

STATE OF ARIZONA

**Joint Legislative Budget Committee**

STATE  
SENATE

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HOUSE OF  
REPRESENTATIVES

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

**MINUTES OF THE MEETING**

**JOINT LEGISLATIVE BUDGET COMMITTEE**

March 28, 2006

The Chairman called the meeting to order at 8:07 a.m., Tuesday, March 28, 2006, in Senate Appropriations Room 109. The following were present:

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

Absent:             Representative Huffman                      Senator Bee  
                         Representative Lopez

**APPROVAL OF MINUTES**

Hearing no objections from the members of the Committee to the minutes of February 28, 2006, Senator Burns stated the minutes would stand as presented.

**ARIZONA DEPARTMENT OF CORRECTIONS – Consider Approval and/or Review of Transfer of Appropriations.**

Mr. Lorenzo Martinez, JLBC Staff, explained a request by the Arizona Department of Corrections (ADC) to transfer \$16 million from the Private Prison Per Diem line item into the All Other Operating Expenditures line item to fund increased health care costs. The Committee has at least the following 3 options:

- Provide the transfer of \$16 million as requested by the department, however that would leave no funding in that Line Item to pay for private prison contracts beginning in April and through the end of the fiscal year.
- Pro rate the \$16 million transfer among 3 line items-Private Prison Line Item, Personal Services and Employee Related Expenditures. This option would require Committee approval as opposed to review because of the department's current budget structure.
- Transfer what is available in the Private Prison Line Item. Although the memo indicates \$4 million is available, the department has stated only \$3 million is available.

Senator Garcia asked if the shortfall is \$16 million or will it be closer to \$10 million.

Mr. Martinez stated that the JLBC Staff believes there is a shortfall in the Other Operating amount of approximately \$9.2 million. We have had discussions with the department for the last month to show them our analysis. They have responded

with additional information and those discussions are continuing. The department has requested a total supplemental for FY 2006 of almost \$27 million.

Senator Burns understood that transferring \$16 million out of the Private Prison line would deplete that line and the department would be short of funding after April. He asked why that would be a proposal.

Ms. Dora Schriro, Director, Arizona Department of Corrections, responded that because they are going to be short in all areas before the end of the year, they looked for an account which had sufficient funds to transfer. They looked to propose the fewest number of transfers possible so as to continue to track the money carefully. As she testified last month, they are going to be completely out of money early in May, so they are continuing to encourage conversations about the supplemental. She explained that the April billings do not arrive until May and, by then, they hoped there would be a supplemental, otherwise they would be having trouble in all categories, not only the Private Prison category.

Senator Burns pointed out that if you are going to be short in these other categories, why wouldn't we be talking more about a supplemental relative to the areas where you are short as opposed to transferring money out of one line and creating a shortage in another line.

Ms. Schriro explained that the areas where they have identified as shortages, was the underfunding of inmate healthcare and the utilization of overtime spending shortages. They identified the shortages to the budget in the past and also in letters as early as July 21.

Representative Pearce stated that does not change the shortfall. All you are doing is shifting where that shortfall is going to be. He asked why this line item was chosen and was there any thought given about other places to shift money.

Ms. Schriro stated that when she made the proposal to JLBC it was because it was the one category that had sufficient monies at this point and because the nature of the billing would not need to draw monies beyond those which would be left until May when the April billings came due.

Representative Pearce stated that one of the problems we have is the tracking of the department's health care expenditures. He asked if it would more helpful to have a more detailed budget structure that includes line items for health care, so the Committee could be more aware of potential shortfalls.

Ms. Schriro said it would be useful to better delineate all of the costs associated with health care, on the other hand, an individual line item might necessitate more meetings such as this, if it is not adequately funded.

Senator Harper supported transferring the \$3 million that is not encumbered and that we need to think seriously about a supplemental appropriation. He explained that he toured the Lewis Prison and believes the department is understaffed and overpopulated with inmates. He believes we need to think seriously about expanding our prisons before our 3 strikes referendum goes into law. He also stated that he disagreed with the study that came out from MAXIMUS or was guided by MAXIMUS, that the private prisons were more expensive. We need to do something right now to ease overcrowding in our prisons and make sure that we retain our Corrections Officers.

