Fiscal Accountability Committee

Interim Report

December 2002

AUTHORIZATION
The Arizona Fiscal Accountability Committee was established in Laws 2002, Chapter 289.

DUTIES
The Committee is directed to study and to develop a comprehensive report, making recommendations, complete with implementation strategies on expenditure policies of the state and local jurisdictions, including counties, municipalities and school districts. Specific emphasis shall be placed on the following:

- integrating services and eliminating duplicative programs
- ensuring that government services are provided in an efficient and effective manner
- exploring the realignment or possible privatization of services

The Committee is required to submit a final report of its findings and recommendations by September 15, 2003.

MEMBERS

Representative Meg Burton Cahill	Kerrie Bluff
Representative Gabrielle Giffords	Mark D. Chernoff
Representative Laura Knaperek	John G. Colton
Representative John Nelson	Elliot Hibbs
Senator Tim Bee	Michael Hunter
Senator Jack Brown	Dr. Kim Sheane
Senator Edward J. Cirillo	Martin Schultz
Senator Ruth Solomon	

ACTION
The study committee met three times in the interim, dividing into four working groups to study and receive information on four key elements:

- Privatization
- Education Formulas
- State Shared Revenues
- Organizational Structure

The working groups met separately between the meetings of the full committee, and reported their findings to the full committee. From the information gathered by the working groups, the following recommendations were adopted:

♦ Requests the Department of Economic Security (DES), the Department of Corrections (DOC) and the State Parks Department to submit recommendations to the Fiscal Accountability Committee as to how they intend to use either privatization or outsourcing as a means to provide more efficient service. This information would then be used in the final report of the Committee.

- Requests a summary of the State of Arizona's outsourcing activities and further requests that the appropriate work group determine additional opportunities for outsourcing to maximize savings plus improve service effectiveness of such strategies.

- Recommends the establishment of a work group to review, discuss and bring recommendations back to the Fiscal Accountability Committee regarding retiree health insurance generally and specifically; rural and urban heath insurance issues; health care risk pool issues.

- Recommends that the Education Formula Working Group investigate the use of a fixed variable approach to eliminate the need for hold harmless considerations which, compromise formulas.

- Recommends that documents and the work in progress of all the work groups be adopted into the interim report and forwarded onto the continuation of this Committee.

- Recommends a review of the statutes with regard to the drop program and the deferred compensation program.

- Recommends that the Appropriations Committee, as well as the ongoing Fiscal Accountability Committee, continue to exam full-time equivalency (FTE) positions with specific reference to a creating a statutory definition of FTE.

- Recommends the creation of a one-stop qualification center to allow the state to better monitor participants and their qualification criteria in state programs and be charged to more actively enforce the collection of co-payments and investigate and prosecute incidences of fraud.

- Recommends that the Colorado TABOR example be included in the report for future consideration.

- Requires the interim report to include the recommendation that the Legislature consider appropriating non-custodial federal monies, the purpose of which must be consistent with federal law, and to open negotiation with the new Governor's staff on looking at better ways to have accountability over the total expenditures of the state.

- Recommends the consideration of a pilot program for virtual reporting of information between agencies and asking an existing agency to look for federal dollars to pay for the pilot program.

ATTACHMENTS

Full Committee – Agendas & Minutes

- HB 2178 – Committee Authorization

- September 19, 2002
- October 25, 2002
- December 18, 2002

Conference Engrossed

FILED

Betsey Bayless
Secretary of State

State of Arizona
House of Representatives
Forty-fifth Legislature
Second Regular Session
2002

CHAPTER 289

HOUSE BILL 2178

AN ACT

AMENDING SECTION 41-1272, ARIZONA REVISED STATUTES; RELATING TO TAXES.

(TEXT OF BILL BEGINS ON NEXT PAGE)

Be it enacted by the Legislature of the State of Arizona:

Section 1. Section 41-1272, Arizona Revised Statutes, is amended to read:

41-1272. Powers and duties; finances

A. The joint legislative budget committee shall:

1. Ascertain facts and make recommendations to the legislature relating to the state budget, revenues and expenditures of the state, future fiscal needs, the organization and functions of state agencies or their divisions and such other matters incident to the above functions as may be provided for by rules of the joint legislative budget committee.

2. Implement a system of fiscal notes to apply to those bills introduced in the legislature that have a fiscal impact. These fiscal notes shall also reflect the fiscal impact of legislation on cities, counties and all other political subdivisions of the state.

3. Implement a system of fiscal notes for any rule as defined by section 41-1001 which has a fiscal impact.

4. ANALYZE THE STATE TAX STRUCTURE, TAX BURDENS ON INDIVIDUALS AND BUSINESSES AND TAX INCENTIVES FOR EXISTING AND PROSPECTIVE BUSINESSES. THE ANALYSES SHALL INCLUDE:

(a) PROJECTION OF THE IMPACT OF INDUSTRY SPECIFIC TAX INCENTIVE PROPOSALS ON THE STATE REVENUE BASE.

(b) COMPARISON AMONG STATES OF RELATIVE TAX BURDENS ON EXISTING AND PROSPECTIVE BUSINESSES.

(c) DETERMINATION OF RELIANCE AND INCIDENCE ASPECTS OF THE TAX STRUCTURE OF THIS STATE.

5. IMPLEMENT A SYSTEM OF FISCAL ANALYSIS THAT APPLIES TO THOSE BILLS INTRODUCED IN THE LEGISLATURE THAT INVOLVE ONE OR MORE PROPOSED CHANGES IN THE TAX LAWS. UNLESS IT IS UNREASONABLE TO DO SO, THE FISCAL ANALYSIS SHALL BE BASED ON ASSUMPTIONS THAT ESTIMATE THE PROBABLE BEHAVIORAL RESPONSE OF TAXPAYERS, BUSINESSES AND OTHER CITIZENS AND SHALL INCLUDE WITHIN THE ANALYSIS A STATEMENT IDENTIFYING THOSE ASSUMPTIONS.

~~4.~~ 6. Adopt rules.

B. The joint legislative budget committee may:

1. Make studies, conduct inquiries and investigations and hold hearings.

2. Meet and conduct its business any place within the state during the sessions of the legislature or any recess of the legislature and in the period when the legislature is not in session.

3. Establish subcommittees from the membership of the legislature and assign to such subcommittee any study, inquiry, investigation or hearing with the right to call witnesses which the joint legislative budget committee has authority to undertake.

C. The joint legislative budget committee shall have the powers conferred by law upon legislative committees.

D. Members of the joint legislative budget committee shall be reimbursed by their respective houses in the same manner as is provided by law for a member of the legislature who attends a duly called meeting of a standing committee.

Sec. 2. Joint legislative budget committee; fiscal analysis report

By October 31, 2002, the staff of the joint legislative budget committee shall report on the progress of implementation of the fiscal analysis prescribed by section 41-1272, subsection A, paragraph 5, Arizona Revised Statutes, to the president of the senate, the speaker of the house of representatives, the chairperson of the senate appropriations committee, the chairperson of the senate finance committee, the chairperson of the house of representatives appropriations committee and the chairperson of the house of representatives ways and means committee.

Sec. 3. Tax reform for Arizona citizens committee; membership; duties; initial report; final report

A. The tax reform for Arizona citizens committee is established consisting of the following members:

1. Four members of the senate who are appointed by the president of the senate, not more than two of whom are members of the same political party, including the chairperson of the finance committee.

2. Four members of the house of representatives who are appointed by the speaker of the house of representatives, not more than two of whom are members of the same political party, including the chairperson of the ways and means committee.

3. One person who represents incorporated cities or towns and who is appointed by the president of the senate.

4. One person who represents counties and who is appointed by the speaker of the house of representatives.

5. One person who represents school districts and who is appointed by the president of the senate.

6. One person who represents a statewide taxpayer organization and who is appointed by the president of the senate.

7. One person who represents the general public and who is appointed by the speaker of the house of representatives.

8. Two people who represent the business community, one who is appointed by the president of the senate and one who is appointed by the speaker of the house of representatives.

B. The chairperson of the ways and means committee in the house of representatives shall call the first meeting and the members of the committee shall choose a chairperson from the committee membership.

C. The committee shall:

1. Study and make recommendations on the fiscal policy and laws of this state, including specific consideration of expansion of state resources and economic development strategies.

2. Study and make recommendations on the tax policies of this state and local jurisdictions, including counties, municipalities, school districts and special taxing districts, to assure that the policies are adequate, equitable, competitive and consistent with economic development strategies.

3. Develop a comprehensive report and recommendations, including recommendations concerning the appropriate tax structure for this state and local jurisdictions and a strategy for transition to the appropriate tax structure.

D. Members of the committee are not eligible to receive compensation or reimbursement of expenses. The committee chairperson may appoint advisory committees as necessary. The governor's office of strategic planning and budgeting, the department of revenue, the joint legislative budget committee and the legislative council shall provide technical assistance to the committee.

E. The committee shall submit a status report to the president of the senate, the speaker of the house of representatives and the governor by December 31, 2002. The committee shall provide a copy of the report to the director of the Arizona state library, archives and public records.

F. The committee shall make a report of its final findings and recommendations to the president of the senate, the speaker of the house of representatives and the governor by September 15, 2003. The committee shall provide a copy of this report to the secretary of state and the director of the Arizona state library, archives and public records.

Sec. 4. Arizona fiscal accountability committee; membership; duties; initial report; final report

A. The Arizona fiscal accountability committee is established consisting of the following members:

1. Four members of the senate who are appointed by the president of the senate, not more than two of whom are members of the same political party, including the chairperson of the appropriations committee.

2. Four members of the house of representatives who are appointed by the speaker of the house of representatives, not more than two of whom are members of the same political party, including the chairperson of the appropriations committee.

3. One person who represents school districts and who is appointed by the president of the senate.

4. One person who represents community colleges and who is appointed by the speaker of the house of representatives.

5. One person who represents a major state agency and who is appointed by the president of the senate.

6. One person who represents a statewide taxpayer organization and who is appointed by the president of the senate.

7. One person who represents the general public and who is appointed by the speaker of the house of representatives.

8. Two people who represent the business community, one who is appointed by the president of the senate and one who is appointed by the speaker of the house of representatives.

B. The chairperson of the appropriations committee in the senate shall call the first meeting and the members of the committee shall choose a chairperson from the committee membership.

C. The committee shall:

1. Study and make recommendations on the expenditure policies of this state, including specific consideration to integrating services and eliminating duplicative programs.

2. Study and make recommendations on the expenditure policies of this state and local jurisdictions, including counties, municipalities and school districts to ensure that government services are provided in an efficient and effective manner. This study shall explore whether savings can be achieved through the privatization of services, the realigning of services between state and political subdivisions and the elimination or streamlining of duplicative programs at the state level.

3. Develop a comprehensive report and recommendations, including recommendations concerning the appropriate policy adjustments related to state expenditures for this state and a strategy for implementation.

D. Members of the committee are not eligible for compensation or reimbursement of expenses. The committee chairperson may appoint advisory committees as necessary. The governor's office of strategic planning and budgeting, the auditor general, the joint legislative budget committee and the legislative council shall provide technical assistance to the committee.

E. The committee shall submit a status report to the president of the senate, the speaker of the house of representatives and the governor by December 31, 2002. The committee shall provide a copy of the report to the director of the Arizona state library, archives and public records.

F. The committee shall make a report of its final findings and recommendations to the president of the senate, the speaker of the house of representatives and the governor by September 15, 2003. The committee shall provide a copy of this report to the secretary of state and the director of the Arizona state library, archives and public records.

Sec. 5. Participation in multistate discussions; definitions

A. Delegates appointed pursuant to subsection B shall enter into multistate discussions on behalf of this state to consider whether this state should enter into an agreement with one or more other states to:

1. Simplify and modernize tax administration in order to substantially reduce the burden of tax compliance for sellers and for all types of commerce.

2. Establish standards for tax compliance software and service providers.

3. Establish performance standards for multistate sellers.

B. For the purposes of this section, delegates shall be appointed as follows:

1. One delegate shall be a member of the house of representatives who is appointed by the speaker of the house of representatives.

2. One delegate shall be a member of the senate who is appointed by the president of the senate.

3. Two delegates shall be appointed by the governor, one of whom shall be the director or a deputy or assistant director of the department of revenue and one of whom shall be a voting member of the municipal tax code commission.

C. After meeting with similar delegations from other states, the delegates shall make recommendations to the legislature regarding the issues the delegates are required to consider under subsection A and any other issue the legislature may require the delegates to consider.

D. If the delegates determine that this state should enter into an agreement with one or more other states, the delegates shall recommend the preparation of legislation to bring this state into substantial compliance with the agreement as a result of the multistate discussions required by this section.

E. In this section, unless the context otherwise requires:

1. "Agreement" means an interstate agreement for simplification and uniformity of taxation among member states in order to reduce the burden of tax compliance for sellers and for all types of commerce.

2. "Seller" means an individual, trust, estate, fiduciary, partnership, limited liability company, limited liability partnership, corporation or any other similar legal entity that sells, leases or rents tangible personal property or a service.

3. "State" means a state of the United States and the District of Columbia.

4. "Tax" or "taxes" means transaction privilege and use taxes imposed pursuant to title 42, chapter 5, Arizona Revised Statutes, or a similar tax imposed by a political subdivision of this state.

Sec. 6. Delayed repeal

A. The following are repealed from and after December 31, 2003:

1. Section 2 of this act, relating to the joint legislative budget committee fiscal analysis report.

2. Section 3 of this act, relating to the tax reform for Arizona citizens committee.

3. Section 4 of this act, relating to the Arizona fiscal accountability committee.

B. Section 5 of this act, relating to participation in multistate discussions, is repealed from and after June 30, 2004.

APPROVED BY THE GOVERNOR MAY 22, 2002.

FILED IN THE OFFICE OF THE SECRETARY OF STATE MAY 23, 2002.

ARIZONA STATE LEGISLATURE

ARIZONA FISCAL ACCOUNTABILITY COMMITTEE

Minutes of the Meeting
September 19, 2002
2:30 p.m. Senate Appropriations Hearing Room 109

Members Present:

Senator Tim Bee	Representative Meg Burton Cahill
Senator Jack Brown	Representative Gabrielle Giffords
Senator Edward J. Cirillo	Representative Laura Knaperek
Senator Ruth Solomon	Representative John Nelson
Kerrie Bluff	Michael Hunter
Mark D. Chernoff	Elliot Hibbs

Members Absent:
John G. Colton
Kim Sheane
Martin Shultz

Staff:
Debbie Johnston, Senate Research Analyst
Brandy Martin, Senate Research Assistant
Joy Hicks, House Research Analyst

Senator Solomon called the meeting to order at 3:05 p.m. and attendance was noted. For additional attendees, see Sign-in Sheet (Attachment A).

Charge of Committee

Brandy Martin, Senate Research Assistant, distributed a handout of the charge of the Committee from the Conference Engrossed version of HB 2178 and the resumes of the non-legislative members of the Committee (Attachment B.) Her testimony came directly from page 4, line 7 of the handout.

Senator Cirillo commented that he was pleased that the second part of the charge of the Committee includes the study of expenditure policies of different levels of government to ensure services are provided in an efficient and effective manner and that duplicative programs can be identified. He stated that he has tried for three years to have the functions of government at all levels reviewed. He stated that to determine how revenue should be shared, the first thing that must be determined is at what level of government programs are being administered currently and the associated costs. Once this has been accomplished, a system for sharing revenues can be developed. He remarked that this Committee has an excellent opportunity to strategically plan.

