



The Executive Budget

Fiscal Year 2005 Summary

Janet Napolitano

Governor



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JANET NAPOLITANO
GOVERNOR

January 2004

To the Citizens of Arizona and
the Members of the Forty-Sixth Legislature:

To fully appreciate the challenges and opportunities of this important legislative session, it is essential that we examine what has transpired and what we have overcome in the past 12 months.

A year ago at this time, a newly elected Governor and a bumper crop of first-term Legislators were welcomed into office by arguably the most daunting fiscal crisis in State history. While state governments across the U.S. were reeling from the nationwide recession, our projected \$1 billion General Fund deficit for Fiscal Year 2004, when viewed as a percentage of the total budget, ranked Arizona among the nation's most fiscally troubled states. Our ability to perform even the most basic governmental functions was seriously at risk.

The process of arriving at a balanced budget was predictably and inevitably contentious. But along the way we realized that, despite the enormity of the task before us, we could and should resolve the State's fiscal crisis without draconian cuts in vital programs, without dismantling and then reconstituting State government, and without raising taxes. We recognized that, while our fiscal problems were severe, their causes would be short-lived. Our wisdom in employing temporary fiscal measures to address temporary, albeit severe, economic pressures has been affirmed, as the rebounding economy and sound decision-making in both the Legislative and Executive branches have sparked a return to fiscal health.

In short, we made the right moves, for the right reasons. While we must again wrestle with projected deficits, and the road ahead remains hazardous in many places, last year's solutions have helped pave the way for renewed innovation in State government and a higher level of responsiveness and service than ever before.

In a society that is increasingly driven by technology, we as policy makers must retain our focus on people. This Executive Budget Recommendation reflects a commitment – backed by phased-in initiatives that respect our fiscal situation – to shaping an environment in which Arizonans of all ages can receive an excellent education, pursue a life of prosperity and abundance, live in peace and safety, and enjoy Arizona's precious natural resources.

I believe we can agree that no function of State government is more important than public education. Providing proper funding is essential, but the State's role does not end there. We must

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strive for excellence in and access to childcare that, in addition to providing safe supervision, will help prepare children to succeed academically from the time they enter first grade. We should recognize that societal and economic trends have evolved to the point that innovations such as voluntary, full day kindergarten are among the ideas whose times have come. In addition, in the early grades, reading literacy must be a centerpiece of instruction. And we must enhance the quality of classroom instruction at all levels, through such strategies as diverting more resources from administration to the classroom, and developing a Master Teachers program in partnership with the private sector.

As young Arizonans complete their formal studies, an atmosphere of economic vitality and opportunity must welcome their entry. We should give strong consideration to tax credits for research and development and for investment in small, high-tech, high-wage companies. We must also invest in and provide direct technical assistance to rural communities in upgrading their physical and human resource infrastructure. Further, at a time when many California business owners are eager to relocate their companies and jobs, we need to make them aware of Arizona's positive business climate and to facilitate their moves to our state. Finally, in recognition of the importance to our economic health of U.S. military bases located within our borders, the Executive Recommendation provides funding mechanisms to protect those installations from the next wave of base closures.

Military bases are security assets as well as economic assets, and preserving them is vital to our citizens' safety. To further enhance our well-being, particularly in times of recurring security alerts, we will continue development of a statewide 2-1-1 phone system that Arizonans can dial for critical health and safety information in times of emergency.

Public safety also depends on effectiveness in incarcerating and reducing the recidivism of convicted criminals. To better prepare inmates for their release from prison, lower the likelihood of their return, and reduce the demand for prison beds, we must involve more inmates in treatment programs for substance abuse and sexual offense; expand work opportunities, especially in training of inmate firefighting crews; improve the methods of dealing with technical violators of probation and parole; and make effective use of minimum-security, level-one beds.

In meeting the needs of vulnerable Arizona children, the Executive Recommendation provides critical support in Child Protective Services, including funding to, in part, achieve a 100% CPS investigation rate, improve foster care, increase pay for CPS staff, and cover budget shortfalls for Children Services and the Division of Children, Youth and Families.

Finally, we must continue to protect our natural resources, especially as droughts make us increasingly susceptible to devastating wildfires and as bark beetles pose an additional threat to our forests. Our budget priorities include doubling the number of inmate crews to assist in tree thinning and brush clearing to protect Arizona communities located near forest areas, and our political priorities include gaining the attention and support of Congress and the White House in their stewardship of forests situated on federal land.

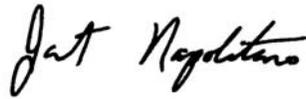
In my letter to you last January, I wrote, "As the national economy improves, as the benefits of our sound decision-making begin to be felt, and as we subordinate the narrow interests of

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various constituencies to the interests of the state as a whole, we will weather the chaos of fiscal year 2004.” Those words have been proved prophetic largely because our two branches of government rose above political and philosophical differences and made common cause for the benefit of the citizens we serve.

