STATE OF ARIZONA

Joint Legislative Budget Committee

STATE SENATE	1716 WEST ADAMS PHOENIX, ARIZONA 85007	HOUSE OF REPRESENTATIVES
ROBERT L. BURNS CHAIRMAN 2006 MARSHA ARZBERGER TIMOTHY S. BEE ROBERT CANNELL JORGE LUIS GARCIA JACK W. HARPER DEAN MARTIN JIM WARING	PHONE (602) 926-5491 FAX (602) 926-5416 http://www.azleg.gov/jlbc.htm	RUSSELL K. PEARCE CHAIRMAN 2005 ANDY BIGGS TOM BOONE MEG BURTON CAHILL PAMELA GORMAN STEVE HUFFMAN LINDA J. LOPEZ STEPHEN TULLY

MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

October 24, 2006

The Chairman called the meeting to order at 9:40 a.m., Tuesday, October 24, 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 Bee
	Representative Gorman	Senator Cannell
	Representative Lopez	Senator Garcia
	Representative Tully	Senator Harper
		Senator Waring
Absent:	Representative Pearce	Senator Martin
	Representative Huffman	

APPROVAL OF MINUTES

Hearing no objections from the members of the Committee to the minutes of September 21, 2006, Senator Burns stated the minutes would stand approved.

DIRECTOR'S REPORT

Mr. Richard Stavneak, Director, JLBC Staff, said that the next meeting is scheduled for November 15, 2006, and that there are already several items on the agenda, including 21st Century Fund, ASU Downtown Campus Plan, State Compensation Fund, and Arizona Department of Administration's Mileage Reimbursement Rate.

Mr. Stavneak also reminded everyone that the JCCR meeting scheduled for later in the day had been cancelled, but to expect a meeting next month. That meeting is also scheduled for November 15, 2006 at 1:30 p.m.

DEPARTMENT OF REVENUE (DOR)

A. Review of Business Reengineering/Integrated Tax System (BRITS) Contract Amendment.

Mr. Bob Hull, JLBC Staff, referring to the slide handout distributed *(Attachment 1)*, gave some background on the project, stating that DOR contracted for a new computer system in September 2002. The goal was to have the 3 main tax types (sales, corporate income tax, and individual income tax) operate off a single database. The object of this was to improve revenue enforcement and customer service. The sales and corporate income taxes have been converted to date. The contactor is paid through a gain sharing arrangement. 85% of the enforcement revenue is paid to the contractor, and 15%

goes to the state. The original cost was just under $130 million and was to take 4 years to complete. The current cost is just under $137 million, which includes $7 million for 2 previous contact amendments, and the project is 2 years behind schedule.

Due to earlier project delays, DOR is seeking a $14.8 million contract amendment to complete conversion of the individual income tax to BRITS. Mr. Hull stated that the Committee had several options. The Committee could give a favorable review, since DOR has provided information on the contract amendment, and there is more revenue than anticipated; or the Committee could give an unfavorable review since the project is over-budget and over-time, with no independent basis to determine whether the vendor is being held appropriately accountable.

Senator Burns asked why GITA was not kept informed, if their purpose is to monitor large computer projects such as this one.

Mr. Hull stated that, to the best of his knowledge, responsibility lies with both DOR and GITA. Perhaps DOR did not communicate as much as they should have and GITA did not ask as many questions as they should have.

Senator Arzberger asked what plans there were to correct the communication issue between DOR and GITA.

Senator Burns also questioned whether the change should be statutory, to ensure this problem does not arise again.

Mr. Richard Stavneak, JLBC Director, responded to Senator Arzberger's question by stating that there is a BRITS oversight committee, comprised by members of DOR, GITA and ITAC. The DOR and GITA Directors met in September to outline DOR's plans for the contract amendment. GITA suggested that the oversight committee needs to be made more active, as a method of information sharing between the 2 departments.

Senator Burns asked whether this was the first contract amendment and if others were expected.

Mr. Hull responded that this was the third cost amendment, as there have been other amendments. At least one more amendment is expected for project support costs, if DOR chooses to implement document imaging and/or customer relationship management.

Senator Burns stated that he would like to put an end to the amendments. If DOR wants to purchase additional products for the system, the competitive bid process should be used, rather than continuing to add on to the existing contract.

Mr. Hull responded that it was a question of the functionality of the system, and the value obtained. With document imaging auditors and collectors could retrieve an electronic copy and improve customer response time, as opposed to using a paper filing system.

Senator Burns stated that, at this point in time, the Committee is in review status only. Regardless of what the Committee determines, DOR could go forward without their approval. He felt that stronger action should be taken to deter any more amendments from coming before the Committee.

Senator Cannell stated that he felt that if the system was getting better, the Committee would be justified in approving the amendment. The system will make tax collection more efficient and taxpayers will be receiving better service.

Senator Arzberger asked whether the oversight advisory committee was part of the original contract, and if the Auditor General's recommendation for an outside expert was a new recommendation.

Mr. Hull responded that the outside consultant was a part of the original contract; however, the oversight committee was not. The outside expert is an IT consultant hired to oversee the entire project. The oversight committee meets regularly to monitor the progress of the project.

Senator Arzberger stated she felt that both the oversight committee and the consultant should have participated more in the management of the project.

Representative Biggs inquired whether the $4.25 million being paid by the contractor will be in the form of a check or reduction in revenue receipts.