Selection of Chairperson

Senator Solomon nominated Representative Knaperek as the Chairperson of the Arizona Fiscal Accountability Committee. Without objection, the motion CARRIED by unanimous voice vote.

Public Testimony

Representative Cooley, representing himself, commented that as a small business owner he has dealt with workers compensation insurance for a number of years. He noted that he has had a relationship with the State Compensation Fund also. He stated that there was a rumor that privatizing the State Compensation Fund may be a subject discussed to address State budgeting problems. He stated that he knows from personal experience the importance of the State Compensation Fund to the small business owners in Arizona. He noted that workers compensation insurance is mandated by the State. He remarked that private insurance carriers only come to the State when there is a profit to be made. He stated that when profitability no longer exists, many of these insurance companies do not remain in the State. He noted that the State Compensation Fund has a policy of excepting all employers and will write policies and become a safety net for the mandatory insurance that is required. He stated that Arizona had presented its workers compensation plan as a model for other states, and he opined that it is well run and well structured. He stated that other states have established state compensation funds because when private insurers choose to not insure a business, that business and any others not chosen for coverage, they are placed in a risk pool and have to pay a premium above what is the standard rate. This rate is filtered down to the small business owner to pay. He stated that the State Compensation Fund acts as a safety net and provides mandatory insurance for every company. He stated that keeping this program is essential to small businesses.

Senator Cirillo commented that a recent report issued by the Goldwater Institute included a recommendation to end the corporate income tax and unemployment insurance fund. He asked for Representative Cooley's opinion on discontinuing the unemployment insurance fund. Representative Cooley stated that the premium is very small for unemployment insurance and opined that this is not onerous on small business owners. He stated that it does provide a pool of funds to help unemployed people and as an employer, he supported this program.

Overview of Potential Items for Committee Consideration and Discussion

Representative Knaperek listed several items from the strategic program area reviews (SPAR) that were set aside in the 2002 legislative session so that staff and members could focus on the budget crisis. She stated at this time, members should feel free to discuss any conceptual issues for further study. She stated that the scope of the Committee is very large and very broad and opined that if the Committee attempts to do everything, nothing would be accomplished. Drawing from the SPAR list, she suggested that privatization and the sale of state assets would be one place to start. She noted that the Health and Welfare SPAR Committee was looking at the delivery of children's services system, specifically focusing on developmental disability services. She stated that issues such as licensing and contracting could be reviewed. She noted that the Education and Natural Resources SPAR Committee focused on special education and the Criminal Justice and Transportation SPAR Committee looked at county assistance. She stated that she would send copies of the SPAR items to members to review for suggestions at the next meeting.

Senator Solomon suggested that because of the projected reduction in state shared revenues with regard to what counties and cities can anticipate next year and in the 2004 budget, a review of what commitments have already been made to the cities and counties needs to be done.

Senator Cirillo commented that he would like to broaden the review of the different levels of government; state, county and city into approximately six categories, such as health, judiciary and public safety to look for duplication of services and study what the three levels of government should be doing with revenue sharing. He stated that a comprehensive review may demonstrate a way to obtaining a better balance.

Representative Knaperek suggested that Senator Cirillo spearhead a working group with any volunteers from the committee. Senator Bee, Representative Burton-Cahill and Mr. Hunter volunteered to be a part of the working group. Senator Cirillo commented that the workgroup would report back to the Committee in approximately four weeks.

Representative Giffords remarked that having tangible goals and timelines would be beneficial to have before session begins in January. Representative Knaperek stated that this is a very good point. She opined that this particular issue will take longer to review than what the Committee is set up for. She suggested that there may be something the committee could review in the remaining time, such as the state agency licensing and contracting issue, on which a lot of work has already been done.

Mr. Elliott suggested obtaining data regarding other states organizational structures, much along the lines that Senator Cirillo was discussing, in addition to state government operations. He stated that some states consolidate all of their boards and commissions under one administrative wing, rather than having every board and commission have those kinds of expenditures. He stated that there must be other areas of state government that can be identified, which may help the Committee to focus attention quickly on issues that could have immediate value to them. Another issue he noted of concern was telecommunications within the State. He noted that this issue cuts across all levels of government. He opined that if the State could learn how to integrate and leverage those expenditures much more effectively, the State could do a better job of building and expanding rural telecommunication capabilities. He stated that there is some opportunity there for consolidation and perhaps some savings, but there is also an opportunity to expand or improve the service delivery in rural areas.

Representative Knaperek agreed with the idea of the 90/10 consolidations and opined that this issue is one that could get done quickly, which will give the Committee some short and long-term goals. She opined that telecommunications is a way to consolidate and integrate some of the states systems and save money for the universities, school districts, state agencies, counties, cities and other entities. She opined that the Committee needs to focus on these two things immediately as well.

Senator Solomon noted that the National Conference of State Legislators (NCSL) has always been wonderful with proving data about what states are doing in specific areas. She recommended staff contact NCSL for information and possible presentations that could be made to the Committee.

Representative Knaperek suggested Richard Stavneak from the Joint Legislative Budget Committee provide the research with NCSL.

Mr. Hunter remarked that in addition to the focus of the Cirillo workgroup, there are many areas within K-12 finance, as well as other areas of funding, that are dependent upon formulas. He stated that a major component of these formulas is how to count the people that the funding is being generated for. Arizona has a national reputation for having a very complicated K-12 funding formula and Mr. Hunter opined that certain components of the formula "count ghosts." For example, there is a $48 million discrepancy between two transportation formulas, depending on how students are counted for transportation services. He noted that this affects the State General Fund as well as local taxpayers. He opined that the State should decide which formula will be used. He suggested that this issue be reviewed by the Committee not only for the current budget difficulties, but also for future fiscal accountability.

Representative Knaperek suggested that another working group be formed with Mr. Hunter spearheading the group to review this education issue. In addition, Senator Brown, Ms. Bluff, and Mr. Shultz will be in the group.

In response to Representative Knaperek, Mr. Chernoff stated as an attorney, he represents the business community. He stated that the most common complaint from his business clients is the difficulty they have with finding the appropriate entity to assist them with solving their problems. He remarked that it is generally felt that if the same job were being done through private organizations, more responsiveness would be evident.

Representative Knaperek suggested that Mr. Chernoff lead a working group on privatization issues with Senator Bee, Representative Giffords and Mr. Colton. Additionally, she suggested that the issue of the selling of assets be researched by staff to be presented at a future committee meeting. Later, it was decided that Senator Bee would lead this working group.

Senator Bee commented that another study committee was established at the same time as this one, to study and make recommendations on the tax policies of the State.

Representative Knaperek suggested that at the next meeting a report of both study committees should be given.

Representative Knaperek commented that she would head the working group to discuss the issues brought up by Mr. Hibbs and stated that the members will be notified of all the various working group meetings and encouraged any of the members to join in any of the workgroups. She announced the next Committee meeting will be Friday, October 25 from 10:00 am to 2:00 p.m. She stated that the remainder of the meetings would be held the day after the JLBC and JCCR Committee meetings.

Without objection, the meeting was adjourned at 3:50 p.m.

Respectfully submitted,

Tracey Moulton

Tracey Moulton
Committee Secretary

(Tapes and attachments on file in the Secretary of the Senate's Office/Resource Center, Room 115.)

Hearing Room No. 109
Date: 9-19-02
Time: 2:30pm

MEETING OF COMMITTEE ON

Arizona Fiscal Responsibility Committee

NAME	REPRESENTING	BILL NO.

A

ARIZONA STATE LEGISLATURE

Interim Meeting Notice

Open to the Public

ARIZONA FISCAL ACCOUNTABILITY COMMITTEE

DATE: Friday, October 25, 2002

TIME: 10:00 a.m.

PLACE: House Hearing Room 4

AGENDA

1. Call to Order
2. Reports from working groups:
   - A. Privatization
   - B. Revenue Sharing
   - C. Education
   - D. Organizational structure of government
3. Public Testimony
4. Discussion
5. Adjourn

MEMBERS:

Senator Bee	Representative Knaperek, Chair
Senator Brown	Representative Burton Cahill
Senator Cirillo	Representative Giffords
Senator Solomon	Representative Nelson
Kerrie Bluff	Michael Hunter
Mark D. Chernoff	Dr. Kim Sheane
John Colton	Martin Shultz
Elliott Hibbs	

va
10/18/02

People with disabilities may request reasonable accommodations such as interpreters, alternative formats, or assistance with physical accessibility. If you require accommodations, please contact the Chief Clerk's Office at (602) 542-3032, (TDD) 542-6241.

ARIZONA STATE LEGISLATURE

ARIZONA FISCAL ACCOUNTABILITY COMMITTEE

Minutes of the Meeting
Friday, October 25, 2002
10:00 a.m., House Hearing Room 4

Members Present:

Senator Bee
Senator Brown
Senator Cirillo
Kerrie Bluff
Mark. D. Chernoff
John Colton
Elliott Hibbs
Dr. Kim Sheane
Representative Knaperek, Chair
Representative Burton Cahill

Members Absent:

Senator Solomon
Michael Hunter
Martin Shultz
Representative Giffords
Representative Nelson

Staff:

Debbie Johnston, Research Staff Director
Joy Hicks, House Research Analyst

Representative Knaperek called the meeting to order at 10:10 a.m. and attendance was noted.

Representative Knaperek stated that the working groups would report their comments and recommendations.

Privatization

Senator Bee reported that the Privatization working group had met once, with the majority of the time spent on a presentation from the Joint Legislative Budget Committee (JLBC) and the Department of Corrections (DOC). The working group will continue to help DOC in their efforts to pursue privatization. He stated that there is quite a bit of money being spent on the Foster Care and Adoption programs and there will be a presentation next month from the Department of Economic Security (DES) explaining where the funds are being spent. The State Parks will also be making a presentation next month. Finally, the working group is looking at the privatization of the Historical Society.

Mark D. Chernoff commented that they addressed the issue of duplication of services across departments which could save funds by subcontracting to private entities. He also suggested that the working group look at areas in the State that are at a high risk of coming in over budget.

Representative Knaperek asked whether the State would be released from liability if it subcontracted a service. Mr. Elliott Hibbs answered that each case would have to be evaluated individually, but in many cases subcontracting does not remove the State from liability as subcontractors are considered agents of the State.

In response to Representative Knaperek, **Richard Stavneak, Director, JLBC,** commented that the University of Arizona Medical School staff and hospital policy was carved out by JLBC to create a relationship that limits the amount of liability the State has with certain functions at the hospital.

Senator Cirillo suggested that concerning privatization, areas of competition should be looked at to get a fixed price contract.

Mr. Hibbs suggested that the working group contact the agencies to see what information on privatization is already available.

Revenue Sharing

Senator Cirillo stated that the Revenue Sharing working group had met once and had a subsequent meeting with the counties and cities. He presented a handout entitled "FY 2002 Actual General Fund Expenditures and Revenues" (Attachment A). He stated that the group is looking at duplications between the levels of government and if the services are being provided in the most efficient manner. He further stated that the handout would be filled out by both the cities and the counties, with JLBC filling out the portion for the State. The objective will be to determine who is doing what, how effective it is being done and how the money is divided.

In response to Representative Knaperek, Senator Cirillo stated that other members of the group are Senator Bee, Michael Hunter, Representative Nelson and Representative Burton Cahill.

Organizational Structure of Government

Representative Knaperek stated that the Arizona Department of Administration (ADOA) and CISCO discussed possible savings opportunities through the investment in a new voice/IP telecommunications system. She further stated that the Auditor General has the technology and is currently saving money.

Mr. Hibbs stated that there is duplication of telecommunication services in the State agencies, which could be consolidated in a centralized service provider for significant savings. The ADOA is in the process of doing an audit to study this program and a report will be out on November 1.

Representative Knaperek further commented on the Arizona State Retirement Savings Contribution Rates. She stated that the following three questions would be answered by the next meeting: Can rate adjustments be phased in; Is it constitutional; and What is the impact of further generations of the phase in?

She further commented that the Office of the Auditor General (OAG) stated that the only mandated full-time student equivalent (FTSE) count is for community colleges. She stated that starting in FY 2003, the OAG will begin to audit dual enrollment.

Representative Knaperek commented that the working group discussed if the Department of Education (DOE) can calculate the net flow of students from public to charter schools, because students are currently being double counted, and thus double funded. She stated that language needs to be adopted for sampling or random count to prevent this problem.

Representative Knaperek commented that the OAG does not currently audit university enrollment. The group is asking the Arizona Board of Regents if they do audits or random counts. She stated that the funding formula is 22:1 students to faculty member. As this formula is not mandated, the State does not have to fund at this level.

Representative Knaperek commented that Arizona Health Care Cost Containment System (AHCCCS) utilizes independent auditors. The OAG is now conducting a performance audit for the first time in 16 years. The report should be out next year.

Education

Senator Cirillo stated that Michael Hunter is the chairman of this group. Their charge is to study formulas that are used for allocating funding. He presented a handout entitled "Fiscal Accountability Formula Issues" (Attachment B). His testimony came directly from the handout.

Representative Knaperek commented that she would like to see compatible laws and compatible formulas added to the criteria for all of the working groups.

Representative Knaperek asked the group to look at the Qualifying Tax Rate (QTR) issue under the guise of equitability. She further asked each working group to come up with a short-term list and a long-term list for recommendations that will have effects on the FY 2003 and the FY 2004 budget and forward.

Representative Knaperek announced that the next meeting will be held on November 21, 2002.

There being no further business, the meeting was adjourned at 10:50 a.m.

Respectfully submitted,

Debbee Kennedy

Debbee Kennedy
Committee Secretary

(Tapes and attachments on file in the Secretary of the Senate's Office/Resource Center, Room 115.)

ARIZONA STATE LEGISLATURE

Interim Meeting Notice

Open to the Public

ARIZONA FISCAL ACCOUNTABILITY COMMITTEE

DATE: Wednesday, December 18, 2002

TIME: 11:00 a.m.

PLACE: House Hearing Room 1

AGENDA

1. Call To Order
2. Reports and Recommendations from Working Groups:
   - A. Privatization
   - B. Revenue Sharing
   - C. Education
   - D. Organizational structure of government
3. JLBC Presentation on State Shared Revenues
4. Public Testimony
5. Discussion
6. Final Recommendations
7. Adjourn

MEMBERS:

Senator Bee
Senator Brown
Senator Cirillo
Senator Solomon
Kerrie Bluff
Mark D. Chernoff
John Colton
Elliott Hibbs

Representative Knaperek, Chair
Representative Burton Cahill
Representative Giffords
Representative Nelson
Michael Hunter
Dr. Kim Sheane
Martin Shultz

va
1/13/2003

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ARIZONA STATE LEGISLATURE

ARIZONA FISCAL ACCOUNTABILITY COMMITTEE

Minutes of the Meeting
December 18, 2002
11:00 a.m. House Hearing Room 1

Members Present:

Representative Laura Knaperek, Chair
Representative Meg Burton Cahill
Representative Gabrielle Giffords
Representative John Nelson
John G. Colton
Michael Hunter
Senator Jack Brown
Senator Edward J. Cirillo
Senator Ruth Solomon
Kerrie Bluff
Elliot Hibbs
Martin Shultz

Members Absent:

Senator Tim Bee
Mark D. Chernoff
Dr. Kim Sheane

Staff:

Joy Hicks, House Research Analyst
Debbie Johnston, Senate Research Analyst
Katy Proctor, House Assistant Research Analyst
Brandy Martin, Senate Assistant Research Analyst

Representative Knaperek called the meeting to order at 11:15 a.m. and attendance was noted. For additional attendees, see Sign-in Sheet (Attachment A).