Representative Pearce stated that the department has had the ability to solve most of those problems and has refused to go forward. Public safety is a number 1 issue and we need to make sure our prisons are staffed properly, and make sure our folks are paid properly.

Mr. Tully asked if Director Schriro had any opinion regarding the 3 options provided by the JLBC Staff.

Ms. Schriro stated their recommendation would be as they suggested in the letter, that they need the \$16 million from the Private Prison line because it is a line that has adequate money to meet bills for the immediate future. You can move comparable amounts of money from many more lines, but she thinks that it simply makes it more difficult to trace. To move less money is going to result in the need for additional action by this Committee.

Representative Tully asked what the difference is between shifting the same amount of money from 3 different accounts as opposed to 1 if it is the same amount of money.

Ms. Schriro stated that they are not all quite the same amount of money, option 3 is less. The difference is in option 2, which recommends taking a considerable amount of money from Personal Services. They continue to draw down on Personal Services to pay their officers and to continue to cover those posts. This an absolutely critical funding source that they need to have uninterrupted.

Representative Tully asked how fast the department anticipates running out of money in Personal Services if we transferred the \$10 million as in recommendation option 2.

Ms. Schriro answered that she did not know and would have to get that information.

Senator Burns believed in the past Ms. Schriro has stated that she does not necessarily consider private prisons as a viable option to addressing our prison situation. He asked if that was correct.

Ms. Schriro stated that, except as a last resort, privatizing incarceration is ill-advised as a policy matter because punishment is a core governmental function and she believes that the state has operated its facilities more efficiently than the private prisons.

Senator Burns indicated that if we were to short the Private Prison line he thinks that the effort to get that line restored might be a little less energetic than the effort to get the actual restoring of the Medical lines that are the real shortage.

Senator Burns expressed his concern with getting information out of the agency, as well as how we address this issue. He believed it would be better addressing the shortages where the shortages are and not shifting money out of some line that might be a little bit difficult to get restored.

Senator Cannell stated that it seems the base problem is that we are underfunding the ADC and supported giving the department a supplemental.

Discussion ensued on the issue of private prisons and the MAXIMUS report.

*Representative Boone moved, to transfer \$3 million from the Private Prison line and that we address the health care shortage issue on its own.*

Senator Arzberger asked if the health care issue would be addressed today.

Senator Burns stated that we are not prepared to address it today. We need to have some analysis from JLBC Staff and it will be addressed later.

The motion carried.

### **ARIZONA DEPARTMENT OF CORRECTIONS – Report on Public-Private Bed Cost Comparison.**

Mr. Martinez stated that this item is a report on a recent public-private cost comparison that was conducted by ADC. The department contracted with a consulting firm (MAXIMUS) to evaluate the methodology the department uses for its statutorily-required public-private bed cost comparisons. MAXIMUS observed that the current methodology does not enable the accurate comparison of department costs to private costs. As a result, MAXIMUS recommended some adjustments to the department's methodology to create a more accurate comparison.

The department applied some of the adjustments and came up with their estimate that the average daily per capita private bed costs was approximately \$5.60 higher than the public beds. This preliminary analysis was for level 2 beds. MAXIMUS reviewed the department's cost comparison and stated it reasonably presents the difference between public and private costs. However they also noted that additional adjustments were still necessary and these adjustments were related to items such as asset depreciation, as well as other-state agency support, such as Department of Administration, and similar types of other adjustments. MAXIMUS did a cursory review of these additional adjustments and estimated that it would impact the \$5.60 gap by less than \$2.

Another item noted by MAXIMUS was that part of the adjustments need to reflect capital costs. While asset depreciation was taken into account on the state side, it is not clear that the full capital costs associated with the private per diem costs is fully accounted for. Finally, MAXIMUS also suggested that the department release a detailed explanation of their methodology. JLBC Staff does not believe it can do an in-depth analysis of these comparisons until that detail is available.