Mr. Hull responded that the $4.25 million will be costs absorbed by the contractor, and not an actual payment.

Representative Biggs asked for elaboration on the question included in the Mr. Hull's presentation: "Has BRITS Paid for Itself Already?", specifically the $37 million from discovery tied to specific taxpayers, and what evidence is there that these individuals could not have been discovered through the previous programs available.

Mr. Hull said that the $37 million was revenue that could be traced to a specific taxpayer that was discovered using BRITS matching programs, which was not available under the legacy system.

Representative Biggs referred to the $145 million from efficiency revenue above baseline amounts, and asked for more information on the $50 million revenue from abusive use of tax shelters, and how it was determined that it was attributable to BRITS.

Mr. Hull stated that the $50 million revenue is not attributable to BRITS, but it is included in the $145 million.

Representative Biggs asked whether there was any other revenue included in the $145 million that was questionable and whether it was attributable to the BRITS program.

Mr. Hull said that not enough detail was available to determine whether there was other revenue that fell into that category. Perhaps the oversight committee could look at the baseline, evaluate what is included in the $145 million revenue, and determine what should and should not be attributed to BRITS. He further explained that the BRITS contract is set to run for 10 years, so there is sufficient time for the additional revenue to pay off the cost of BRITS, even if it doesn't come in at the levels projected.

Senator Garcia asked whether the BRITS system, as it is being financed now, would have cost more if it had been paid for through an appropriation.

Mr. Hull explained that the statutory change which allowed agencies to contract for IT projects through gain sharing was something that DOR worked to get into place. The financing mechanism was viewed as a way of running the project more smoothly, and not having to worry about the stops and starts, and possible uncertainties of appropriation after appropriation.

<u>Ms. Kristine Ward, Department of Revenue</u> explained that the department had released the first of 3 primary components of BRITS, the Transaction Privilege Tax, and the second component, Corporate Income Tax was released on September 5, 2006. The third component is individual income tax. The cost of the delay for the release of the first component was $7.1 million, and DOR assumed 44% of that cost.

Representative Biggs asked why DOR had assumed the 44% of the delay costs.

Ms. Ward clarified that DOR had some responsibility in the delay of the first release. When the contract was originally established, it was developed under a partnership concept. The vendor was to bring the IT expertise and DOR would bring the business expertise. The vendor was expected to act in their best interest to ensure the benefits continued to produce. However, the proper people with the proper skill sets were not applied to managing the project and overseeing the vendor.

Senator Waring requested clarification on how the $14.8 million was to be used, and whether this was the last time that DOR was to come before the Committee on this issue.

Ms. Ward stated that some of the funds went for work that has already been completed to fix BRITS, and some for support through August 2008. She also said that DOR will come before the Committee again regarding future contract amendments.

Representative Boone asked for an estimate on a timeline for implementing CRM.

Ms. Ward responded that, if a decision is made that it is needed, planning for CRM would begin after the release of individual income tax, which is scheduled for November 2007.

Senator Waring asked if DOR expected that the system would do what it was supposed to do.

Ms. Ward said that the department is now enjoying offset payments as one of the aspects of an integrated system. If a taxpayer has a liability in TPT, and they have a refund or overpayment in Corporate Income Tax, the system is capable of taking the overpayment and applying it to the liability. Since September 5, 2006, 18,279 offsets have been processed for a benefit of $4.1 million. This was a feature that was not available until the release of the corporate income tax component of BRITS.

Representative Boone asked Ms. Ward why DOR is paying an additional $14.8 million if all the products were included in the original contract.

Ms. Ward responded that when the scope of the contract was defined, time was a factor. If time to implement the various components increases, cost also increases.

Representative Boone asked Ms. Ward to give her opinion on how GITA failed to be informed and involved in the project.

Ms. Ward stated that she agreed with Mr. Hull's comments. From the department's perspective, the issue was not trumpeted loudly enough. In its early stages, the issue was discussed with the external oversight committee, which meets every 2 months. Two meetings were cancelled twice due to lack of attendance. Two more meetings were subsequently cancelled, for a total of 4 months during the crucial months of negotiations on the $14.8 million contract amendment.

Senator Burns expressed that the concern is that the process has some problems with significant cost increases, and how DOR is dealing with them; not whether the program has benefited the department.

<u>*Representative Boone moved*</u> *that the Committee give an unfavorable review of the DOR BRITS contract amendment, since the project is over time and over budget, and implement all 5 recommendations on further reporting and oversight:*

1) *DOR/GITA provide joint monthly status reports to JLBC and Office of Strategic Planning and Budgeting (OSPB) Staff on the project until its conclusion, including reports from the project's outside oversight consultant.*
2) *DOR not pursue contract amendments for the document imaging and "customer relationship management" components until the individual income tax is implemented. This delay would give the Legislature time to consider in the 2007 session the value of these components. To assist in this evaluation, DOR should submit detailed rationale for these last 2 components to the JLBC by January 31, 2007.*
3) *ITAC report by December 31, 2006 to the JLBC as to improving general procedures for ensuring that all agencies keep them apprised of high dollar value contract changes to automation projects, and GITA's efforts to ensure that they provide sufficient monitoring.*
4) *JLBC Staff with DOR and OSPB jointly convene an outside panel to evaluate the BRITS baseline calculation and provide feedback regarding the effects of automation versus an improving economy on the increased level of collections. We would report on the results by November 30, 2006.*
5) *The Arizona Department of Administration (ADOA) report to the JLBC by November 30, 2006 as to steps to improve agencies' understanding of contract provisions.*

The motion carried.