Reports and Recommendations from Working Groups

Privatization Work Group

Representative Giffords stated that the privatization work group met once and information relating to the Department of Economic Security (DES) and State Parks was presented. She stated that no further discussion was held and no recommendations were made.

Joy Hicks, House Research Analyst, explained that State Parks gave a preliminary review of their privatization report that is due in December. She stated that in addition, Stefan Shepherd from the Joint Legislative Budget Committee (JLBC) and a representative from DES presented information regarding privatization issues within DES based on ways other states have researched, specifically on foster care. She stated that it was noted that a comparison of states is difficult. The final topic that was discussed was regarding the privatization of prisons or improving the utilization of other options for the Department of Corrections (DOC). Brad Regens, from JLBC as well as Mr. Smith from DOC talked about considerations they needed in terms of language and statutory changes that would help enable them to further privatize some of their facilities.

Representative Knaperek requested Senator Bee and Ms. Hicks work with staff to develop language to be placed within the Committee's report.

In response to Senator Solomon, Ms. Hicks stated that an example that the work group reviewed was that of Kansas and how they privatized their foster care adoption service. She deferred further explanation to Mr. Shepherd.

Mr. Shepherd stated that Kansas has privatized their case management, which is something that other states have not done and in the brief review given to the working group, it was noted that this is one area that DES has not privatized in Arizona. He stated that although there are no State operated orphanages, the case management of these cases is done through DES. He remarked that Kansas privatized its case management and at the same time, it added a lot of new money into the system as a whole, which made it impossible to determine if privatization cost or saved Kansas any money.

Senator Solomon asked if the privatization of Kansas case management was a benefit to children and families. Mr. Shepherd stated that most of the information that he had reviewed on the Kansas experience spoke about privatization, but the problem was that there was so much new money added into the system, that privatization itself was not the focus of the reviews. He stated that it was difficult to distinguish if the children lives were better because more money was placed in the system or if the State's case management of child welfare cases was better than private, not for profit, entities case management of kids in the system. He remarked that several states have privatized child support programs, including Arizona where a couple of counties have their case management privatized, as opposed to child welfare.

Senator Solomon remarked that there is a lot more of this issue to review and expressed her hope that the Committee report reflects the need for further study, given the circumstances and the need, and possible legislation to that effect.

Senator Cirillo commented that a word of caution regarding privatization should be in the Committee report as well. He opined that privatization is not going to be effective unless there are competitive sources involved. He opined that this should be a point of criteria for the establishment of privatization.

Representative Nelson concurred with Senator Cirillo and noted that the City of Phoenix has seen with the privatization of sanitation and a number of janitorial services, the need for a bid program and has set criteria for an effective cross comparison of the bidders and services that would be rendered.

Mr. Shultz commented that there is some outsourcing occurring within the State in the business sector. He noted that this is an alternative to privatization and is an efficient means of reducing certain costs. He remarked that Mr. Hibbs might have further information on this issue.

Mr. Hibbs stated that there is a long list of outsourcing being investigated by the Department of Administration (ADOA) for outsourcing and privatization in State government for all of State agencies. He stated that the Office of Excellence in Government has compiled information for the last few years about the growth of outsourcing and privatization. He remarked that approximately 60% of the money that is spent is paid to outside organizations to provide service or function such as some ADOA custodial services and some of the Departments telecommunication and data center services are outsourced. Additionally, many other areas have partial outsourcing or privatization occurring.

Revenue Sharing Work Group

Senator Cirillo distributed a handout entitled FY 2001 Actual Expenditures and Revenues (Attachment B). He explained that the revenue sharing work group's project was to review state, county and municipality functions to identify what programs/services each of the levels is providing and if there is any duplication of programs/services. Additionally, the work group was to review the way revenue is split up among the governmental levels and examine whether the revenues match their expenditures. He remarked that surprisingly the total revenues and total expenditures are not far out of balance. He stated that this is a great starting point for the Committee to continue with and that this document can be used as a template. He opined that next year, each of the line item expenditures, starting with economic development should be reviewed individually. This review should answer the following questions: 1) what is the service being provided, 2) what does each of the governmental levels do in the area of economic development and 3) is there any ability to save money, coordinate effort or consolidate. He stated that this should be applied to all the areas of expenditure.

In response to Representative Knaperak, Senator Cirillo explained that the data in this document came from the County Supervisors Association, counties and cities, and the League of Cities and Towns. He noted that information was obtained from all the counties and from municipalities of over 100,000 people.

Representative Giffords requested that the revenue/expenditure information be separated by county.

Representative Nelson requested information from smaller cities and towns that are impacted by State shared revenues. He opined that this information is important in order to know whether the cap is valid.

Representative Knaperek commented that this work would need to be directed to staff to obtain.

Education Formulas Work Group

Mr. Hunter stated that the working group on education funding formulas had participation from several legislators and citizens on the Committee. He stated that one of the initial understandings of the Committee was that it would be as comprehensive as possible in looking at funding formulas. He distributed a handout entitled Arizona Fiscal Accountability Committee, Working Group on Education Funding Formulas (Attachment C).

The following are highlights from his presentation:

- Criteria for Reform – avoiding redundancy, accountability, flexibility, predictability, timely, realistic, divisible, efficient, equitable/fair
- Initial Focus : Transportation Revenue Control Limit (TRCL): Problem and Policy Options; Career Ladder: Problem and Policy Options; and Community College Equalization: Problem and Policy Options
- Formulaic funding in general
- K-12 and K-12 Capital(Students First) issues
- Community College issues
- Arizona State Retirement System (ASRS): imminent Actuarial increases
- Arizona Department of Corrections issues
- State and local relationships
- Other issues needing analysis

In response to Representative Knaperek, **Steve Schimpp, Fiscal Analyst, JLBC,** explained the way the Career Ladder program works is if a district is in the program, the district can increase their base level by 5.5%, which is not designated for drop out prevention or anything specific. He stated that parts of the Career Ladder give basic guidelines as to how the program is supposed to improve instruction. Each district must have some sort of plan to demonstrate how it intends to use funds to improve instruction.

Representative Giffords commented that she would like to know what type of performance studies, if any have been done on this issue.

Mr. Hunter remarked that the only information that he is aware of is from former members of the advisory committee. He stated that to his knowledge no such study has been performed.

Senator Solomon asked if the question of supplanting has been discussed with regard to using Proposition 301 monies. Mr. Schimpp remarked that if there were language specifically linking the loss of Career Ladder money to the new money, there would be a stronger argument for saying that supplanting would be involved.

Mr. Hunter remarked that supplanting versus supplementing was discussed in the working group. He opined that this argument could be used whenever a program has been capped and is going to be phased out, to keep the program intact. He stated that is why the work group suggests phasing out the Career Ladder program rather than having the program phased into Proposition 301. He stated that if not phasing the program out, an evaluation should be preformed by the Committee to answer the important questions that are being raised about it. He opined that Proposition 301 does not take Career Ladder completely off the table.

Senator Cirillo commented that instead of having any entity held harmless, a fixed variable concept should be used.

Organizational Structure of Government Work Group

Representative Knaperek invited Elliott Hibbs to comment and update the Committee on the privatization of telecommunication services. He remarked that the Legislature had required ADOA and the Government Information Technology Agency (GITA) to examine the State telecommunication system for efficiencies with a due date of November 1, 2002. The study was completed and other alternatives were reviewed with information gathered from all of the State agencies that have telecommunication services. Based on this information, a study was initiated looking at four different alternatives. The first alternative was to completely de-centralize telecommunication services and allowing each agency to have their own system. The second alternative was to continue the type and level of current services, which is 30% centralized and 70% de-centralized. The third alternative was the consolidation or centralization of all services administered and operated by ADOA, which operates the current 30% of services. The fourth alternative is the centralization of services along with privatizing the operation of the system. Three of the major criteria of study were cost, flexibility, and service deliverability. The recommendation from GITA and ADOA is to move toward privatization of telecommunication services in a centralized context. He stated ADOA and GITA are moving ahead with the development of a request for a proposal with the assistance of all the agencies that would be affected by such a move. The anticipated date for completion of the proposal is March 2003 and there is an objective to have centralization that is privatized in approximately one year.

In response to Representative Knaperek, Mr. Hibbs stated that statute requires that any organization that wants to procure telecommunication services go through ADOA. He opined that this requirement would be continued with the requirement that the organization clearly demonstrate that there are service capabilities that can not be provided by the current provider/contractor, there are specialized needs that can not be met or there are cost savings that cannot be achieved by the current provider before ADOA would allow an organization to go outside of a centralized system.

Representative Knaperek noted that another topic of study for her work group had been contribution rates, and asked staff to make a presentation on the information received from the Arizona State Retirement System (ASRS). She noted that representatives from ASRS were not available at this time.

Ms. Hicks stated that although she was not present at any of the discussions, she was aware that the presentation is an explanation of what the contribution rate increase would be for this year and the general fund impact. She stated that she was present at a private meeting with staff, Mr. Stephenson and Mr. McGuire prior to Thanksgiving. At that time it was stated that the 2004 increases, for both employer and employee, would increase from the current rate of 2.49% to a 5.7% contribution rate. JLBC estimates this will have a $30 million impact on the general fund and an impact of $11.3 million on other funds. She stated that school districts and political subdivisions that participate in ASRS would also experience an increase in cost.

Representative Knaperek remarked that the increase in costs is a result of changes to pension benefits as well as changes in the stock market. She distributed a handout entitled ASRS Informational Bulletin (Attachment D). She further explained that another issue was that the State of Arizona's contribution rate is amongst the national average, but it is a very rich plan. She remarked that there is a difference in some states' reports that include social security.

Katy Proctor, House Assistant Research Analyst, explained another issue that was discussed was that Arizona would soon be experiencing an increase in retirees entering into the system, while other states will not.

Representative Knaperek noted that ASRS would continue to ask for additional staff to deal with the increased number of retirees that will have an effect on the workload of the agency.

In response to Representative Knaperek, Ms. Hicks suggested that Mr. McGuire put his comments and explanation of the Internal Revenue Service (IRS) issue in writing for distribution among the Committee members.

Representative Knaperek stated that Mr. McGuire explained that if one state were to request an exception in a modified plan, the IRS would likely accept it, but apparently there are many states with similar requests. It was Mr. McGuire's opinion that the IRS would not accept multiple requests. She stated that her work group would like to request the Committee to review the drop program and the DC program.

Representative Knaperek remarked that the Director of the School Facilities Board (SFB), Mr. Boot, gave a presentation and discussed some outstanding issues at her request. One of the topics was building renewal distribution for FY 2003. She stated that the law was suspended in the 2003 budget for $110 million and this issue is in court. She stated that there was $38 million available and the SFB voted 5-4 to distribute half of the money in January/February and the other half in the later part of the year. She stated that this issue has yet to be resolved and there are separate interpretations of the intent in the law. Additionally, the Tanque Verde issue remains to be settled. She stated that if the Legislature chose, the building of the Tanque Verde could still be stopped, but it would have to be done in the early part of the next legislative session, with savings of approximately $15 million.

Lorenzo Martinez, Fiscal Analyst, JLBC, explained four other cost savings ideas brought to the working group. The SFB recommended making changes to the building renewal formula that could potentially generate approximately $35 million. The four components would be treating portable space the same as permanent space. Currently the formula allocates more money to portable space on the assumption that the life span of portable space is less than permanent space. SFB states however that the life span for both are essentially the same. Another component is to not include 15% of the funding for replacement space when it is being built, because typically 15% is spent on fixtures, furniture and equipment. The third component addressed any new construction, and a recommendation to not include 15% of funding to pay for software and computers. The final component was to limit the age of the buildings to 30 years because the formula adds more funding the older the building is. However, the logic, is that within a 30 year span, a significant amount of the building components would have been replaced, thereby, reducing the age of the building.

Mr. Martinez stated another item discussed was the elimination of a requirement in statute to have SFB provide project management for new construction programs. He stated that SFB estimates that this new requirement would cost approximately $8 million. Additionally, the SFB suggested eliminating the requirement in statute to take into account whether construction includes quality products. There is no definition for quality products and SFB has stated that in their opinion as long as construction is meeting the minimum guidelines established by the SFB, this would constitute quality products. Another item that was discussed was requesting the Legislature to reconsider the requirement that SFB provide an accommodation school if requested by a county.

Mr. Martinez commented another item discussed was possibly developing a process by which SFB could make sure that schools are using the building renewal monies appropriately. He remarked that SFB suggested the creation of a graded square foot formula. Currently, there is one formula that is applied to all new school construction and SFB suggested creating a scale for schools.

In response to Senator Solomon, Representative Knaperek commented that currently SFB is statutorily required to inspect schools every five years. If they find that the school district is not maintaining the school properly, they do not have the ability to make them do so. This has been a complaint for the last two years and a request has been made to have legislation created to address this problem.

Representative Knaperek commented that gathering information relating to full time employee (FTE) positions in State government has always been difficult to come by. For example, the Arizona Department of Transportation (ADOT) FTE census has different terms and definitions from other State agencies.

Richard Stavneak, Director, JLBC, stated that there is a difference in how seasonal and temporary FTEs are counted. He remarked that ADOT does not count these positions, but JLBC is of the belief that an employee who works a total of 2,080 hours in a year, represents a FTE position and should be considered in terms of putting a ceiling on the number of State employees.

Representative Knaperek stated that the House Rules Attorney reviewed the issue and recommended language. She suggested that rather than use that language, the Committee should make a recommendation that something be put into statute so that there is a clear definition of what an FTE is and that the Legislature receive an FTE census count from every State agency in the next budget.

Representative Knaperek commented that the work group started to investigate audit counts. She stated that this information has been gathered and no further work needs to be done at this time.

Representative Knaperek stated that the issue of maximizing federal dollars is another issue under review. She stated that DES is looking at bringing down federal dollars from Title 4 for foster kids.

Mr. Hibbs commented that there are a number of State agencies that are looking into federal dollar maximization in addition to DES and opined that there is a request for proposal (RFP) for Arizona Heath Care Cost Containment (AHCCCS) that other agencies are trying to join for a massive study as opposed to individual studies.

JLBC Presentation on State Shared Revenues

Michael Stelpstra, Fiscal Analyst, JLBC, distributed a handout entitled State Policy Reports (Attachment E) and explained that Arizona is ranked third in the country providing 45% of the State's general expenditures to local governments. This includes not only State revenue sharing but also all aid including restricted grants. He said some of the variables included in the report depends on the mix of State and local responsibilities. States that assume more responsibility have less aid to local governments and it also varies based on the authority that local governments have to raise their own revenues. In states where local governments can raise more revenue on their own, the State is providing less revenue. He noted that it also varies on geographic considerations. States that are more centralized and compact can provide more services at the State level. States, like Arizona, which are large with a dispersed population, provide more services at the local level. Arizona is also ranked high among the states for the percentage of local government's revenue that is coming from the State. According to the study, 39% of the Arizona local government's revenue was coming from the State in FY 99. He stated that 18% of the aid that Arizona is sending to local government is unrestricted, which is considered revenue sharing, which places Arizona 11th in the country. Referring to page 7 of the handout, he noted that Arizona is only one of 18 states that actually provides aid in all four of the major areas.

Kim Hohman, Fiscal Analyst, JLBC, distributed a handout entitled State-Shared Revenue Worksheet (Attachment F). She explained that the top portion of the handout demonstrates various scenarios adjusting urban revenue sharing. Currently the distribution rate is 14.8. The bottom portion of the handout demonstrates the sales tax distribution and changing from an immediate distribution to a one or two year lag.