Senator Cannell asked if he was correct that this compared level 2 beds only.

Mr. Martinez referred Senator Cannell to Exhibit A in the JLBC Agenda book which indicates these are level 2 comparisons.

In response to Representative Gorman, Mr. Martinez stated that the department hired MAXIMUS to evaluate their per capita cost report. That is a report the department produces annually to translate their budget into a per bed per diem cost. When MAXIMUS evaluated it, they said the methodology is okay for translating their budget into a per diem cost, however when they use those amounts to compare to private per diem costs, they need to make some adjustments because both sides do not necessarily have the same type of cost factors.

Senator Arzberger seemed to remember from prior discussions that there was a question comparing per diem costs between private prisons and state prisons. The private prisons did not include the medical expenses for the prisoners. She was not sure if that was in-house medical expenses or transportation medical expenses, but there was a large item that was not included in the comparison between the two and yet the state was responsible for it. She asked if MAXIMUS took that into consideration.

Mr. Martinez explained that the calculations were done by ADC and that analysis was reviewed by MAXIMUS. After MAXIMUS' review they noted that there were some items that were still not accounted for, one of which was some of the health care issues. In certain circumstances the private prison pays for certain health care costs. When they exceed a certain amount, in general, the department then is responsible for paying those high health care costs. Part of that \$2 adjustment that MAXIMUS did a cursory review on included some of those adjustments.

Representative Pearce mentioned that the actual public-private comparison consists only of 6 to 8 pages of charts. MAXIMUS recommended that ADC publish a detailed methodology of its comparison. He asked the department when they expect to release a full detailed report as recommended by MAXIMUS.

Ms. Schriro stated that the department sought the services of MAXIMUS through the competitive bid to evaluate the per capita report and also the method by which we respond to several legislative directives. Those are specifically that every 5 years retroactively we are to make an assessment to ascertain whether the state accrued a savings by virtue of retaining and utilizing private prison beds by comparing actual costs of state expenditures for public beds versus state expenditures for private beds. To that end, they provided MAXIMUS with their per capita report which had been their basis for making that comparison. In turn, MAXIMUS made an evaluation and recommendation specific to the preparation of the per capita report and it also went on to observe that the per capita report would be applied to the determination of that statutory mandate. The report in and of itself was insufficient to make the comparison of costs for spending for public and private beds and so MAXIMUS proposed the methodology for the public versus private cost comparison report. In both of those instances, it has recommended that the department prepare technical manuals that would delineate the actual methods by which they implement their recommendations.

MAXIMUS also evaluated an old methodology developed by the Governor's Office of Excellence and previous administrations to make the prospective comparison, that is, when the state is contemplating further expansion of beds and wants to consider public as well as private. MAXIMUS has recommended that there be a manual prepared to implement those recommendations. The department has adopted all of MAXIMUS' recommendations including the preparation of manuals. The department is currently preparing the manuals specific to the per capita report and to the state versus private. By the end of the day she should have an idea as to when they think those might be done. They have not yet developed the other manual because they have not had the opportunity yet to make a prospective comparison under the new set of recommendations.

Representative Pearce stated that MAXIMUS recommended that public costs be adjusted for non-ADC state agency support costs and depreciation costs. The department asked MAXIMUS to prepare preliminary estimates of those costs, which MAXIMUS admits was based on a cursory review. He asked why would the department release a public-private comparison prior to having fully completed the background work on those adjustments.

Ms. Schriro indicated in their response to MAXIMUS in a number of instances they could adopt their recommendations because the data was available, so they could go back and disaggregate it and apply those recommendations for the FY 2003-2004 comparison. In several instances, it was not possible to go back and disaggregate the data because it was not collected in a format that would work for making the recommendations.