DEPARTMENT OF REVENUE

B. Review of General Fund Revenue Enforcement Goals.

Mr. Hull stated that enforcement revenue consists of audit, collections and accounts receivable. DOR's FY 2007 goal is $333.4 million, which is $12.1 million, or 3.8% above their FY 2006 goal of $321.3 million. Compared to the FY 2006 goal, the FY 2007 goal for collections and accounts receivable increase approximately $10 million each. Audit revenue decreases $8 million, due to a hiring freeze in the Audit Division, to pay for $1.7 million of annual software licensing fees for BRITS.

Compared to the FY 2006 actual, the FY 2007 goal is $(57.6) million, or (14.7)% below the FY 2006 actual. The 2 reasons for this are corporate income tax audit and license compliance both have large one-time amounts in FY 2006, mainly due to a few large taxpayers, which DOR does not expect to repeat in FY 2007. There was a temporary spike in sales tax collections, which was caused by BRITS billing problems, which have now been fixed.

Mr. Hull outlined the 2 options of the Committee, to either give a favorable review because the report provides information on DOR's general fund revenue enforcement goals for FY 2007, which are $12.1 million above FY 2006, or give an unfavorable review because the FY 2007 goal is $(57) million below the FY 2006 actual.

Representative Biggs asked whether DOR had explained why accounts receivable are increasing.

Mr. Hull explained that DOR had not tracked accounts receivable until a couple of years ago. The goal was increased based on the fact that accounts receivable have increased year after year.

<u>*Representative Boone moved*</u> *that the Committee give a favorable review of the DOR report of general fund revenue enforcement goals for 2007.* The motion carried.

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

Ms. Leatta McLaughlin, JLBC Staff, instructed the Committee members to refer to the presentation distributed *(Attachment 2)*. She stated that the Committee is required annually, by statute, to approve an inflation adjustment for building renewal and new construction formulas.

SFB can award money over the new school construction formula amount if a district cannot build a minimum guidelines school within the formula amount. From FY 2002 to FY 2005, SFB awarded approximately an additional $6 million to 14% of their new school projects. That number jumped to approximately 38% of the projects in FY 2007 for additional funding of approximately $20 million. So far, in FY 2007, SFB has awarded approximately an additional $9 million to 82% of their projects, which breaks out to approximately $1 million per project.

Senator Waring asked that, if SFB was awarding funds above the formula amount, how did the Board not run out of funds.

Mr. Stavneak explained that only approximately 5% of the approved amount is spent for architectural and engineering fees. These additional amounts are essentially being built into the FY 2008 through FY 2011 budgets, depending on when the schools are constructed.

Ms. McLaughlin summarized by stating that the Committee had several options in combining the 4 indices, of which only 2 were identified. The first option is a combination of a national and Phoenix index at 6.9%, and the Committee adopted an index based on this methodology at last year's meeting. The second option is a combination of 2 Phoenix indices at 12.2%, and that is the option recommended by SFB.

Senator Arzberger asked Ms. McLaughlin if the PinnacleOne index did not measure inflation for high schools or schools outside the Phoenix Metropolitan area.

Ms. McLaughlin answered that the PinnacleOne index is only for Phoenix-based elementary schools.

Senator Arzberger asked if construction costs were higher in rural areas.

Ms. McLaughlin responded that Senator Arzberger was correct, and that SFB has the ability to approve rural districts above the funding amount in statute.

Representative Biggs asked whether there was a rule that stipulates that rural areas are automatically 5% more than urban areas.

Ms. McLaughlin responded that SFB is statutorily mandated to give urban areas 5% more in funding for schools construction than urban areas.

Representative Tully stated that, according to a Wall Street Journal article he read, lumber prices were at a 10-12 year low nationally. He asked if there were any cycles during that same period that indicated that real costs of construction can decrease, as opposed to the rate of increase or inflation lessen.

Ms. McLaughlin replied that she had not conducted any research on construction cost cycles, but offered to research and provide the Committee with the information.

Representative Biggs asked if there was a general decrease in construction materials costs, and the school districts are approved at a higher rate, and whether there is a mechanism in place to recapture those funds.

Ms. McLaughlin responded that, as she understood the approval process, the district goes before SFB for initial approval for the project, with an actual dollar amount. A second approval must be obtained before construction begins. At that time, the district is required to obtain a hard bid, and obtain additional funding for the project.

Mr. Stavneak interjected to say that the process Ms. McLaughlin spoke about had been used to increase funding, but he was unaware whether it had ever been used to decrease funding.

Senator Waring inquired whether the $131 per square foot included contractors, labor, materials, and land.

Ms. McLaughlin stated that the amount did not include the land.

Senator Bee asked if the Tucson schools were considered to be in rural areas.

Ms. McLaughlin responded that there is a definition in statute for rural, and it refers to the municipality and its size. Phoenix and Tucson are the only cities in the state that are not considered rural.

Senator Bee requested that the information regarding urban versus rural areas be provided to the Committee. He asked if the formulas being used to fund school construction projects are keeping up with inflation, and commented that when the formula was originally adopted, an adequate school could be built with the resources that were provided but over time, it has become more and more challenging to do that.