In response to Representative Knaperek, Mr. Stavneak explained that the State shares with local governments, 14.8% right now. With the alt-fuel problem, the State agreed to hold the cities and counties harmless because urban revenue sharing is based upon 14.8% of both income and corporate tax collections from two years ago. From that perspective, when there was a drop in income tax collections due to the claims of alternative fuel tax credits, the State decided that this would not be factored into how much the cities would receive in terms of revenue sharing.

Final Recommendations

> **Senator Solomon moved that the Committee request DES, ADC and the State Parks Department to submit recommendations to the Fiscal Accountability Committee as to how they intend to use either privatization or outsourcing as a means to provide a more efficient service to be used in the final report of the Committee. The motion CARRIED by voice vote.**
>
> **Mr. Shultz moved that the recommendation that the Fiscal Accountability Committee request a summary of the State of Arizona's outsourcing activities and further requests that the appropriate work group be requested to determine additional opportunities for outsourcing to maximize savings plus improve the service effectiveness of such strategies. The motion CARRIED by voice vote.**
>
> **Senator Cirillo moved to establish a work group to review, discuss and bring recommendations back to the Fiscal Accountability Committee regarding retiree health insurance generally and specifically: rural and urban heath insurance issues and health care risk pool issues. The motion CARRIED by voice vote.**
>
> **Senator Cirillo moved that the funding formula working group should investigate the use of a fixed variable approach to eliminate the need for hold harmless considerations, which compromise formulas. The motion CARRIED by voice vote.**

Senator Solomon remarked that her first motion, with regard to privatization and outsourcing, should deal with child support enforcement. She requested that if this is unclear, that it be included.

Representative Knaperek suggested that the report from her work group regarding the cost savings suggestions from the SFB be incorporated into the interim report.

Mr. Hunter moved that the documents and the work in progress of all the work groups be adopted into the interim report and forwarded onto the continuation of this Committee. The motion CARRIED by voice vote.

Senator Solomon moved that the interim report include a recommendation to review the statutes with regard to the drop program and the deferred compensation program. The motion CARRIED by voice vote.

Senator Solomon moved that the interim report include a recommendation that the Appropriations Committee as well as the ongoing Fiscal Accountability Committee continue to exam FTE with specific reference to a definition of what an FTE is. The motion CARRIED by voice vote.

Senator Solomon moved the creation of a one-stop qualification center to allow the State to better monitor participants and their qualification criteria in State programs and be charged to more actively enforce the collection of co-payments and investigate and prosecute incidences of fraud. The motion CARRIED by voice vote.

Representative Knaperek stated that a bill analogous to the Colorado Taxpayers Bill of Rights (TABOR) was introduced last year as HCR 2027 by Representative Pearce. HCR 2027 would have limited the amount of State revenues appropriated by the Legislature in FY 2004 and each fiscal year thereafter not to exceed the amount of State revenues appropriated in the preceding fiscal year adjusted for change in cost of living. Excess revenues collected would be returned to taxpayers. She explained that the Colorado TABOR is very similar, with these differences:

- the types of capital construction that are exempt for the revenue limit calculation.
- court settlements, orders or new programs mandated by the federal government can also be exempt in the first year, and the legislature has the authority to enact exemptions, but would require a public vote.
- revenue limits are required to be reviewed every ten years and are then adjusted for population and inflation.

Representative Knaperek commented that both Colorado and Arizona have expenditure limits of sorts. Arizona is limited to appropriate no more than 7% of personal income of the State for that FY, while Colorado's limit is 6%. She opined that this should be included in the Committee's report as a means to be more fiscally accountable.

Senator Cirillo commented that there have been some problems in Colorado. He stated that he would want to amend the Colorado TABOR so that any excess tax, over the amount the State should receive by the demographics and cost of living, should be used before tax reductions are given or should be placed in the rainy day fund.

Senator Solomon asked how another tragic event would effect the Legislature's ability to provide for those populations.

Representative Knaperek stated that the State would only be allowed to spend what revenues are coming in. Exceptions would be for court settlements, new programs mandated by the federal government, or legislative discretion for new programs.

Senator Solomon remarked that she had concerns regarding the language and questioned the use of rebates versus the wisdom of permanent tax reduction. She stated that she could not support this recommendation.

Representative Nelson moved that the Colorado TABOR example be included in the report for future consideration. The motion CARRIED by voice vote.

Senator Solomon moved that the interim report include the concept of the Legislature appropriating non-custodial federal monies, the purpose of which must be consistent with federal law, as good public policy. The motion CARRIED by voice vote.

Senator Cirillo moved to amend the Solomon motion to: recommend that the Fiscal Accountability Committee open negotiation with the new Governor's staff on looking at better ways to have accountability over the total expenditures of the State. The motion CARRIED by voice vote.

Representative Knaperek moved to amend the Solomon motion to include language in the interim report that talks about not only appropriating federal dollars as an option, but another option could be a pilot program for virtual reporting of information between agencies and asking some existing agency to look for federal dollars to pay for the pilot program. The motion CARRIED by voice vote.

Without objection, the meeting was adjourned at 1:25 p.m.

Respectfully submitted,

Tracey Moulton
Committee Secretary

(Tapes and attachments on file in the Secretary of the Senate's Office/Resource Center, Room 115.)

Privatization Handouts

- Department of Corrections – Prison Privatization
- State Parks
- Department of Economic Security – Adoption/Foster Care
- Pioneer's Home

Arizona Department of Corrections (ADC) - Prison Privatization

I. Background:
   i. FY 1993 - First appropriation for a private prison in Arizona
   ii. FY 1995 - First Arizona private prison opened
   iii. First contract for 450 (350 male & 100 female) community treatment beds

II. Current Usage of Private Prisons by ADC:
   i. FY 2002 – a total of 1,450 beds at 3 private prison facilities (minimum security beds)
   ii. FY 2003 – funding for additional 1,295 private prison beds (a total of 2,745 at year-end)

III. FY 2001 Cost Comparison – ADC Level 2 Beds (minimum security) vs. Private Prison:
   i. Average ADC Level 2 per capita cost of $50.14
   ii. Average Private Prison per capital cost of $44.06

IV. Comparison of Private Prison Usage:
   i. Arizona – 9.1% of inmate population in privately-operated facilities (FY 2003 year-end)
   ii. National Average – 6.1%
   iii. Federal Government – 11.9%
   iv. Highest percentage of inmate population privatized – District of Columbia at 47.1%
   v. Lowest percentage of inmate population privatized – 19 states with no privatization

V. Arizona Privatization Statutes:
   i. Allows ADC director to site private prison (any security level)
   ii. Requires public notification and Joint Select Committee on Corrections review
   iii. Requires JLBC review of Request for Proposals
   iv. Private prison must provide at least the same quality of services as the state at a lower cost or superior quality of service at the same cost
   v. ADC retains task of awarding earned release credits and calculating inmate release dates
   vi. Private vendor liable for emergency, public safety or security costs provided by state or political subdivision

VI. ADC Oversight of Private Prisons
   i. Department employed staff on site at each private prison
   ii. Annual audits and inspections
   iii. Biennially compare private prison services to services in state-operated complexes
   iv. Five-year cost comparison study

VII. Future Privatization (Add New Beds and Private Existing State-Operated Facilities)
   i. Add New Beds - Footnote in General Appropriation Act directs ADC to solicit bids to add 1,000 additional private beds in FY 2004 and to privatize the female population in FY 2005 (2500-2800)
   ii. Privatize Existing State-Operated Facilities – Some issues to resolve:
      - which facilities
      - value of facilities
      - which prisoners
      - what to do with ADC employees

JLBC Staff
10/8/02

Privatization Presentation to the Privatization Subcommittee of the Fiscal Accountability Committee

Scott A. Smith
Bureau Administrator, Privatization
Arizona Department of Corrections
November 13, 2002

ADC PRIVATIZATION OVERVIEW

- ADC FY-03 Operating Budget........$614,251,300

- Annual Cost of Private Contracts:
  - Private Prisons..................................$35,917,400
  - Food Service......................................$30,852,194
  - Health Services...................................$16,485,860
  - Educational Services.............................$5,312,000

  - Total Cost of Privatized Services.............$88,564,454

- Approximately 14% of ADC Budget Dedicated to Private Contracts

INMATE POPULATION

- November 12, 2002:
  - Total Number of ADC inmates: 29,368
  - Total Number of ADC inmate in private prisons: 1,774
  - % of inmates in private prisons: 6%

ONE-WAY POPULATIONS

Homogeneous Groups

- DUI
- Mental Health
- Return-to-Custody
- Medical
- Substance Abuse Treatment
- Sexual Offender
- Females
- Geriatric

STATUTORY REQUIREMENTS

- ARS § 41-1609.01
  - Requires JLBC review of any private prison request for proposal on publication
  - Prohibits delegation of certain functions (classification, discipline, inmate work assignments)

STATUTORY REQUIREMENTS

- ARS § 41-1609.01
  - To be considered for an award, the company must demonstrate:
    - The qualifications, operations and management experience and experienced personnel necessary to carry out the terms of the contract
    - The ability to comply with applicable correctional standards and any specific court order, if required
    - A demonstrated history of successful operation and management of other secure facilities

STATUTORY REQUIREMENTS

- ARS § 41-1609.02
  - Requires ADC to consider contracting for private prisons for selected populations (DUI, sex offenders, females, prisoners over 55 years of age) before expanding or establishing a minimum or medium security level prison
  - 60-day notice to elected officials before incurring an obligation
  - 10-day notice before holding a public hearing

STATUTORY REQUIREMENTS

- ARS § 41-1609.02
  - Requires a contractor to provide at least the same quality of services as ADC at a lower cost or services superior in quality to those provided by the ADC at essentially the same cost

COST COMPARISON

- ADC estimated cost to operate:
  - FY-01 Per Capita for DUI Beds: $43.74*
  - FY-01 Per Capita for RTC Beds: $53.54

* Does not include land, buildings & improvements – unable to disclose, at this time, due to confidentiality of current procurement

ASP-FLORENCE WEST

- Operated by Correctional Services Corporation
- Annual Cost: $11,151,818
- 400 DUI Beds – Per Diem: $49.55
- 200 Return to Custody Beds – Per Diem: $39.95
- 150 Emergency Beds – Per Diem: $24.13
- Recently awarded ten-year contract with two five-year renewals

ASP-PHOENIX WEST

- Operated by Correctional Services Corporation
- Annual Cost: $6,805,218
- 400 DUI Beds – Per Diem: $43.77
- 50 Emergency Beds – Per Diem: $29.99
- Recently awarded ten-year contract with two five-year renewals

MARANA COMMUNITY CORRECTIONAL TREATMENT FACILITY

- Operated by Management & Training Corporation
- Annual Cost: $7,613,564
- 450 Substance Abuse Treatment Beds – Per Diem: $43.54
- 50 Emergency Beds – Per Diem: $22.30
- Awarded ten-year contract, with two five-year renewals, in October 2000

ON-GOING PRIVATIZATION PROJECTS

- Placement of 645 inmates in a private prison in Texas
  - Minimum to high-medium security inmates
- 1,400-bed DUI private prison
  - Minimum to high-medium security facility
- 2,200-bed all female private prison
  - Anticipate expanding by 600 to 2,800 inmates
  - Minimum to maximum security facility

PRIVATIZED FOOD SERVICE

- ADC privatized food service in 1997
- State Employees
  - Right of first employment with contractor
  - Qualified for ADC positions
  - Severance package based on years of service
- Annual Cost: $30,852,194
  - Aramark @ Lewis Prison ($4,761,594)
  - Canteen @ remaining prisons ($26,090,600)
- ADC recently awarded statewide contract to Canteen

PRIVATIZED HEALTH SERVICES

- Annual Cost: $16,485,860

- Includes contracts for:
  - Regional Hospitals..............................$3,330,800
  - Lab Fees..$1,347,631
  - Dental Services.................................$150,000
  - Psychiatrists......................................$109,400

PRIVATIZED EDUCATION

- Annual Cost: $5,312,000
- Contracts with seven community colleges to provide vocational and GED
- Contract for adult literacy

PRIVATIZATION BARRIERS

- Availability of capital funding/financing
- Inflationary adjustments
- Arizona Revised Statutes
- Procurement Code
- Lack of mechanism(s) to reward cost effective operations

POTENTIAL FOR PRIVATIZATION

- Specialized Inmate Populations
  - Sex Offender Treatment
  - Geriatrics -
  - Other Populations -
- Medical & Related Services -
- Motor Vehicle Maintenance -

Privatization Report

During the 5th Special Session this summer the legislature directed State Parks to "review, evaluate and make recommendations as to whether this state should enter into an agreement with a private entity, a university of this state or a political subdivision of this state for the privatization or operation of one or more Arizona state parks and submit the report to the joint legislative budget committee on or before December 31, 2002."

We were asked to come today to give a status report, and I hope to solicit some input from the committee as to how this information strikes you.

Why Privatize?

a. Lower costs – by introducing competition
b. Higher service levels – competition leads to innovation
c. Focus on core mission

Notable recent example: The United States Army. According to recent articles, the Army is looking at privatizing 214,000 military and civilian jobs, nearly 1 in 6. They will attempt to move employees who perform support functions, such as accounting, legal services and maintenance, to the private sector so that they can focus on what they do best, their core mission, namely, finding and neutralizing the bad guys.

Arizona State Parks
Where privatization works – Done for decades, enables us to focus on our core mission:

"Managing and conserving Arizona's natural cultural and recreational resources for the benefit of the people, both in our parks and through our Partners."

1. Concessions – Retail operations - $350,000 revenue in FY02
   a. Kartchner Caverns – Aramark, $250,000 revenue 21-40% of sales
   b. Alamo, Buckskin, Cattail Cove, Lyman, Patagonia, Slide Rock, Tombstone

2. Service Contracts – public wants face-to-face with rangers
   a. Design & Construction
   b. Professional Services – Tug maintenance/repair Kartchner , carpet cleaning and toilet service, CPA for grant audit, Historic consultantants for BCAs, historical context studies, M&H for trademark

3. Municipalities
   a. Yuma – Historic Park legislation (§41.511.11.c.1)
   b. Fool Hollow – USFS, G&F, City, Electrical Utility
   c Tubac, Camp Verde/Fort Verde, Florence/McFarland, Oro Valley/Catalina, Oracle, Payson/Tonto

4. Tribes
   a. Hopi/Homolovi

5. Universities
   a. Boyce Thompson

Where privatization is difficult.
Privatizing an entire park.

1. Legal problems
   a. Liability (State remains the deep pockets)
   b. Land issues (ASP manages 61,000 acres, owns about 1/3)

2. Costs
   a. State Parks are cheap ($6.8 mil GF for 30 parks, less that .01 of 1% of total GF – less than half of what other states spend)
   b. Enhancement Fund vs. agency reliance on GF "cherry picking"
   c. Resources shifted from operating parks (our core mission), to accounting and monitoring contracts (not our core mission)
   d. Not what the public, your constituents and neighbors, and our customers, desire. The vision for Kartchner Caverns is not to present it to Sen. Bee, but to insure that Sen. Bee's great-great grandchildren see the cave in the same condition that the cave's discoverers first saw it. While it's important that we use our resources, fiscal, human and physical, wisely, we as government are not required to wring every last dime from our properties.

3. Other challenges include the remote location of parks (Alamo), and the profitability of park resources.

Questions for Committee

1. Welcome any suggestions for places to look for privatization opportunities.

Adoption / Foster Care Privatization

1. "Budget Reduction Options" from last session

Proposal: Privatization of Adoption
Savings: $? GF
Brief Description: This option would further privatize the state's adoption system. The state already uses private entities to help place children who are wards of the state into adoptive families. This option would transfer more of these responsibilities, particularly case management, to the private sector. It is unknown at this time how much money would be saved under this option.