Representative Pearce expressed concerns with the report not properly dealing with capital and benefit packages. Nationally private prisons save 15% to 20% and he believes that is the case in the state of Arizona too.

Ms. Schriro responded that MAXIMUS did identify inclusion of our benefit package and those monies that are appropriated to the department that represents state spending for benefits, including retirement. They are all included in state costs.

Further discussion occurred on whether all relevant costs have been accounted for.

Representative Pearce stated that MAXIMUS offered the suggested revisions in your methodology and asked if it was true that the actual public-private comparison was done by ADC itself.

Ms. Schriro answered yes and that it was reviewed by MAXIMUS. MAXIMUS provided letters that referenced each of the years of analysis (FY 2003 and 2004) and it indicated in those letters that the department had made correct applications of their recommendations

There was discussion by Representative Pearce and Director Schriro as to whether ADC disobeyed the law with regard to prior directives to privatize the female inmate population.

Representative Boone asked for clarification on page 3 of the MAXIMUS report. It states, "Although in our opinion the Cost Report presents reasonable cost analysis, it does not enable the accurate comparison of ADC operated prison costs to private prison costs." It further states, "In order to provide information in which a valid cost comparison could be made in response to A.R.S. § 41-1609.01 (L), a separate, distinct report should be developed that includes all costs, and appropriately allocates costs to both ADC and private prisons and/or excludes costs not borne by both ADC and private prisons." In other words until that report is done and includes all of those appropriate cost comparisons, no accurate comparison can be made. His clarification was when Representative Pearce asked you a question in terms of when that would be ready, you said you did not have a date.

Ms. Schriro stated no. She believed what she heard Representative Pearce ask was when was the documentation going to be ready, which amplifies the preparation of the report that we have submitted. If that is not the question then she misunderstood.

Representative Boone stated that it seems by the findings in the MAXIMUS report that an accurate comparison cannot be made based upon what they reviewed and you prepared. In order to do an accurate comparison to include certain costs, that a separate report needs to be done. His concern is that he would hope that it would be a priority of ADC to get that done, because if MAXIMUS is saying they cannot do a valid comparison now with the data that they reviewed that you have, it seems that should be a high priority to get that done.

Ms. Schriro agreed and it is completed and that is what was submitted. She indicated to Representative Boone that what he was reading is their critique of the operating per capita cost report. For a number of years this agency had relied on that per capita report to be the basis for the public versus private comparison. MAXIMUS said that while it should be incorporated that was not an adequate method for comparison. She referred Representative Boone to page 4 of the MAXIMUS report under "Recommendations Related to Development of a State Versus Private Prison Cost Comparison."

Representative Boone asked if that has been completed and is MAXIMUS in agreement that all those costs were appropriated in that also.

Ms. Schriro answered yes and stated that MAXIMUS reviewed their application of their recommendations which are attached to their FY 2003 and 2004 comparison. There are 2 letters from MAXIMUS, one attached to each of those comparisons, reviewing their application of their recommendations. As mentioned previously in a response to a question by Representative Pearce, there are several recommendations that cannot be reconstructed historically, so those recommendations are adopted, but they can only be incorporated beginning in FY 2007.

Representative Boone stated that we would not have an accurate comparison until FY 2007 and asked if that was correct.

Ms. Schriro believes you have a reasonable representation. MAXIMUS has estimated that when those 4 remaining recommendations are adopted it will raise state costs no greater or less than \$2 as JLBC Staff also reported and that is why when they presented the material in their summary, they demonstrated the range so as never to overestimate the savings. They provided the range based on the actual and then adjusted for the no greater than the \$2 difference in cost.

Senator Garcia asked if anyone was present from MAXIMUS.

Mr. Joel Nolan, Vice President, MAXIMUS introduced himself as the author of the MAXIMUS report.

Senator Garcia asked if the department made an accurate portrayal in the discussions it had with MAXIMUS, in terms of developing a good source of data.