Ms. McLaughlin stated that, in speaking with several of the school districts, it was felt that the formula was indeed not keeping up with inflation. She also explained that the 12.2% increase, according to the FY 2007 additional funding approved, would correct the problem.

Representative Lopez stated that the costs of building materials used in the construction of new schools are increasing, and commercial construction is also rising.

Ms. McLaughlin commented that, through her research, she found that commercial construction is increasing.

Mr. Stavneak expanded by saying that commercial construction growth is estimated at 15%.

Representative Burton Cahill requested that a 6- to 10-year history be provided to the Committee regarding the inflation adjustments they have approved for school construction projects.

Representative Bee asked why the national construction indices presented to the Committee are less than the actual costs.

Mr. Stavneak responded that the indices do not appear to capture either nationally or statewide the same cost increases that had been talked about anecdotally. This lead to the creation of the PinnacleOne and Rider indices, because of a belief that local information was not being captured.

Representative Burton Cahill asked whether a comparison had been done between Arizona and Nevada, since they seem to have the fastest growing populations, which makes the construction industry more on demand, and causes material costs to rise.

Mr. Stavneak responded that staff will check on the new construction demand in both Arizona and Nevada.

Responding to Representative Boone's question, <u>Mr. John Arnold, Acting Director of the SFB</u>, stated that the minimum standards have not been changed since they were established in 2001. However, as the cost of building a new school has exceeded the cost of the formula, questions have come up as to what the appropriate quality standards are, to which new schools are built. The originally established minimum standards were established to be applied to existing schools, and thus are very general and generic in nature. For example, the minimum standards say that roofs shall be weather tight, with no specification on the materials to be used.

Representative Boone referred to a list of projects distributed by JLBC Staff, which have been approved by SFB over the current square footage cost approved by the Committee. SFB has assessed each project individually, and determined they could not be built to minimum standards with the funds allocated. He asked if the Committee approved the 12.2% funding increase, will SFB continue to assess projects individually and, if the 12.2% increase is not sufficient to build a new school to minimum standards school, will that amount will be adjusted as necessary.

Mr. Arnold responded that Representative Boone's statement was correct.

Representative Boone asked if there was a mechanism in place to decrease the amount that has been approved by the Committee, should building costs drop. He also asked if the bid process should be followed if the school district wants to go above the approved square footage cost.

Mr. Arnold stated he would give a background of the process, to help everyone better understand the process. SFB establishes the budget for a new school construction based on the formula. The district would procure the architect, and then bring the design back to SFB for minimum standards review. The construction of the new school would go to bid. As long as the bid was within the formula or the district's budget, it would be approved. If the district was adding local funds, it would be presented to SFB, and then the school would be constructed. At the end of the construction period, if there were funds left over, the district would have 1 year to expend the funds on the school site. At the end of one year, any remaining funds are returned to the state. The Committee sets the inflation amount based on June and July numbers. The projects are awarded from February to May of the following year. Those projects will be designed and go into construction from 6 to 18 months after the formula amount was established. In post-2001, when inflation was flat, the formula worked. The formula no longer is sufficient to build a new school. There are currently 46 projects in design that have established budgets, to which inflation funding will need to be added to complete, because they were approved at a different inflation rate.

Senator Bee stated that the Legislature gave the SFB the authority to establish the rules to create the formula. He asked what would be required to have the formulas and the entire process reviewed.

Mr. Arnold responded that the formulas were established by legislative action, and any adjustment would require legislative approval. He stated PinnacleOne has already published the 3rd quarter inflation report showing a 1.4% cost increase. Based on that figure, SFB would recommend a 13.6% inflation increase, which would even the funding with inflation through October 2006. Another increase is expected in January 2007 and SFB would recommend that the Committee approve an additional inflation increase then. The procurement for the building of a new school would still be 6 to 12 months away.

Senator Cannell asked if the Committee continues to under fund, would the new schools being built be of lower quality; and if the expenses are just being pushed back, taking into consideration repairs that will need to be performed on the buildings in the near future.

Mr. Arnold stated that building low quality schools is one of the dangers of a cost-based system. SFB has taken design authority and control from the district, and is responsible for making decisions on the construction materials to be used, etc. This has also taken cost and budget responsibility from JLBC and put it on SFB.

Senator Bee asked what would be required to review the minimum building standards.

Mr. Arnold said that SFB does have the authority to review and revise the minimum standards. However, any minimum standard that is changed, would apply to all existing space.

Representative Burton Cahill asked whether, when SFB is considering equipment pricing, maintenance is taken into consideration.

Mr. Arnold responded that SFB takes into consideration first what type, design of equipment will benefit the school most, academically. Other things considered are safety, maintenance, energy efficiency and environmental impact.

Representative Tully asked Mr. Arnold if he was confident that quality schools were being built, and what percentage of schools are using district funds to enhance the formula funds.

Mr. Arnold affirmed that he felt confident that quality schools are being built. He also stated that SFB is taking steps to improve the quality of those schools. Mr. Arnold said that the vast majority of schools have requested district funds to enhance the formula funds received. Local funds are, however, also experiencing the same inflationary pressures, and the local resources are also depleting.