Proposal: Privatize Foster Care
Savings: $? GF
Brief Description: This proposal would further privatize the state's foster care system. The state already uses private entities for out-of-home placements of children taken into the foster care. This option would transfer more case management responsibilities to the private sector. It is unknown at this time how much money would be saved under this option.

2. Kansas experience

In 1995, Kansas privatized the child welfare system (family preservation, foster care, and adoption). At the same time, it put a significant amount of additional money into the system. For this reason, it is impossible to determine whether privatizing the child welfare system saved (or cost) the state money.

3. Other notes

Laws 1998, Chapter 276 mandated DES to contract for a comprehensive actuarial study to determine the costs of delivering a continuum of services to children and their families by Child Protective Services. The study looked at the costs of delivering Out-of-Home Care, Adoption Services (not subsidies), and case management. There has been no study of adoption case management by DCYF vs. private providers.

SB 1375 as originally introduced in 1998 would have required DES to develop one flat rate paid to providers for these types of services. For a number of reasons, JLBC Staff could not provide a reliable fiscal impact statement at that time.

JLBC Staff
10/3/02

Joint Legislative Budget Committee
Staff Memorandum

1716 West Adams
Phoenix, Arizona 85007

Telephone: (602) 542-5491
Facsimile: (602) 542-1616

DATE: October 8, 2002

TO: Senator Tim Bee

FROM: John Malloy, Fiscal Analyst

SUBJECT: PIONEERS' HOME

Background

The Arizona Pioneers' Home was established in 1909 as a way to ensure that those individuals instrumental to Arizona's development were properly cared for. Criteria for admission to the Home has been modified to allow individuals that have lived in Arizona for over 30 years to gain admittance. This change in statute was enacted recognizing the fact that the number of individuals that played a role in Arizona's development has diminished significantly, making the current Arizona Pioneers' Home a place for long-term residents rather than true "pioneers." There are currently 122 residents at the Pioneers' Home with a staff of 116. Alaska and Wyoming are the only other states with a Pioneers' Home.

Pioneers' Home Funding

The Home is funded through General Fund monies, the Miners' Hospital Fund and the State Charitable Fund. In FY 03, the Pioneers' Home was appropriated \$5.5 million - \$285,300 in General Fund monies, \$4.5 million from the Miners' Fund and \$715,000 from the State Charitable Fund.

Miners' Hospital Fund

The Miners' Hospital Grant consists of 47,771 acres derived from the 1912 Miners' Hospital for Disabled Miners' Grant and an additional 47,843 acres from the 1929 Miners' Hospital Grant.

State Trust lands benefit 14 trust beneficiaries in the state of Arizona. In addition to miners, state trust lands benefit a multitude of recipients including the University of Arizona, military institutes, agricultural and mechanical colleges, School for the Deaf and Blind, state hospitals, Department of Corrections as well as legislative, executive and judicial buildings. Common Schools (K-12) are the largest beneficiary, owning 87% of the land and receiving close to 90% of the revenue.

The 1912 Miners' Hospital grant consists of blocks of grazing lands in seven areas:

- 11,500 acres near Picacho Peak;

- 10,000 acres in the Florence Junction and Magma areas of Pinal County;
- 1,800 acres near Skull Valley in Yavapai County;
- 3,800 acres near Vail in Pima County;
- 5,400 acres north of the San Francisco Peaks in Coconino County;
- 6,200 acres near Bonita in Graham County;
- 5,100 acres near Gleason in Cochise County

The 1929 grant contains smaller parcels of land scattered throughout all of the counties of Arizona. According to the Land Department, many of the parcels are valuable and have development potential, most notably in Case Grande, Mesa, San Luis, Topock, Lake Havasu City, Buckeye and Mammoth areas. The Trust also owns a partial interest in Colorado River-front lands at Bullhead City.

Miners' Hospital Fund Acres and Income – Fiscal Year 2001

	Acres	Income
Expendable Fund:		
Surface Leases		
Agriculture	13,877	$265,000
Commercial	594	697,000
Grazing	73,915	30,000
Rights-of-Way	1,998	13,000
Use Permits	3,053	39,000
Subsurface Leases		
Mineral	119	100
Exploration Permit	225	900
Sub-Total	**93,781**	**$1,045,000**
Penalty and Interest		28,000
Sales Interest		7,000
Treasurer's Distribution		307,000
Grand Total Dispensable		**$1,387,000**
Unexpendable Permanent Fund ("Corpus"):		
Permanent Fund Receipts		490,000
Permanent Fund Balance		**$4,900,000**

Resident's Eligibility for Federal Reimbursement

A.R.S. § 41-923 requires that residents of the Pioneers' Home pay for costs incurred for care, to the extent that the resident is able to do so, with any residual costs then paid for by the State. In calculating payment for care, the Home takes into consideration income earned through social security and pension payments as well as all interest earned on income and assets. The Home also attempts to seek reimbursement for care provided to individuals qualifying for such programs as AHCCCS and Supplemental Security Income (SSI). The AHCCCS Program for which the Home residents could qualify (if they met income guidelines) pays Medicare premiums for the enrollee. It does not provide direct reimbursement to the Home. In addition,

the Home is not licensed and is not eligible for Medicare reimbursement. The SSI Program provides supplemental payments to eligible individuals and also does not provide direct reimbursement to the Home.

The Home has recently furnished information to JLBC Staff indicating that 47 residents qualify for AHCCCS and 6 for SSI out of a total of 122 residents. Currently, the Home is not able to receive Arizona Long-Term Care System (ALTCS) reimbursement monies from the federal government due to the Home not meeting licensure and regulatory requirements. The Home is not licensed due to a number of structural issues in the building that do not meet licensure standards. The ALTCS program is designed to provide reimbursement to nursing facilities. As such, if the Home were licensed, ALTCS would likely pay for the cost of care for some residents of the Home. The Home does not attempt to determine eligibility for this program, therefore JLBC Staff is unable to determine how much ALTCS reimbursement would be available if the Home were able to meet licensure standards.

While there has been no dollar figure associated with the costs of refurbishing the Home to meet federal standards for these reimbursement monies, the Arizona Department of Administration in 1997 indicated the Pioneers' Home required $7.9 million in repairs to "make it safe" for residents. Current maintenance projects have included a $1.2 million expenditure to address fire safety issues as well as $1.3 million to overhaul the Home's plumbing system.

Alternatives

The 1997 Auditor General's Report offered alternatives in operation of the Home, which remain salient recognizing declining revenue sources for capital improvements and ongoing maintenance needs. The Home could reduce the scope of care provided to residents, offering personal care only. Those individuals requiring high levels of care could be discharged to a nursing home facility. Such a shift in scope would reduce staff costs as well.

The report also suggested that a phase-out option for the Home could be utilized, where no new residents would be accepted with time allowed for current residents to find new living arrangements and staff new places to work. Such a phase out would eliminate any liability issues associated with residents living in the Home.

A third option, not mentioned in the Auditor General report, would be to discontinue state subsidies for residents who cannot pay the full cost of care. This option would require a statutory change. A variation of this option would be for the Home to tighten its requirements regarding residents' assets. Currently, only interest earnings are considered in assessing residents' ability to pay. This could be changed to be more similar to the ALTCS program to require assets to be spent down to a prespecified level before the state subsidizes the cost of care. Alaska and Wyoming, which both operate Pioneers' Homes, require assets to be spent down to a particular level before the state contributes additional funding.

If you have any questions or require additional information, please contact me at 542-5491.

JM:ck
xc: Richard Stavneak, Director
Deborah Johnston, Director, Senate Research Staff

Education Formulas

Arizona Fiscal Accountability Committee

Working Group on Education Funding Formulas

Criteria for Reform

- Avoid redundancy
- Flexible
- Timely
- Divisible
- Accountable
- Predictable
- Realistic
- Efficient
- Equitable/Fair

Initial Focus

- TRCL versus TSL
- Career ladder
- Community college equalization

TRCL: Problem

- Transportation Revenue Control Limit (TRCL) grows through increases in transportation support level (TSL); TRCL never declines
- State equalizes DSL (which includes TSL) or RCL (which includes TRCL) whichever is less
- District budgets are set using RCL, meaning local property taxes pick up the difference
- Roughly equal in 1980; now a $48 million difference

TRCL: Problem (continued)

- Responsible for high property tax rates in numerous districts
- Approximately $10 million in additional state aid for 35% homeowner rebate
- Not required to be spent on transportation; creates inequities across districts

TRCL: Policy Options

- Reduce TRCL by prescribed percentage until TRCL matches TSL, at which point TRCL is eliminated
- Cap TRCL
- Eliminate TRCL
- Consolidation and unification of school districts should be considered and encouraged to maximize efficiency in pupil transportation

Career Ladder: Problem

- Applies to only 28 school districts; capped due to cost; questions raised about effectiveness
- General fund impact approximately $35 million (plus additional state aid for homeowner rebate)
- Conflict with Arizona's adopted statewide policy regarding pay for performance

Career Ladder: Policy Options

- Eliminate program
- Phase program out

Community College Equalization: Problem

- Formula driven by average NAV in eight “rural” districts; not related to student population, need, or tax effort
- Valuation growth in Coconino and Yavapai driving a wedge; four to five districts qualifying for funding
- Created to grandfather EAC into system
- Grew about $2.9 million (35%) between 1997 and 2002 to over $11 million (reduced for FY03 to $10.7 million)

Equalization: Policy Options

- Eliminate
- Fold specified amount into operating state aid for most recent qualifying colleges
- Fold specified amount into operating state aid for EAC only

FISCAL ACCOUNTABILITY FORMULA ISSUES

Version: 11/19/02

CRITERIA FOR REFORM

Avoid Redundancy:	Counts should not be duplicative or overlapping for a single service.
Accountable:	Key components are understandable and verifiable by appropriators, taxpayers, and beneficiaries.
Flexible:	Government should maintain the ability to adjust appropriations in accordance with available revenue and changing priorities.
Predictable:	Elements of formula must be able to be both estimated and to have the actual distribution calculated accurately.
Timely:	Reflect current activities.
Realistic:	Provisions that recognize both inflation and productivity.
Divisible:	Allocated within the organization to get to the people generating the money.
Efficient:	Formulas should serve their intended purpose and provide appropriate levels of funding.
Equitable/Fair:	Treats both beneficiaries and taxpayers equitably and fairly.

Formulaic funding in general

Most state spending is driven by statutory and budgetary formulas that provide greater funding for per capita and inflationary increases.

- **Counts**: A main component of most legislative formulas is based on who and how we count persons intended for a particular government service.
- **Inflation factors**: Automatic, mandatory inflation adjustments can reduce flexibility.

K-12

- **Prior year versus current year**: Prior-year funding can result in duplication in cases where students move from one district to another district or charter.
- **Open enrollment versus "refusal by students to attend classes"**: Open enrollment laws include an exception for deseg/OCR districts who can continue to claim students that have left the district.
- **TRCL versus TSL**: $48 million discrepancy results in inequitable tax rates and uncontrolled general fund impact.
- **Additional state aid and unlimited levies**: Efforts to reform excess utilities and deseg/OCR continue to meet with resistance.
- **Group B weights for ELL**: Doubling of ELL weights created increased finanacial incentive to misclassify and over-identify students.
- **Career ladder**: Available to a limited number of school districts while performance pay has become a statewide policy since the enactment of Prop. 301.
- **Special Education ESY weights**: Financial incentive to misclassify mild special education cases.
- **Vouchers**: School choice grants provide an opportunity to reduce state funding requirements.
- **JTEDs**: Student counts between school district and JTED can add up to 1.25 ADM. Who is checking?

K-12 Capital (Students FIRST)

- **Minimum Adequacy Guidelines**: Are the standards set too high? Are they dealing with areas beyond the scope of SFB?
- **Building Renewal and New Construction**: Are formulas generating appropriate levels of funding?
- **5% add-on for "rural area"**: Should new construction and building renewal formulas automatically add 5% for rural areas? If so, does the statutory definition of *rural* make sense?
- **Class B bonds and gross square footage**: New construction square footage funded by class B bonds or overrides is invisible to the state in its gross square footage calculations.
- **Inflation indexing**: New construction and building renewal formulas are indexed for inflation.

Community College

- **Dual enrollment**: Students in dual enrollment programs continue to be counted by both the high school and the college for the same "seat time" as if it were two students.
- **Hold harmless**: Operating state aid for colleges increases through student growth, but never decreases for declining student counts.
- **Equalization assistance**: State aid going to 4-5 rural districts, driven by assessed value growth in Yavapai and Coconino. No relation to college need or student growth.

ASRS: Imminent actuarial increases

- **Increases in benefits over last 5 years affecting future budget years**: Increases authorized in 2001 are impacting 2004. Decreases in the stock market are exacerbating the problem. Pre-funding benefit increases would add accountability.

Dept. of Corrections

- Alternatives to new beds

State & Local Relationships

- Budget/levy oversight (PTOC, County BOS)
- Revenue sharing
- 1% cap implications

Other issues needing analysis

- Transportation issues
- Business property taxes
- Health care inflationary increases
- University formulas and tuition

State Shared Revenues

FY 2001 Actual Expenditures and Revenues

	State	Counties	Municipalities	TOTAL
Expenditures				
Economic Development	$95,112,300	$39,374,200	$35,462,600	$169,949,100
Education	$5,670,637,200	$33,868,600	$42,856,000	$5,747,361,800
Health and Welfare	$5,003,174,800	$1,284,250,100	$192,603,700	$6,480,028,600
Inspection and Regulation	$169,941,100	$0	$117,724,200	$287,665,300
Judiciary	$180,591,800	$322,987,700	$61,395,700	$564,975,200
Natural Resources	$331,957,600	$32,146,900	$160,612,600	$524,717,100
Public Safety	$960,020,500	$574,116,600	$957,994,800	$2,492,131,900
Transportation	$1,480,873,500	$256,350,400	$311,714,100	$2,048,938,000
General Government	$1,231,605,600	$402,702,800	$531,158,300	$2,165,466,700
Capital Projects	$0	$355,796,600	$1,202,463,800	$1,558,260,400
Enterprise Functions	$0	$0	$965,747,000	$965,747,000
Total Expenditures	$15,123,914,400	$3,301,593,900	$4,579,732,800	$23,005,241,100
Revenues				
Sales Tax	$3,802,889,700	$156,178,600	$1,126,436,700	$5,085,505,000
Individual Income Tax	$2,300,752,000	$0	$0	$2,300,752,000
Corporate Income Tax	$541,173,600	$0	$0	$541,173,600
Property Tax	$39,636,400	$627,802,300	$238,076,700	$905,515,400
State-shared Revenue:				
Sales Tax	($819,337,500)	$506,169,700	$249,468,400	($63,699,400)
Income Tax	($396,452,600)	$0	$313,058,000	($83,394,600)
Vehicle License Tax	$0	$145,903,700	$102,962,700	$248,866,400
Highway User Revenue Fund (HURF)	$0	$213,095,200	$243,891,200	$456,986,400
Local Transportation Assistance	$0	$6,929,100	$37,187,100	$44,116,200
Subtotal State-shared	($1,215,790,100)	$872,097,700	$946,567,400	$602,875,000
Special Levies	$0	$24,319,100	$0	$24,319,100
Healthcare System Revenue	$0	$795,680,100	$0	$795,680,100
Disproportionate Share Revenue	$56,387,700	$53,373,000	$0	$109,760,700
Utility Revenue	$0	$0	$1,194,300,000	$1,194,300,000
Other	$9,501,717,000	$718,291,200	$1,254,412,000	$11,474,420,200
Total Revenues	$15,026,766,300	$3,247,742,000	$4,759,792,800	$23,034,301,100

State-Shared Revenue Worksheet

Urban Revenue Sharing

FY 2002 Individual Income Tax:	$ 2,086,648,700
FY 2002 Corporate Income Tax:	$ 346,280,400
Subtotal:	$ 2,432,929,100
FY 2002 BSF Alt-fuel Transfer:	$ 33,277,654
Total:	$ 2,466,206,754

Percentage Distributed in FY 2004 (*)	Amount Distributed	Reduced FY 2004 Distribution
14.8%	$ 365,065,155	
14.6%	360,199,297	$ (4,865,858)
14.4%	355,333,439	(9,731,716)
14.2%	350,467,580	(14,597,575)
14.0%	345,601,722	(19,463,433)
13.0%	321,272,431	(43,792,724)
12.0%	296,943,140	(68,122,015)

(*) Assumes cities are "held harmless" for FY 2002 BSF alt-fuel transfer - distributed @ 15%.