Mr. Nolan stated that he believed so. He stated that he is a certified government financial manager for about 30 years and one of the first steps he did was go back and look at the cost report to ascertain if the information was based on auditable records. He identified that all the costs that were in the current cost report was in their total cost and were traced back to auditable records and then the financial report. He did find out that the methods they were using to present those numbers were not an accurate representation of what was going on and that was when he started with the cost report. Yes, they did have all the numbers in there. He said he can trace all the numbers back.

Getting to the definition of trying to see whether or not we are actually comparing apples to apples, Senator Garcia said you have made some recommendations to the department. He asked if the department has been cooperating with MAXIMUS.

Mr. Nolan stated that so far they have been very cooperative. The issue with some of the items is they have not tracked these costs in a format that I feel like should be tracked. They need to track health costs and inmate transportation costs. Before they have just been capturing costs at a facility level. They need to break each facility down into a different type of cost. Whether they do that on a budget level or not, they need to track it for reporting purposes so we can more accurately see what is going on.

Senator Garcia stated that there have been some discussions about benefits, specifically retirement benefits that have not been included in those calculations. He asked if they were included.

Mr. Nolan said that in all of the numbers that he reviewed related to the cost report and, subsequently, the comparison that the department had done, all benefit numbers were in those numbers. What was not in those numbers were the costs that were being incurred on their behalf by an outside agency.

Senator Garcia asked what was meant by the benefits that were incurred outside of the agency.

Mr. Nolan referred to the Department of Administration accounting services and financial reporting services. There are several departments that are contributing to those costs and they can vary from year to year. The state prepares a report every year that identifies how much of those costs go to each agency and those are the costs he was referring to.

He clarified that the cost report was only presenting what the agency is occurring in their own budget. It was not taking these other costs, plus it had some errors in the way it was being presented which he recommended fixing. The second thing was the state is saying that every 5 years the department needs to do a cost comparison of the actual costs to what was actually paid. The department has done that. He keeps hearing questions as to whether that is a good comparison. It still has some inherent problems when you are comparing actual to actual because you are dealing with a different period in time. We are comparing the cost to run a facility that was built 30 years ago to a cost of a facility that was built 5 or 3 years or even 1 year ago. To meet the state's requirement, we felt they needed to compare actual to actual, which is what they gave me to review. What he has not heard discussed here, was that in the third part of their report, it said, you really need to be comparing apples to apples. Instead of \$2 in depreciation, which is what we may have currently, a new facility may be closer to \$7 or \$8. By the same token, in our historical costs we have a lot of old facilities which have a lot of maintenance costs, so in order to do a real comparison we need to back out all of those costs. If you are always basing it on historical costs you are never going to have a complete apples to apples comparison.

Representative Burton Cahill stated that with regard to prison construction, when a private prison is built, how do we finance a private prison and who is responsible if the contract with that corporation is terminated.

Mr. Nolan stated that in his experience with other states, in some cases they are financed through a county or a city and so the city is issuing bonds and the method they are using to pay those bonds is a revenue stream that comes from the per diem that the city pays. If for some reason the state were to cancel a contract and that enterprise was no longer going to pay the amount for the bond, then they would default, and in most states it would fall back to the state.

Representative Burton Cahill believes we should have our lawyers look at this. She asked if the Committee could have the JLBC Staff look at this to see where we stand as far as the liability.

Senator Burns said yes.

Senator Cannell asked if there was a reason we looked at level 2 prisons rather than the various levels. It seems like there would be a difference.

Ms. Schriro said that in FY 2003 and 2004, the only beds they had contracts for were level 2 male beds and that was the basis for comparison. In FY 2005, their contracting expanded to include level 3 beds and so the comparison will be broader for 2005 data. In 2006 it will continue to be levels 2 and 3. In a partial response to Representative Burton Cahill's question, the private prisons are financed by tax-free government bonds. If the state was to cancel the contract, the private prisons would be liable.

The meeting adjourned at 9:20 a.m.

Respectfully submitted:

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Amanda Ruiz, Secretary

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Richard Stavneak, Director

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Senator Robert Burns, Chairman