Representative Tully questioned if the districts could return to a formula-driven building once inflation tapers, instead of making major changes to the formula to account for inflation.

Mr. Arnold responded that it was hard to predict when, if, and how much inflation would stabilize, but that Representative Tully was correct in stating that no changes should be made to the formula before all aspects are considered.

Representative Lopez asked if it was true that in new schools being built, energy-efficient equipment is not being installed, due to prohibitive costs, which will, in turn, cost the schools more in energy fees. She also asked if the new schools being built meet the standards with which the districts are concerned, such as noise attenuation, in order to provide a good learning environment.

Mr. Arnold gave an example of standard R 12 value insulation that is used in new school construction. A proposal was recently presented to SFB to use a certain type of block that would raise the insulation's R value to 33. The cost was approximately $100,000. The energy bill savings to the school was $3,000 per year. The district would not have recovered its investment for 35 years. At this time, the SFB is using an 8-year payback threshold. If the district can prove that an item will have an 8-year payback, SFB will fund it. SFB has been studying the elements that Representative Lopez mentioned and that are not specifically identified by the minimum guidelines such as playground equipment, landscaping, playing fields, etc.

In response to Senator Harper's question regarding concrete costs, Mr. Arnold stated that over the last year, concrete prices had risen 10.4% nationally. According to the PinnacleOne index for 3rd quarter 2006, a 1.4% inflation increase took place, which is about one-half that of prior quarters. What is most noticeable is a distinction in cost of approximately 10% to 15% in metropolitan versus rural areas.

Mr. Edwin Moore, a member of the Higley Unified School District Board, stated that he had witnessed a hyper-growth in that district, going from 1 K-8 school with 342 students in 2000, to 6 K-8 schools and 1 high school with over 8,000 students. Construction is underway for the eighth K-8 school and the second high school. He urged the Committee to change the methodology for SFB, to allow them to return to formula-based funding.

Kathy Shiba, Principal at a soon-to-open Sahuarita district school, stated that as she has gone through the new school building process, she discovered that from the time the district received the funds for the building of the new school to the time the building was finished, costs rose. As an example, she referred to permits and taxes, for which the district was allotted $113,000. The total cost for those items was $1.4 million. She stated that the funds approved for new schools was inadequate with no funding allotted for security items such as fencing. Ms. Shiba stated that although she appreciated the inflation increase being approved, asked the Committee to consider approving a higher percentage.

Senator Arzberger asked JLBC Staff if it was possible to legislatively add a safety component to minimum standards requirements.

Mr. Arnold stated that the minimum guidelines include a security standard, but it is generic and minimal. The requirements is for fencing for school sites that have grades K-6. A study on school safety will begin in December 2006, that should produce some recommendations to further enhance school safety from a design standpoint.

Mr. Jay St. John stated that his concern was with the point of funding, which he felt should be at the time of the construction contract signing, not when approval is received from SFB.

Ms. Kristen Ham, a parent and business owner from the Sahuarita School District, stated that her family owns a landscaping business that serves Tucson and the surrounding areas. Bids are not sought out with the school districts because financially, it does not assume a reasonable profit margin.

Ms. Colleen Guerrero, an 11th and 12th grade English teacher at Sunnyside High School, spoke about not having a permanent classroom. The problems caused by this are that teachers are not easily accessible to students and parents, and inaccessibility of necessary materials and equipment.

Ms. Barbara MacDonald, a 38-year art teacher at the Sunnyside School District, stated that when she came to the district in 1985, she had a 1,200 seat auditorium complete with dressing rooms; and last year, she had a cart. She emphasized that this is a new phenomenon that is taking place due to overcrowding. There are 22 floating teachers in the district. She asked for the Committee's help by approving the inflation increase. In response to Senator Harper's question, Ms. MacDonald stated that, to her knowledge, at least 3 of the 22 floating teachers were Special Education teachers.

Mr. Robert Miranda, Principal of Lauffer Middle School, spoke about opening of a new school in the Sunnyside School District. He spoke of not being able to have any landscaping, other than on the soccer field, due to lack of funds. The basketball court was only big enough to hold one full game at a time. He stated that half of the flooring in the school is polished concrete. The SFB approved funding for landscaping, flooring for the basketball court. He asked the Committee to increase the funding level to at least 20%, and to consider adding security measures to the minimum new school construction standards.

Mr. John Aitken, a parent in the Vail School District in Tucson, spoke to the Committee about the disparity between the escalating cost of construction and the current funding guidelines. He gave an example of selling a home. He stated it would be unlikely that the seller would ask for a 6% increase per year for each year of ownership, as opposed to asking for fair market value. He asked the Committee to approve the inflation increase to allow new schools to be built commensurate with today's fair market value cost of construction.

Ms. Nicole Aitken, a parent in the Vail School District in Tucson, asked the Committee to approve a higher inflation increase to cover the disparity between funding and new school construction costs.

Representative Boone moved that the Committee approve a 12.2% increase in the cost per square foot for construction factors as recommended by SFB Staff.

Representative Lopez made a substitute motion to approve a 20% increase in the cost per square foot factor as submitted by American Institute of Architects (AIA) Arizona. The substitute motion failed.

Representative Boone's motion passed.

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

Mr. Tyler Palmer, JLBC Staff, stated that in distributing monies from this plan, the Arizona Department of Administration (ADOA) provides a centralized management and oversight role for the counties and cities which have the primary responsibility for implementing new services.