State Sales Tax

	Cities	Counties	Total
FY 2002 Actual Distribution:	$ 311,693,101	$ 505,067,501	$ 816,760,602
Projected FY 2003 Distribution: (based on 0.7% baseline growth)	$ 315,610,900	$ 513,434,000	$ 829,044,900
Projected FY 2004 Distribution: (based on 2.5% baseline growth)	$ 323,417,100	$ 526,133,000	$ 849,550,100

State-Shared Sales Tax Reduction	Reduced FY 2004 Distribution: Cities	Counties	Total
One-Year Lag: (distribute FY 2003 amount in FY 2004)	$ (7,806,200)	$ (12,699,000)	$ (20,505,200)
Two-Year Lag: (distribute FY 2002 amount in FY 2004)	$ (11,723,999)	$ (21,065,499)	$ (32,789,498)

SPR

State Policy Reports

VOLUME 19 ISSUE 19

In This Issue

It is often observed that, "Local governments are creatures of the state." This can be a good thing or a bad thing, depending on which state is calling the shots. Variation in the degree to which states help—or don't help—their local governments is enormous and may change even more if the economy remains in a slump.

To what degree should states regulate the auto insurance industry? The current situation ranges from near-deregulation to almost total regulation. Advocates of both approaches use state experiences to defend their positions.

It's hard to know if Medicaid spending pressure is a cause or an effect of economic problems in the states, but one thing is certain: when Medicaid costs are out of whack, the rest of the state budget is too. No wonder, then, that Medicaid figures prominently in the stimulus proposals that state organizations sent to Capitol Hill.

October 2001

State-Local Relations

The fiscal outlook for state governments is deteriorating. In recent months, states have lowered revenue estimates, reduced budgets and confronted significant expenditure pressures. Taxpayers, accustomed to years of consecutive tax cuts, will likely resist large tax increases. At the same time, the outlook for federal aid to states is uncertain. While Congress will approve sizeable funds for an economic stimulus package, the president's education priorities and defense spending, other areas—such as health and human service programs—may bear the brunt.

If states are hard pressed to maintain funding for current state programs, it follows that state aid to local governments will likely suffer in the coming legislative sessions. Many states may even decide to shift some of the costs of providing services to counties and localities—either through reduced aid or unfunded mandates. In fact, counties in two states—**California** and **Kansas**—already have suffered budget cuts this year.

The most recent data detailing the financial relationship between state and local governments was released by the Census Bureau in September. It provides information on intergovernmental transfers between state and local governments for fiscal year (FY) 1999.

State Aid to Local Governments

Aid to local government is the largest component of state expenditures. State governments provided local governments with $301 billion in FY 1999. This accounts for approximately 34% of total state expenditures. The table on the next page shows payments to local governments as a percent of total state expenditures.

State aid to local governments takes many forms, such as direct grants-in-aid (transfers of funds on a formula basis, such as for education), shared taxes (distributing a portion or all of the revenue from a specific state tax or taxes) and reimbursement by states for the costs of certain programs carried out by localities (such as tax collection, care of prisoners and hospital care for the needy).

Under the Census Bureau's definition, state aid must involve the actual payment of money to local governments. So if a state assumes responsibility for a function, it does not count as state aid. The treatment of property tax relief varies by the type of relief provided. If a state provides funds to localities to pay for property tax exemptions or credits, the Census Bureau counts this as aid. If, however, property tax relief is provided directly to taxpayers (such as through refund checks), this is not counted as aid.

State Aid to Locals as a Percent of State General Expenditures
Fiscal Year 1999

Rank	State	Percent	Rank	State	Percent
1	California	49%	26	Colorado	30%
2	Michigan	46	27	Nebraska	30
3	Arizona	45	28	Washington	30
4	Wisconsin	43	29	Missouri	29
5	Nevada	40	30	Vermont	28
6	New York	39	31	Pennsylvania	28
7	Minnesota	38	32	Tennessee	28
8	Kansas	37	33	Alabama	27
9	Wyoming	36	34	South Carolina	27
10	Ohio	36	35	Maryland	26
11	Indiana	36	36	Massachusetts	26
12	North Carolina	35	37	Louisiana	26
	United States	**34**	38	Utah	25
13	Florida	34	39	West Virginia	25
14	Mississippi	33	40	Kentucky	24
15	Oklahoma	32	41	North Dakota	23
16	Idaho	32	42	Montana	23
17	New Mexico	32	43	South Dakota	22
18	Arkansas	32	44	Connecticut	21
19	Oregon	32	45	Delaware	20
20	Illinois	31	46	Maine	20
21	Georgia	31	47	Alaska	18
22	Virginia	31	48	Rhode Island	16
23	Texas	30	49	New Hampshire	15
24	New Jersey	30	50	Hawaii	3
25	Iowa	30			

State aid to local governments as a percent of state expenditures ranges from 49% in **California** to 3% in **Hawaii**. Fourteen states spend more than one-third of their budgets on local aid while four states—**Alaska, Rhode Island, New Hampshire** and **Hawaii**—spend less than 20%.

The amount of money states give to local governments varies widely among states due to variations in the mix of state and local responsibilities, local revenue-raising powers and geographic differences. States assuming greater responsibility for services eliminate the need to fund programs through local governments. **Hawaii** (#50), for example, funds almost all of K-12 spending at the state level.

States that provide local governments with greater ability to raise revenue tend to have a smaller percentage of their expenditures going to local governments. Local income taxes are widely used in **Pennsylvania** (#31) and **Maryland** (# 35). **Louisiana** (#37) allows New Orleans to levy a 5% local sales tax rate on top of the 4% state rate.

Generally speaking, smaller states tend to be fiscally centralized and thus fund many programs that local governments handle in larger states. This helps to explain why nine of the 10 bottom-ranking states are among the 10 lowest states in population. In contrast, states with large populations tend to be fiscally decentralized. **California** (#1) and **New York** (#6) are examples of this. Physically large and sparsely populated states, such as #3 **Arizona**, #4 **Wisconsin** and #5 **Nevada**, also rank at the top. These states must provide services across a wide area and, thus, are unable to take advantage of economies of scale. For example, they tend to have many school districts even though they have relatively few students.

The next table shows the percentage of local government revenue that comes from state governments. For the most part, states receive similar rankings on both tables. The most interesting states are those that rank high on one table but not on the other.

For example, **Delaware, Kentucky** and **West Virginia** provide a small amount of state aid to local governments but that aid makes up a large portion of local government revenue. These states limit the ability of local governments to levy their own taxes.

Percentage of Local Revenue from State Governments
Fiscal Year 1999

Rank	State	Percent	Rank	State	Percent
1	Vermont	57%		**United States**	**35%**
2	New Mexico	50	27	Louisiana	34
3	Michigan	48	28	Ohio	34
4	Delaware	47	29	Alaska	34
5	Wisconsin	45	30	North Dakota	32
6	California	45	31	Montana	32
7	West Virginia	44	32	Virginia	32
8	Minnesota	41	33	South Carolina	32
9	Arkansas	41	34	New York	32
10	Mississippi	40	35	Missouri	31
11	Idaho	40	36	Georgia	31
12	North Carolina	39	37	Tennessee	31
13	Arizona	39	38	Illinois	30
14	Massachusetts	39	39	Connecticut	30
15	Nevada	38	40	New Jersey	29
16	Kentucky	38	41	Maine	29
17	Alabama	37	42	Florida	29
18	Oregon	37	43	Nebraska	29
19	Washington	36	44	Maryland	28
20	Iowa	36	45	Texas	28
21	Kansas	36	46	Rhode Island	27
22	Wyoming	36	47	South Dakota	27
23	Pennsylvania	36	48	Colorado	25
24	Utah	35	49	New Hampshire	13
25	Oklahoma	35	50	Hawaii	10
26	Indiana	35			

At the other end, **New York**, **Florida**, **Texas** and **Colorado** provide a large amount of state aid but that aid is a relatively small percentage of local government revenue. Local governments in these states raise a significant portion of their total revenue. For example, localities in New York raise more than half of the total state and local revenue in the state.

Trends in State Aid

The table below shows the trends in state aid to local governments. State aid accounted for approximately 60% of state expenditures in 1980 but dropped to 35% in 1985. The reduction had more to do with a substantial increase in state expenditures than a change in aid to locals. General state expenditures grew from $144 billion in 1980 to $345 billion in 1985, an increase of more than 140%. The 1981-1983 recession resulted in large increases in state spending for AFDC (the welfare program in place at that time) and Medicaid. States also increased spending on education as a result of political pressure to reduce local property taxes and a flood of legal challenges. Since 1985, payments to local government have remained at an almost-constant percentage of total state expenditures.

State Aid to Locals as a Percent of General Expenditures
(Dollars in millions)

Fiscal Year	State Aid	State Expenditures	Percent
1980	$84,504	$143,718	59%
1985	121,571	345,133	35%
1990	175,028	508,284	34%
1995	237,361	733,503	32%
1996	248,206	755,277	33%
1997	260,367	788,176	33%
1998	275,338	827,655	33%
1999	301,132	889,475	34%

Composition of State Aid

State aid to local governments is divided into two categories—restricted or categorical aid and unrestricted or general purpose aid. Restricted aid includes revenues that must be spent on a specific area while unrestricted aid has no requirements as to how it is spent.

Approximately 93% of state aid to local governments is restricted. The next table provides a breakdown of restricted state aid to local governments for the four major spending categories—education, public welfare, highways and health. By far, the majority of aid to local governments is for education. In 1999, education expenditures accounted for approximately 69% of aid to local governments, followed by public welfare (which includes Medicaid) at 13%. Highways and health made up about 4% and 5%, respectively. The other category includes items such as government support, housing and community development, libraries, corrections, hospitals and airports.

State Aid to Locals by Category

State	Total	Education	Public welfare	Highways	Health	Other
Alabama	100%	89%	0%	5%	0%	5%
Alaska	100	73	0	3	6	18
Arizona	100	57	22	10	5	7
Arkansas	100	88	0	5	0	6
California	100	58	27	3	7	4
Colorado	100	64	19	8	1	8
Connecticut	100	70	7	1	5	16
Delaware	100	87	0	1	1	11
Florida	100	89	0	2	0	8
Georgia	100	88	0	0	7	5
Hawaii	100	0	0	0	44	56
Idaho	100	87	0	10	1	2
Illinois	100	69	12	6	1	12
Indiana	100	61	4	12	1	21
Iowa	100	76	0	14	4	6
Kansas	100	87	0	5	3	4
Kentucky	100	83	2	3	4	8
Louisiana	100	83	2	2	0	13
Maine	100	89	1	3	0	7
Maryland	100	70	0	10	7	13
Massachusetts	100	66	2	4	0	27
Michigan	100	72	2	8	12	5
Minnesota	100	70	10	8	2	10
Mississippi	100	78	7	7	2	6
Missouri	100	83	1	6	0	10
Montana	100	81	1	3	2	13
Nebraska	100	66	0	11	10	12
Nevada	100	91	2	4	0	3
New Hampshire	100	53	21	6	6	14
New Jersey	100	76	13	4	0	7
New Mexico	100	96	0	1	0	3
New York	100	44	35	0	6	15
North Carolina	100	84	5	1	6	4
North Dakota	100	73	0	11	2	13
Ohio	100	59	10	7	6	18
Oklahoma	100	83	0	8	2	7
Oregon	100	76	1	10	7	5
Pennsylvania	100	56	16	5	8	15
Rhode Island	100	98	0	0	0	1
South Carolina	100	85	0	4	3	8
South Dakota	100	80	0	6	0	14
Tennessee	100	72	10	8	0	10
Texas	100	85	5	0	4	6
Utah	100	95	1	1	2	1
Vermont	100	93	0	5	0	2
Virginia	100	72	7	3	3	15
Washington	100	79	0	8	2	11
West Virginia	100	94	0	0	1	5
Wisconsin	100	75	4	7	6	8
Wyoming	100	82	0	1	4	12
United States	**100%**	**69%**	**13%**	**4%**	**5%**	**9%**

The national averages mask the situation in individual states. Six states—**Nevada**, **New Mexico**, **Rhode Island**, **Utah**, **Vermont** and **West Virginia**—spend more than 90% of their state aid on education while **New York** spends less than 50%.

An unusually high proportion of state aid in **Arizona**, **California**, **Colorado**, **New Hampshire**, **New York** and **Pennsylvania** is spent on welfare because local governments in these states have greater responsibilities for such services than in other states. In some cases, local governments actually administer welfare or assistance programs directly.

Hawaii, in contrast, provides most state and local services at the state level, so local governments don't receive funds for education, public welfare or highways.

Unrestricted Aid

Unrestricted aid is given to local governments with no stipulations or specification as to how it is spent. In other words, local governments may spend the aid according to their own priorities. General local government support has decreased slightly as a proportion of total state aid, from 8% in 1993 to 7% in 1999. States that provide larger amounts of unrestricted aid instead of restricted aid generally give more control to local units. The next table shows unrestricted aid as a percentage of total aid to local governments.

Unrestricted Aid as a Percentage of Total Aid to Locals
Fiscal Year 1999

Rank	State	Percent	Rank	State	Percent
1	Hawaii	74%	26	Arkansas	5%
2	Nevada	31	27	Louisiana	4
3	New Mexico	26	28	Kansas	4
4	Wisconsin	23	29	Connecticut	4
5	Massachusetts	23	30	Oregon	3
6	South Carolina	21	31	Alabama	3
7	New Jersey	20	32	South Dakota	3
8	Florida	19	33	New York	2
9	Mississippi	19	34	Alaska	2
10	Wyoming	18	35	Nebraska	2
11	Arizona	18	36	Washington	2
12	Minnesota	16	37	Oklahoma	2
13	Illinois	11	38	Pennsylvania	2
14	Maine	11	39	West Virginia	1
15	Indiana	10	40	Maryland	1
16	New Hampshire	9	41	Vermont	1
17	North Dakota	9	42	Virginia	1
18	Michigan	9	43	Texas	0
19	Tennessee	9	44	Colorado	0
20	Idaho	8	45	Missouri	0
21	Rhode Island	7	46	Ohio	0
22	North Carolina	7	47	Delaware	0
23	Montana	7	47	Georgia	0
	United States	7	47	Kentucky	0
24	California	6	47	Utah	0
25	Iowa	5			

On average, unrestricted aid accounts for 7% of total aid to local governments. The percentage of unrestricted aid ranges from 74% in **Hawaii** to approximately 0% in eight states—**Texas, Colorado, Missouri, Ohio, Delaware, Georgia, Kentucky** and **Utah**. Hawaii provides a large percentage of unrestricted aid but the amount is insignificant; local governments received $102 million in unrestricted aid and $139 million in total aid in FY 1999. In contrast, other states with large percentages, such as #2 **Nevada**, #3 **New Mexico** and #4 **Wisconsin**, provide substantial aid to local governments.

