

Table 1

Health Insurer Fee Capitation Rate Revisions
General Fund Impact 1/
($ in millions)

Populations	FY 2015 Budget	Rate Revision	Difference
AHCCCS Acute Care	$ 13.1	$ 7.8	$ (5.3)
ALTCS Elderly & Physically Disabled	$ 2.0	$ 0.1	$ (1.9)
DHS Behavioral Health Services	$ 5.1	$ 3.7	$ (1.4)
DES Developmentally Disabled 2/	$ -	$ 0.4	$ 0.4
Total	**$ 20.2**	**$ 12.0**	**$ (8.2)**

1/ State match expenditures for the health insurer fee are also funded through a hospital assessment and county contributions.

2/ The FY 2015 budget allocated all health insurer fee costs to AHCCCS and DHS. The revised rates, however, include amounts to reimburse fees paid by DD health insurers for acute care costs.

RS/JS:kp
Attachment

AHCCCS
Arizona Health Care Cost Containment System

Janice K. Brewer, Governor
Thomas J. Betlach, Director

November 25, 2014

The Honorable Don Shooter
Arizona State Senate
1700 W. Washington
Phoenix, AZ 85007

Dear Senator Shooter:

AHCCCS is amending prior year capitation rates in order to include the costs of the Affordable Care Act (ACA) Health Insurer Fee mandate impacting nearly all insurers, including the majority of the AHCCCS contracted Managed Care Organizations (MCOs). However, please note that it is not the Contract Year Ending (CYE) 2015 (October 1, 2014, through September 30, 2015) approved rates that are being amended. (Those rates were approved by the Joint Legislative Budget Committee on September 30, 2014.) Rather, AHCCCS is amending capitation rates from calendar year 2013, using a methodology approved by the Centers for Medicare and Medicaid Services (CMS).

Background

The Affordable Care Act (ACA) imposes a new tax on most health insurers beginning in calendar year 2014. In the first year the Health Insurer Fee is expected to generate $8 billion in payments, and the fee increases to total payments of $14.3 billion by 2018. The tax is imposed on commercial, Medicare and Medicaid insurers with certain exemptions. Those exclusions impacting AHCCCS include:

- Government entities, including independent nonprofit county-organized health system entities that contract with state Medicaid agencies; and
- Nonprofit entities that receive more than 80% of gross revenue from government programs that target low-income, elderly, or disabled populations including Medicare, Medicaid, Children's Health Insurance Plan (CHIP), and dual eligible (Medicare/Medicaid) plans

The 2014 health insurer fee was due by MCOs to the IRS on September 30, 2014. Subsequent years' payments will be due on the same schedule.

Capitation rates must be actuarially-sound pursuant to 42 CFR §438.6. That is, they must cover the projected costs of the membership, including the costs of doing business such as administrative expenses, and fees and taxes. As such, AHCCCS is amending capitation rates to include the costs of the health insurer fee. Additionally, MCOs will pay federal and state income taxes on this new revenue in the spring of 2015, and in the spring following subsequent years' fee payments. AHCCCS intends to amend these capitation rates again when the tax liability for each MCO is known.

Honorable Don Shooter
November 25, 2014
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Capitation Rate Adjustments

The total cost of the health insurer fee, including Arizona premium tax but before federal and state income tax, is approximately $42.3 million ($14.4 million State Match and $27.9 million Federal Funds). Since this tax covers Calendar Year 2014, half of this payment will be eligible for administrative adjustment back to the FY 2014 appropriation. Capitation rate adjustments were developed separately for each MCO based on the MCO's fee liability allocation to each program in which they hold a contract. These rates have been submitted to CMS for approval; the Actuarial Certifications are attached. Federal and state income taxes are estimated to cost an additional $28 million total fund. These estimates are also included in this Actuarial Certification although the adjustments won't be made until the spring of 2015, and will necessitate an updated approval from CMS.

Capitation rates are amended for each of the following AHCCCS programs:

Program	Rates Amended	Contract Year Impacted	TF Fiscal Impact	SM Fiscal Impact	Fed Fiscal Impact	% Impact
Acute Care	September 1 – 30, 2013*	CYE 2013*	$27.8 million	$9.4 million	$18.3 million	0.88%
Children's Rehabilitative Services (CRS)	October 1 – 31, 2014	CYE 2014	$2 million	$700,000	$1.3 million	1.01%
Arizona Department of Health Services (ADHS)/Behavioral Health Services (BHS)	September 1 – 30, 2013	CYE 2013	$11 million	$3.75 million	$7.25 million	1.02%
Arizona Long Term Care System (ALTCS) Division of Developmental Disabilities (DDD)	September 1 – 30, 2013	CYE 2013	$1.15 million	$390,000	$760,000	0.12%
ALTCS Elderly & Physically Disabled (EPD)	September 1 – 30, 2013	CYE 2013	$400,000	$140,000	$260,000	0.04%

* Health Net Access did not have a contract with AHCCCS in September 2013 thus for this Acute Care Contractor only the CYE 2014 contract was amended

Should you have any questions on these adjustments, or wish to place AHCCCS on the December 17, 2014 Joint Legislative Budget Committee (JLBC) meeting agenda, please feel free to contact Shelli Silver, Assistant Director, at shelli.silver@azahcccs.gov or (602) 417-4647.

Sincerely,

Thomas J. Betlach
Director

cc: The Honorable John Kavanagh, Arizona House of Representatives
Richard Stavneak, Joint Legislative Budget Committee
John Arnold, Governor's Office of Strategic Planning & Budgeting