Mr. Palmer referred to the map that was distributed *(Attachment 3)*, saying that it addressed the current status of 911 wireless capability across the state.

Representative Boone moved that the Committee give a favorable review to the $9.4 million wireless portion of the Emergency Telecommunications Services Revolving Fund Expenditure plan. The motion carried.

AHCCCS – Review of Capitation Rate Change.

Ms. Jenna Seplow, JLBC Staff, gave a brief background on the AHCCCS proposed capitation rates for Title XIX, KidsCare and the Long-Term Care populations. The proposed rates are below forecast, and will cost $6.4 million less from the General Fund than budgeted in FY 2007. In the first quarter of FY 2007, acute care and long-term care caseloads have been below projected and, as a result, additional savings may be generated by lower-than-anticipated enrollment. Statutory language was recently added restricting capitation rate changes to utilization and inflation, unless federally or court-mandated. This capitation rate does include one such change, as a result of a court mandate from the lawsuit of Ekloff v. Rodgers, which requires the state to provide incontinence supplies for eligible members.

Representative Boone moved that the Committee give a favorable review to the capitation rates proposed by AHCCCS. The motion carried.

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

Ms. Leatta McLaughlin stated that this was a review on the Commission on the Arts private contributions. Each year the Committee reviews what the commission receives in public monies, in conjunction with private contributions from the Arizona Art Endowment Fund. In FY 2006, the commission received $2 million in public monies. In calendar year 2005, the commission generated $3 million in private donations. This is approximately a $2 million decrease from calendar year 2004, due to a decrease in communication with art organizations and staff vacancies, which have since been filled.

Representative Boone moved that the Committee give a favorable review of the Arizona Arts Endowment Fund and private contributions. The motion carried.

Senator Burns invited the remaining speakers to come forward if they still wished to be heard regarding item #1 on the Approval of Index for School Facilities Board Construction Costs.

Mr. Bill Taylor, a board member of the AIA Arizona (AIA), referred to the position paper the agency had submitted for the Committee's review and which was distributed *(Attachment 4)*, recommending a 20% increase for SFB funding for this fiscal year.

Mr. Kurt Wadlington, General Contractor and Architect with Sun Construction, working in both the school markets of southern Arizona and the Phoenix area, stated that the 12.2% proposed increase only brings school funding current to July 2006, which will still leave a 10% to 20% disparity in funding, because the funding approved over the next 6 to 8 months, is for schools that will not be built for another 18 to 24 months.

Ms. Debbie King, a member of the Vail School District board for 6 years, said that 7 schools have been built in the time she has been on the board. The student population in the district has grown from approximately 2,500 to over 8,000 currently. She asked the Committee to look at actual construction costs in the future, to provide adequate facilities for students.

Mr. Phil Swaim, an architect who has been designing SFB schools since its inception, spoke of the unique opportunity to analyze actual construction costs. He stated that the 12.2% inflationary increase only brings the Phoenix Metropolitan area current.

Dr. Jan Langer, Superintendent of the J. O. Combs School District, stated that the district has grown from 250 students to over 2,500 students in 10 years. She compared the costs of a school opened in August 2004, and one that is currently under construction. The school opened in 2004 was a campus plan, but was revised to an under-one-roof plan intended to save $1 million, at the request of the SFB, to which adjacent waste funding was added, which was not available for school under construction. The SFB increased funding for the new school by over $1 million to cover the new school construction needs.

EXECUTIVE SESSION – Arizona Department of Administration – Review of Request for Proposal

Senator Burns stated that the Executive Session would be deferred to a future meeting, due to time constraints.

The meeting adjourned at 12:40 p.m.

Respectfully submitted:

Diana Torres, Secretary

Richard Stavneak, Director

Senator Robert Burns, Chairman

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

Business Re-engineering/ Integrated Tax System (BRITS)

JLBC Meeting

October 24, 2006

JLBC

What Is BRITS?

- DOR contracted for a new revenue collection computer system in September 2002

- Goal was to have sales, corporate, and individual income taxes share a single database to improve enforcement and customer service
  - Sales and corporate income taxes have been converted

- Paid by gain-sharing of increased enforcement revenue
  - 85% to contractor/15% to state

- Original cost was $129.7 million and 4 years to complete

- Current cost is $136.7 million, including $7 million for 2 previous contract amendments and 2 years behind schedule

What Is The Issue?

- Due to earlier project delays, DOR is seeking $14.8 million contract amendment
- JLBC reviews contract amendments that increase costs
- Contract amendment will result in foregone revenue of:
  - $12.6 million General Fund
  - $1.7 million cities and counties
  - $500,000 Proposition 301 education programs
- In addition to state share of $14.8 million, contractor will pay $4.25 million

Who Is Responsible For Project Delay?

- Until recently, DOR thought the contractor had to finish the project for the original contract price
  - It is unclear when DOR learned from ADOA that the contract permitted cost increases in some cases

- DOR and contractor agreed to split sales tax delay costs 44%/56% respectively ($3.4 million DOR/$4.25 million contractor)
  - DOR pays 100% of other costs

- No independent assessment of responsibility for the delays
  - GITA has not been involved

Further Costs Beyond Contract Amendment

- Contract amendment does not cover project support costs for document imaging and customer relationship management
  - Could cost $10 million

- Contract amendment does not cover DOR's transition costs to continue running the project
  - Could cost $8 million in FY 2008 and $4 million in FY 2009

Has BRITS Paid for Itself Already?