States that provide very little in total aid to local governments as well as no unrestricted aid include **Utah**, **Kentucky** and **Delaware**. **Ohio** and **Missouri** give local governments a significant amount of aid but all of the aid is for specific purposes.

Recent Changes

The National Association of State Budget Officers (NASBO) tracks changes in state aid to local government in *The Fiscal Survey of States*. A few major changes have taken place in recent years. **West Virginia** began distributing approximately 10% of its oil and gas severance tax revenue to local governments in the form of revenue sharing. **Michigan** capped its state revenue-sharing program—which distributes state-collected sales tax as unrestricted revenue to local governments—at the rate of inflation.

Connecticut increased aid to local governments by 10% in FY 1999. **Indiana** removed the support for selected welfare costs from local property taxes and transferred the costs to the state. **New Hampshire** and **Vermont** dramatically increased state funding for local education costs. **Virginia** now uses all lottery proceeds for local public education.

More than half the states enacted changes in aid to local governments in FY 2001. Four states—**Florida, Kansas, Louisiana** and **New Mexico**—reduced aid to local governments. In Florida, local governments are expected to lose $7 million due to various new sales tax exemptions. Moreover, the dollar amount of county revenue sharing was reduced by $43 million, or 12.4%. Local government aid in Kansas was reduced by approximately $50 million. Louisiana reduced the tobacco tax distribution by $12 million.

Many states increased aid to education and provided property tax relief. **Montana**, for example, increased aid to local governments by $42 million to offset the effects of a statewide property tax reduction.

Local Requirements

While states provide local governments with a considerable amount of aid, local governments are required to provide financial and administrative support for many state programs. In some cases, the state requires locals to contribute all or a portion of the state matching requirements for federal funds. Other times, states place conditional requirements that local governments must meet if they want to participate in optional programs or receive aid. And in some instances, local governments are required to fund and administer a program.

Typically, local officials consider these requirements to be state mandates on local governments. Although there are valid arguments for and against these requirements, states have the upper hand and most are in a position to impose mandates on local governments without providing the funds to pay for them.

Local governments in 33 states provide some degree of financial support for health and human service programs, according to the National Association of Counties (NACo). Some local governments are required to provide aid (for example, providing a portion of the Medicaid match) while others have chosen to do so. (For example, providing general assistance is a county option in many states.) The table on the next page shows county participation in each state for the major programs.

The extent of financial requirements varies widely among states. Certain states require local governments to bear a greater burden of funding services than other states do. Local governments in seven states—**California**, **Colorado**, **Indiana**, **Montana**, **New York**, **North Carolina** and **Ohio**—provide significant funding for health and human service programs. Counties in a few of these states—most notably Colorado, New York and Ohio—actually administer some of the programs. There are costs and benefits to this. While most agree that local service provision is generally more responsive to the needs of residents and often less costly, local officials argue that states either fail to provide adequate fiscal assistance or place restrictions on the ability of local governments to raise the revenue they need to run the programs.

In contrast, some states have minimal county involvement. Counties in **Idaho** and **Georgia**, for example, do not run TANF or child welfare programs, but they do have general assistance programs that cover services such as housing, rent, utilities and transportation. Counties in **Utah** and **New Mexico** contribute to Medicaid only. Utah requires counties to provide 20% of the state's Medicaid matching rate. Similarly, counties in New Mexico contribute about 7% of the total Medicaid budget. Counties in **Kansas** and **Missouri** administer the child support enforcement program only.

County Participation in States' Health and Human Services Costs

State	Medicaid	Medicaid Admin.	TANF	TANF Admin	Foster Care	Child Support	Other
Alabama							
Alaska							
Arizona	X					X	X
Arkansas							
California		X	X	X	X	X	
Colorado		X	X	X	X	X	X
Connecticut							
Delaware							
Florida	X						X
Georgia							X
Hawaii							
Idaho							X
Illinois						X	X
Indiana	X	X	X		X	X	
Iowa	X						X
Kansas						X	
Kentucky						X	X
Louisiana							
Maine							
Maryland			X	X			
Massachusetts							
Michigan	X				X	X	X
Minnesota		X		X	X	X	
Mississippi							
Missouri						X	
Montana		X	X	X	X		X
Nebraska							X
Nevada	X	X				X	X
New Hampshire	X		X				
New Jersey		X		X		X	X
New Mexico	X						
New York	X		X	X	X	X	
North Carolina	X	X	X	X	X	X	
North Dakota	X		X	X			X
Ohio		X	X	X		X	X
Oklahoma							
Oregon							
Pennsylvania	X				X		X
Rhode Island							
South Carolina	X					X	X
South Dakota	X						X
Tennessee						X	X
Texas						X	X
Utah	X						
Vermont							
Virginia		X		X	X		X
Washington							
West Virginia							
Wisconsin			X	X		X	X
Wyoming							
Total	**15**	**10**	**11**	**12**	**10**	**19**	**22**

Medicaid

The Medicaid program provides federal matching funds to states to pay for medical services for poor, elderly and disabled recipients. For program administration costs, the federal government contributes 50% for each state. For medical services, the federal matching rate varies among states based on per capita personal income. Most states contribute general fund appropriations as their Medicaid match, although some states also require local governments to contribute a portion.

Local governments in 22 states provide matching funds for Medicaid. Seven states require a contribution for administrative costs only, 12 states require county contribution for vendor payments only and three states—**Indiana**, **Nevada** and **North Carolina**—require both. In Nevada, for example, counties pay all of the administrative costs and a portion of the vendor payments.

The degree of local contributions varies considerably among states. Counties in **California** are required to contribute a relatively small portion of administrative costs while counties in **Arizona** pay almost all of the non-federal share for long-term care for the elderly and disabled and fund a portion of acute care. Localities in six states contribute 50% or more of the costs for at least some services while five localities pay 50% or more for administrative costs.

TANF

The 1996 welfare reform law changed the welfare program from an open-ended entitlement program to a block grant—the Temporary Assistance to Needy Families (TANF) program. While states no longer provide matching funds, they must maintain certain spending levels.

Local governments in 14 states provide funds for TANF. **Indiana** and **New Hampshire** require counties to contribute to program costs and **Minnesota**, **New Jersey** and **Virginia** mandate local support for administrative costs. In addition, local governments in nine states provide funds for both program and administrative costs: **California**, **Colorado**, **Maryland**, **Montana**, **New York**, **North Carolina**, **North Dakota**, **Ohio** and **Wisconsin**.

A few counties administer TANF rather than provide financial support to the state. In **Colorado**, counties administer TANF, foster care, child welfare and child support enforcement. Local governments in **North Dakota** administer and pay a portion of the TANF program.

Other Human Service Programs

Many local governments provide funds for foster care, child support and other human service programs, such as general assistance and support services. Local governments in 10 states provide support for foster care costs. For example, counties in **California** pay 60% of the state match for both maintenance and administration.

Of all the health and human service programs, child support receives the most assistance from local governments. In many cases, child support is administered at the county level through the courts.

Future Outlook

States are free to choose how they set up the delivery of public services. In general, states pay for and administer most programs for which there are uniform statewide benefits and eligibility. However, some states look to local governments to administer programs and to provide financial support. This is especially true during times of fiscal stress.

There already is growing evidence that states are shifting some of the costs of proving services to locals—through reduced aid, unfunded mandates or both. **Arizona's** governor plans to ask the legislature at its November 13 special budget reduction session to cut state revenue sharing with cities and counties by $50 million. A proposal in **Iowa** would reduce the amount of funds set aside for local property tax replacement programs. This would force local governments to scale back property tax credits or cut spending. Counties in **New York** recently asked the state to cap the local share of Medicaid expenses.

States frequently battle with federal lawmakers over unfunded mandates or reduced aid for grant programs. Yet, at the same time, many states do the same to local governments. As state policymakers lobby the federal government for increased support during difficult times, they will hear more about mandates—both existing and proposed—from local governments. Existing requirements likely will become even more burdensome to local governments as local revenue sources diminish and expenditure pressures grow. And new mandates will face even greater opposition by local lawmakers. Still, local governments are creatures of the states and will always be subject to federal and state politics and policies.

Technical Notes

State-Local Relations. The Census Bureau in the U.S. Department of Commerce collects data on intergovernmental transfers as part of its series on state and local finance (www.census.org). State rankings are based on actual numbers rather than the rounded amounts shown on the table.

County participation in states' health and human services costs is from the National Association of Counties. It is based on information provided by state associations of counties in March 1995. The information has not been updated. Information on recent proposals comes from www.stateline.org.

Auto Insurance. The data on auto insurance premiums and traffic density is from the National Association of Insurance Commissioners. More information can be found at www.naic.org. The testimony of AEI-Brookings is available at www.aei.brookings.org. Additional information on insurance regulation in California can be found on the Consumer

Federation of America's website at www.consumerfed.org.

Medicaid Matching Rates. The NCSL proposal was included in a letter sent to President Bush (www.ncsl.org). The NGA proposal is on its website at www.nga.org. The report, "Federal Aid to State Medicaid Programs is Falling while the Economy is Weakening," by the CBPP, is available online at www.cbpp.org.

Copies of *State Fact Finder 2001* Available

Reports subscribers can buy copies of the 2001 edition of *State Fact Finder* for $45 per copy, plus shipping and handling. This CQ Press publication is a gold mine of state rankings. It includes rankings on demographic and economic measures, as well as fiscal data relating to taxes, employment and federal spending. It also highlights state rankings in health care, welfare, education, transportation and criminal justice. There are more than 200 tables in all.

To order your copy, call Carol Ryder at 202/624-5849 or send an e-mail to cryder@ffis.org.

State Policy Reports (ISSN #8750-6637) is published twice a month by Federal Funds Information for States (FFIS) at an annual subscription rate of $460 (or $420 without *State Fact Finder*). Editor: Marcia Howard, 444 N. Capitol Street, NW, Suite 642, Washington, DC 20001 (phone: 202/624-5848, fax: 202/624-7745, e-mail: mhoward@ffis.org, website: www.ffis.org). For ordering and subscription services, contact Carol Ryder at FFIS (phone: 202/624-5849, e-mail: cryder@ffis.org).

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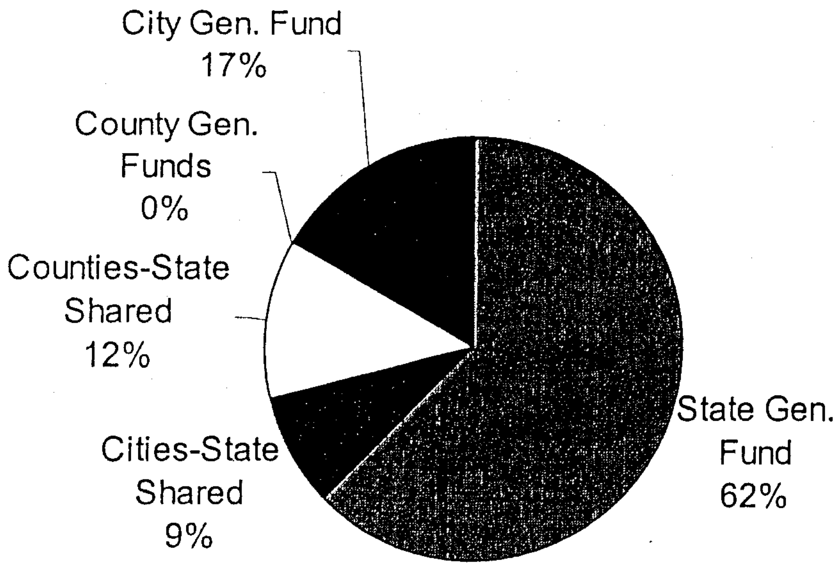
FY 1980 State and Local Sales Tax Distributions

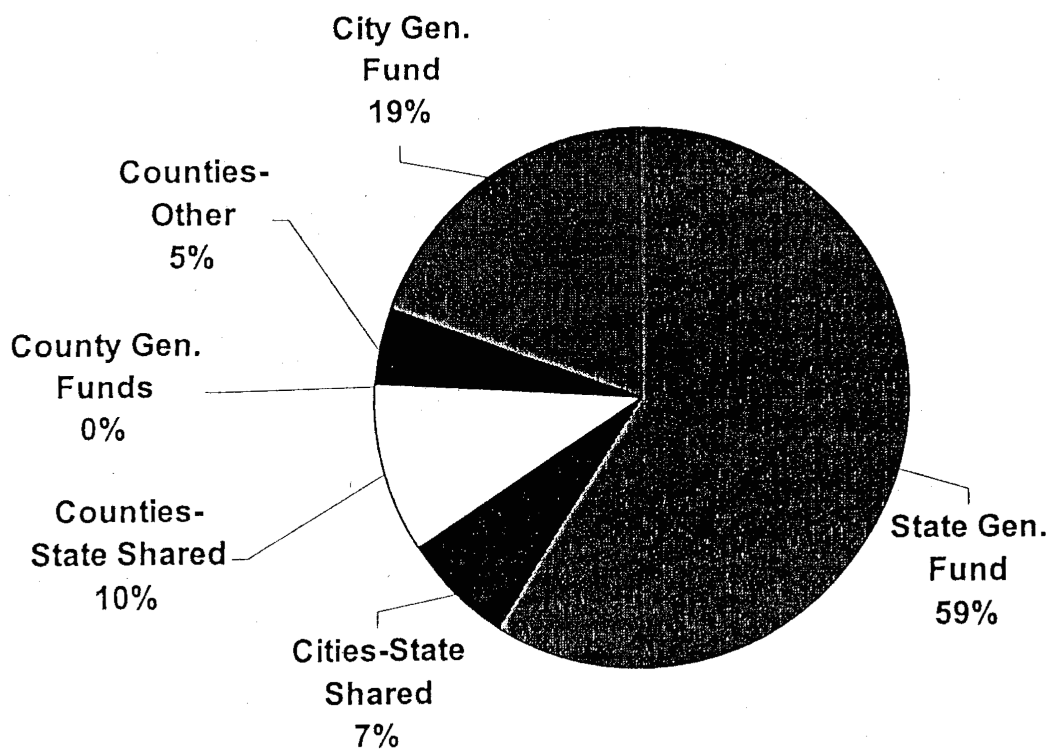


State:		
State Gen. Fund	$	613,572,917
Cities-State Shared		86,047,277
Counties-State Shared		115,647,540
State Total	**$**	**815,267,734**
Counties:		
County Gen. Funds	$	-
Counties-Other		0
Counties Total	**$**	**-**
Cities:		
City Gen. Fund	$	167,807,380
Total	**$**	**983,075,114**