- $182 million of revenue through August 2006, including:
  - $37 million from discovery tied to specific taxpayers
  - $145 million from efficiency revenue above baseline amounts

- Is some of efficiency revenue due to higher taxpayer liability associated with an improved economy and other enforcement programs?

What Is GITA's Perspective?

- DOR and GITA do not appear to have sufficiently communicated on this project
- GITA does not have sufficient information to:
  - Comment on the $14.8 million amendment's revised timeline and cost
  - Evaluate the 44%/56% division of cost for sales tax delays
- GITA shows BRITS with a "green" status in its "green-yellow-red" project status report

What Are The Next Steps?

Beyond the issue of a favorable or unfavorable review, the Committee has the following options:

1) DOR/GITA joint monthly status reports to JLBC Staff/OSPB

2) Defer document imaging and customer relationship management until the individual income tax is implemented -- Submit detailed rationale for these last 2 components to the JLBC by January 31, 2007

3) ITAC report by December 31, 2006 on improving procedures for ensuring agencies keep them apprised

4) Convene an outside panel to evaluate the BRITS baseline calculation and provide feedback on impact of automation versus an improving economy

5) ADOA report on steps to improve agencies' understanding of contract provisions

Construction Costs Index Approval

JLBC Meeting

October 24, 2006

JLBC

Construction Cost Indices

	% Change	Avg. % Change	Market	Measure
BEA	7.9%	6.9%	National	US state & local government structures
MVS	5.9%		Phoenix	Class C Masonry Bearing Walls
PinnacleOne	13.1%	12.2%	Phoenix	Elementary schools
Rider	11.27%		Phoenix	All types of construction

Dollars per Square Foot Amounts for Each Option			
	K-6	**7-8**	**9-12**
Current Amount	$116.87	$123.37	$142.85
Option 1- BEA/MVS average	$124.93	$131.88	$152.71
Option 2- PinnacleOne/Rider average	$131.13	$138.42	$160.28

New Construction Costs
($ in Millions)

	FY 2007 (1st year)	FY 2008 - 2011 (Fully Implemented)
Option 1- BEA/MVS average	$1.1	$22.0
Option 2- PinnacleOne/Rider average	$1.9	$38.9

Building Renewal Costs
($ in Millions)

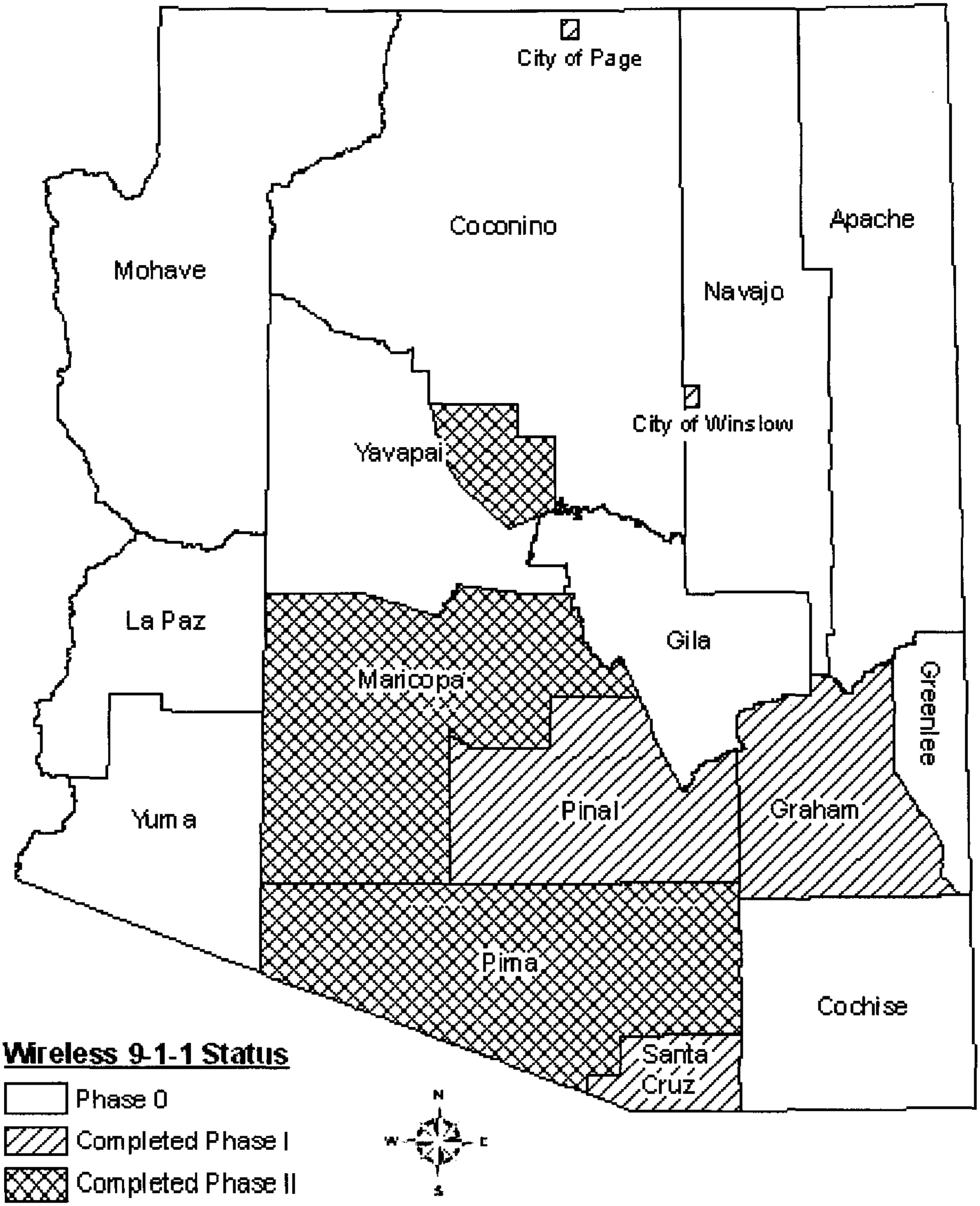
	FY 2008
Option 1- BEA/MVS average	$6.0 – 11.1
Option 2- PinnacleOne/Rider average	$10.5 – 19.7

An inflation adjustment will not change the existing FY 2007 appropriation.

SFB Has Discretion to Provide Funding Above Formula Amount

	FY 2002- FY 2005	**FY 2006**	**FY 2007 (so far)**
% of schools	14%	38%	83%
Additional Amount	$6.0 M	$20.4 M	$11.4 M
Total Additional Funding FY 2002- FY 2007: ***$37.5 M***			

Arizona Wireless 9-1-1 Status



Map as of October 2006
Created by Adam Iten (adam.iten@azdoa.gov)

AIA Arizona

A State Component of the American Institute of Architects

Arizona School Facilities Board Funding Concerns

October 2006
AIA Arizona, the statewide component of the American Institute of Architects has great concern about the level of funding for the construction of new schools provided by the Arizona School Facilities Board (SFB).

Specific Concerns:

1. Formula funding levels are (still) not keeping pace with the construction market.
2. The current formula levels of funding will not provide educational space with a construction quality necessary for operational maintenance and long-term utilization.
3. The current formula levels of funding are not providing environmental elements proven to support the learning process.

Current funding is not a formula based system.
Funding levels are not keeping pace with the construction market:

The following example illustrates the funding level shortfall. The SFB project budget for a K-8 in an urban area is currently $118.40. This number is for ***total project costs*** and includes construction and all soft costs which equals 25% of the budget (telephone and data design consultant, kitchen design consultant, all furniture, fixtures and equipment, computers, survey, permits, construction testing, plan review fees, construction advertising, architecture and engineering fees plus civil engineering and landscape architecture fees, CM@Risk fee, reimbursable expenses, and geotechnical reporting). The ***construction cost*** budget for that school, therefore, is approximately ($118.40 x .75) = **$88.80/s.f.**)

For comparison, here are SFB funded schools that have been recently priced and have started construction:

Higley Unified School District			
Chaparral Estates K-8	94,710 GSF	GMP 9/8/06	
16.83 acres / 1025 students			
Campus plan; 4 buildings, site adapt for previous design, steel studs / stucco, masonry multi-purpose building, foam roofing, roof package HVAC	SFB Budget: **$88.80**	SFB **$108.23**	**18% higher**
Saddle Mountain Unified School District			
Tartesso K-8	69,300 GSF	GMP 8/29/06	
11.7 acres / 750 students			
Single building, 2-story, masonry construction, foam roofing, and 50% roof package HVAC - 50% split system	SFB Budget: **$88.80**	SFB **$110.79**	**20% higher**
J. O. Combs School District			
Pecan Creek South K-5	67,500 GSF	GMP 7/12/06	
12 acres / 750 students			
Single building, steel studs / stucco, masonry multi-purpose, foam roofing, roof package HVAC	SFB Budget: **$88.80**	SFB **$114.41**	**22% higher**

Coolidge Unified School District K-8	73,920 GSF		
	SFB Budget: **$88.80**	SFB **$106.14**	**16% higher**
Chandler Unified School District K-6	88,920 GSF		
Masonry, carpet, energy management system, landscaping, ceramic tile, playground equipment, shade ramadas, and phone & data	SFB Budget: **$88.80**	SFB **$125.94**	**29% higher**

The current formula levels of funding are not providing educational space with a construction quality necessary for operational maintenance and long-term utilization:

As funding levels have not kept pace with construction costs and actual buying power has decreased, it compounds the disparity from a reasonable school construction budget. This disparity has now passed a critical point where school districts cannot build the same prototypical school that they built only a year before. School districts are looking at stripping away even more from a "bare-bones" prototype school – ones without insulation, interior furring, flooring, fields, courts and flagpoles.

The current formula levels of funding are not providing environmental elements proven to support the learning process:

<u>As architects, we support educational excellence. The effect of environment on learning cannot be ignored. Adequately funded schools are critical to maintaining competitiveness in meeting the needs of students, instructors and our demand for quality education.</u>

In summary, AIA Arizona is recommending that the current SFB funding formula be increased 20% for FY07.

30 North Third Avenue, Suite 200
Phoenix, AZ 85003
Telephone: 602-252-4200
Facsimile: 602-273-6814
Toll free: 800-367-2781
www.aia-arizona.org