Source: Arizona Department of Revenue; Arizona Tax Research Association

ATRA

FY 1990 State and Local Sales Tax Distributions

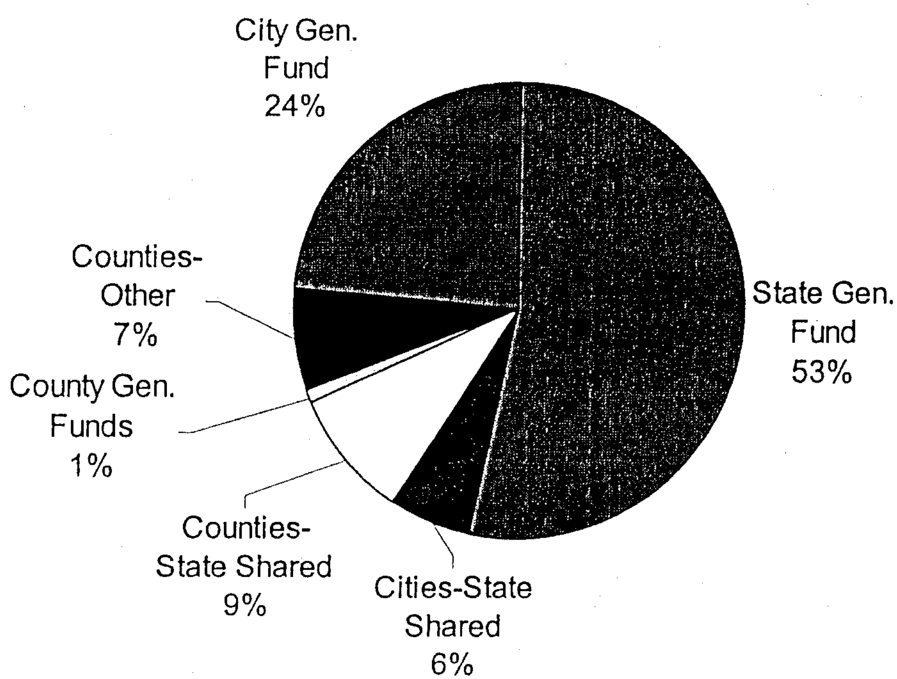


State:	
State Gen. Fund	$ 1,393,045,295
Cities-State Shared	159,021,328
Counties-State Shared	242,221,287
State Total	**$ 1,794,287,910**
Counties:	
County Gen. Funds	$ -
Counties-Other	115,893,136
Counties Total	**$ 115,893,136**
Cities:	
City Gen. Fund	$ 458,394,494
Total	**$ 2,368,575,540**

Source: Arizona Department of Revenue; Arizona Tax Research Association

ATRA

FY 2000 State and Local Sales Tax Distributions

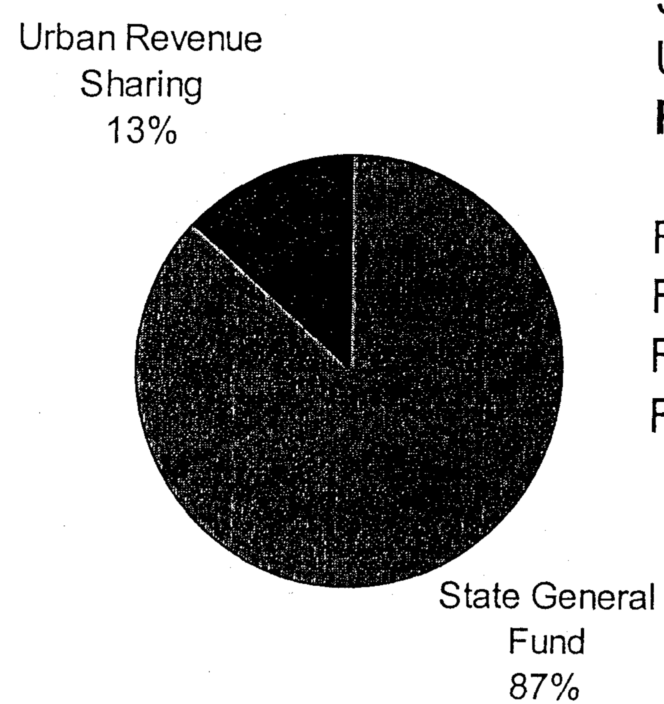


State:	
State Gen. Fund	$ 2,817,525,828
Cities-State Shared	299,386,513
Counties-State Shared	485,126,158
State Total	**$ 3,602,038,499**
Counties:	
County Gen. Funds	$ 51,331,411
Counties-Other	371,823,329
Counties Total	**$ 423,154,740**
Cities:	
City Gen. Fund	$ 1,251,435,566
Total	**$ 5,276,628,805**

Source: Arizona Department of Revenue; Arizona Tax Research Association

ATRA

FY 1980 Personal Income Tax Distribution



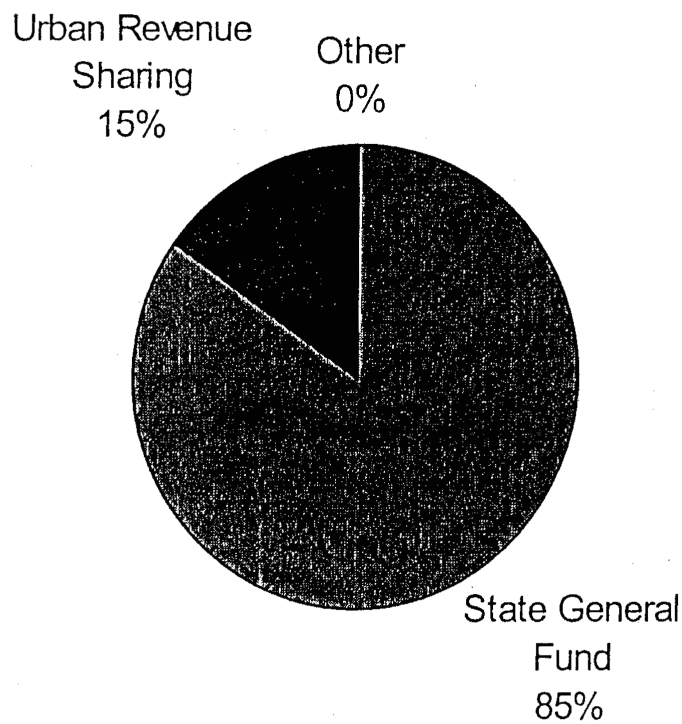
State General Fund	$276,341,892
Urban Revenue Sharing	42,997,581
FY 1980 Total	**$319,339,473**
FY 1979	270,264,587
FY 1978	222,808,090
FY 1977	190,591,709
FY 1976	162,869,338

NOTE: Cities and towns receive a percentage of both personal and corporate income tax revenue based on the net income tax collections two years earlier. The money distributed for FY 1980 was based on collections in FY 78.

Source: Arizona Department of Revenue; Arizona Tax Research Association

ATRA

FY 1990 Personal Income Tax Distribution



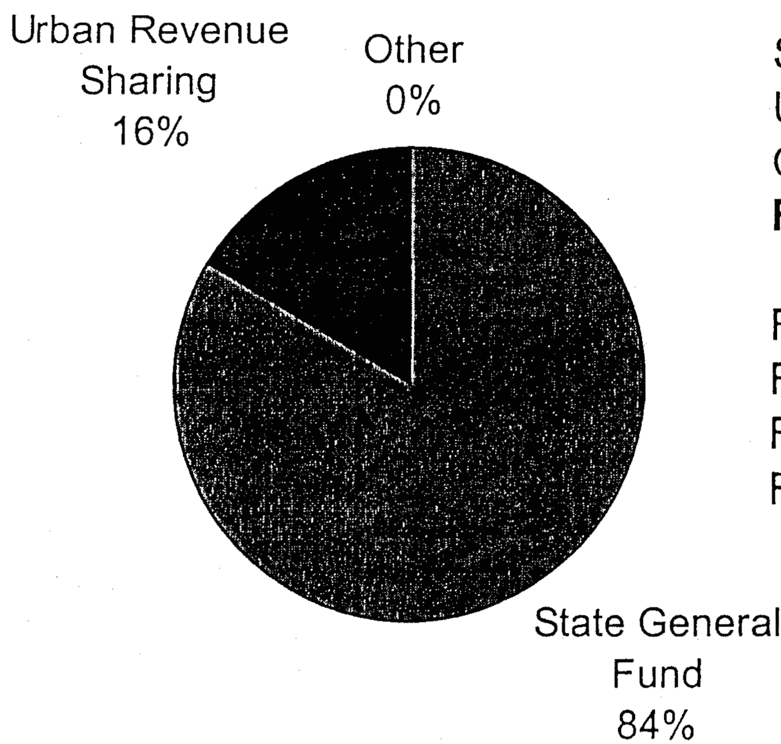
State General Fund	$845,224,634
Urban Revenue Sharing	150,622,581
Other	558,470
FY 1990 Total	**$996,405,685**
FY 1989	912,980,226
FY 1988	853,980,226
FY 1987	761,421,688
FY 1986	702,956,800

NOTE: Cities and towns receive a percentage of both personal and corporate income tax revenue based on the net income tax collections two years earlier. The money distributed for FY 1990 was based on collections in FY 88.

Source: Arizona Department of Revenue; Arizona Tax Research Association

ATRA

FY 2000 Personal Income Tax Distribution



State General Fund	$1,911,617,809
Urban Revenue Sharing	377,710,988
Other	2,553,642
FY 2000 Total	**$2,291,882,439**
FY 1999	2,098,349,339
FY 1998	1,863,196,533
FY 1997	1,668,414,355
FY 1996	1,494,282,275

NOTE: Cities and towns receive a percentage of both personal and corporate income tax revenue based on the net income tax collections two years earlier. The money distributed for FY 2000 was based on collections in FY 98.

Source: Arizona Department of Revenue; Arizona Tax Research Association

ATRA

Organizational Structure

- School Facilities Board
- Contribution Rates

STATE OF ARIZONA
SCHOOL FACILITIES BOARD

Governor of Arizona
Jane Dee Hull

Interim Executive Director
Edward E. Boot

Legislative Review Meeting of December 18, 2002

SFB Topics of Discussion

1. Building Renewal distribution for FY 2003

   At the December 5, 2002 meeting the SFB Board voted 5-4 to distribute ½ the available FY 2003 money after JCCR review. This was determined to be an appropriate action by the Board as a result of the legal concern regarding the suspension of the two equal annual distribution requirements in November and May, and amounts to a current distribution of $19,137,089. The second FY 2003 distribution for an equal amount will be made in May 2003.

2. Tanque Verde

   In November 1999 in accordance with the Students FIRST Law, the School Facilities Board awarded an 800-student high school to the Tanque Verde Unified School District. A parcel of land was required for this school and the land acquisition process commenced. The District's #1 parcel was rejected; parcel #2 was purchased (and subsequently re-sold): parcel #3 was approved, however, prior to purchase the district asked for re-consideration of parcel #1 which was subsequently approved by the SFB. This has taken 3 years, and parcel #1 is now in condemnation (at a price of $2,580,000 +). Because of the 3-year project limit the SFB re-examined and re-approved the award in October 2002 for a 650-student high school. This project will ultimately cost $15,000,000. There has been considerable unrest in the local community by the citizenry – location, size, environmental, need, and NIMBY are some of the issues, and this school location resides <2 miles from Sabina High School (a TUSD high school). In the 2002 Session the legislature re-confirmed their desire for the SFB to proceed with this school.

3. Cost Savings Thoughts

   Building Renewal formula changes – potential $35 million annually
   Project Management for New Construction – potential $8 million annually
   Quality Product definition in New Construction – potential $ 6 million annually
   Re-examine SFB and County Accommodation schools – potential $10 million
   Tanque Verde High School – potential $15 million

1700 WEST WASHINGTON, SUITE 602, PHOENIX, ARIZONA 85007
Phone: (602) 542-6501 • Fax: (602) 542-6529 • www.sfb.state.az.us

4. SFB Budget Issues

Deficiency Correction - The SFB needs $280 million to complete the Program and will reach the available funding limit by +/- February 1, 2003. This needs immediate action by the Legislation in the next session. We have approximately 1,850 projects remaining to contract at this time. The SFB has recommended bonding against the Land Trust and $280 million will complete this one time program. The SFB will request this amount from the Treasurer for FY 2004 to finish this Program.

New Construction Fund – The SFB has been provided by the Legislature and is utilizing $400 million of Lease-to-own authority in FY 2003, and will request from the Treasurer $250 million for FY 2004. In the 2002 Session the Legislature provided the SFB with ongoing $200 million of Lease-to-own funding beginning in FY 2004. The continued usage of Lease-to-own is not a long-term option for this program. The initial estimate for New Construction for FY 2005 indicates a potential need for $250 million.

Building Renewal Fund – The formula has been suspended by the Legislature for both FY 2003 and FY 2004 and the SFB has been provided $38,274,062 for distribution for each year. Our initial analysis indicates a request for approximately $110 million for FY 2005. The State of Arizona lost the lawsuit regarding Building Renewal reductions for FY 2000, FY 2002, and FY 2003 and this case is currently in the Court of Appeals. If the State ultimately loses this case, an amount of $158 million will be required for these three years. The AG believes a decision in this matter will be forthcoming in the spring of 2003. Additionally, the SFB has been authorized $38,274,062 for FY 2004 (short funding the formula by $71,494,847).

ARIZONA LEGISLATIVE COUNCIL

MEMO

October 22, 2002

TO: Senator Ruth Solomon
Representative Laura Knaperek

FROM: Kenneth C. Behringer, General Counsel

RE: Retirement Contributions (R-45-138)

BACKGROUND

Actuarial estimates indicate that the combined employer and employee contributions will increase to just under ten percent of employee payroll for the next biennial contribution period for the Arizona State Retirement System (ASRS).

QUESTIONS

1. May the Legislature phase in the increase in the contributions over more than a single year?

2. May actuarial determination of the contribution rate be made for more than a one year period?

ANSWERS

1. Probably not, because the contribution rates must be determined in accordance with actuarial standards.

2. Yes. The constitution does not specify a time period for which contribution rates must be determined. As long as the rates are determined in accordance with actuarial standards, the constitutional requirements have been met.

DISCUSSION

In 1998 the voters approved Proposition 100, which added article XXIX to the Constitution of Arizona. Section 1, subsection A of this article provides:

> Public retirement systems shall be funded with contributions and investment earnings using actuarial methods and assumptions that are consistent with generally accepted actuarial standards.

This provision clearly provides that the funding of public retirement systems shall be based on methods and assumptions that are consistent with generally accepted actuarial standards. This provision does not specifically require that the retirement system be fully funded, but the section read as a whole would appear to require full funding.

The constitutional provision provides that "public retirement system benefits shall not be diminished or impaired." Constitution of Arizona, article XXIX, section 1, subsection C. The section protects these benefits by mandating that funding requirements be determined using accepted actuarial methods. These funding requirements must be met through contributions and earnings, so that benefits are not impaired.

A proposal has been made to phase in the actuarially determined contribution rate. For example, if the determined employer rate were five percent, the Legislature would set the rate at four percent the first year and then five percent the second year. This plan is contrary to the constitutional requirement that the contribution rate be based on actuarial standards. Although, in one sense actuarial standards would be "used" to come up with a rate, in reality, the plan determines the rate actuarially then ignores this determination for one of the years. The plan would underfund the system the first year.

The second proposal is to use a contribution period of more than one year.[1] The constitution does not mandate any particular period for which a contribution rate must be determined. The only requirement is that the funding level be determined according to accepted actuarial standards. Therefore, unless a particular period is contrary to accepted actuarial standards, the Legislature is free to establish the period for which contribution rates are determined.

CONCLUSIONS

The Legislature may not phase in the actuarially determined contribution rate for the ASRS, but the Legislature is only limited by generally accepted actuarial standards in setting the period for which contribution rates are effective.

cc: Deborah Johnston

[1] ASRS contributions are currently determined on a biennial basis. *See* Arizona Revised Statutes section 38-737.