I am confident that our upcoming budget debate and decisions will likewise reflect our shared commitment to the public trust. Together, we will produce a Fiscal Year 2005 budget that allows State government to meet the needs and expectations and serve the best interests of the people of Arizona.

Respectfully yours,

A handwritten signature in black ink that reads "Janet Napolitano". The signature is written in a cursive, flowing style.

Janet Napolitano
Governor

JN/neh

Pulling it all together

Economic prosperity has its roots in the interrelationship of financial, physical and human capital

IN AN INCREASINGLY technologically driven society, investment in human capital pays dividends many times over. The availability of financial capital allows for continued investment in people – as well as physical infrastructure – helping them keep up with the inevitable changes of an evolving civilization.

The Fiscal Year 2005 Executive Budget reflects the necessity of those investments. It recognizes that education is a lifelong process and seeks to protect the investments made there and in other areas that develop human capital. And, it seeks to take advantage of those investments to enhance the well being of all Arizonans

■ Education

The Executive Budget views education as a continuum, a lifelong process. The budget further reflects the view that education and preparation for education are an investment.

Research shows that a child's early experiences form the foundation for learning. Ninety percent of a child's brain is developed by age three. Therefore, if children do not receive high-quality early learning experiences, a learning readiness gap begins to develop.

Executive initiatives for Early Childhood Education are not only budgetary; they include other measures such as public-private partnerships and increased opportunities for early childhood professionals to enhance their skills. However, there are measures that call for increased investments:

- providing technical assistance to child care centers;
- ensuring that children of more low-income parents have access to child care; and



- voluntary Full Day Kindergarten.

Child Care. To support these investments, ten Child Development Specialists are recommended for the Department of Health Services. The mission of these individuals will be to aid child care providers to help make the early childhood experience a healthy one for the child's mind and body. These ten professionals will, at a cost of \$674,100, advise the facilities on curriculum, professional development, fiscal automation and other matters to ensure that all facilities can help put each child in the best possible position to learn when they begin their more formal educational experiences.

The Executive Budget also reflects the belief that, in addition to providing an enhanced experience for children in child care, as many parents as choose to avail themselves of child care facilities should have the opportunity to do so, without regard to income level.

Arizona has a program for child care designed to ensure that low-income families and those that are transitioning from welfare do not have to choose between quitting work to care for a child and continuing work at the risk of leaving their child in an unacceptable environment. However, due to the budget problems of FY 2004, child care subsidies could not be fully funded. The result is a waiting list that

contained about 8,000 children at this writing.

Therefore, in order to continue investing in the human capital of Arizona, the Executive Budget provides almost \$24 million to shorten the child care waiting list and provide for mandatory caseload growth in FY 2005. Eliminating the entire waiting list would cost an incremental \$42 million, not fiscally possible even in an improving economy.

Full Day Kindergarten. Consistent with the strategy of investing in Arizona's human infrastructure, the Executive Budget provides \$25 million for classroom teachers and new facilities as the first step in a five-year phase-in of voluntary Full Day Kindergarten. The first group of schools to be funded in the Full Day Kindergarten program will be those schools of greatest need, defined as having 90% of the students eligible for the free and reduced-price lunch program. Additional schools will be added each year according to need, so that by the 2008-2009 school year all schools in Arizona will be able to offer Full Day Kindergarten as a part of their integrated learning curriculum.

Community colleges. Arizona's two-year community colleges provide high school graduates with a variety of educational opportunities, including technical education needed to participate in Arizona's and the nation's new economy. The community colleges also allow students to complete their first two years of a four-year baccalaureate degree received from Arizona universities. These two critical functions will be further advanced in the Executive Budget with full funding of enrollment growth, equalization aid, and capital outlay, amounting to \$15.3 million.

Universities. A top-notch university system allows each person and business in Arizona to be a world class competitor. Recognizing this, the Executive Budget provides full funding for FY 2005 enrollment growth at our three State universities.

In addition, taking into account the different missions and identified priorities of each university, funding for faculty retention is provided to the University of Arizona and Northern Arizona University, and funding for enrollment growth that occurred in FY 2004 is provided to Arizona State University.

Part of the pay package recommended for State employees will help universities further retain and recruit faculty and staff.

Finally, to help alleviate Arizona's shortage of nurses, over \$1 million is recommended for the nursing school at Northern Arizona University. In total, the incremental amount recommended for the university system is approximately \$46 million.

■ Health and welfare

Other human infrastructure investments that are proposed in the FY 2005 Executive Budget include additional funding for the Division of Children, Youth and Families (DCYF) in the Department of Economic Security. In the fall 2003 Special Session, the Legislature appropriated almost \$17 million; however, to bring DCYF up to national standards, the Executive Budget recommends approximately \$14 million in supplemental appropriations for FY 2004 and approximately \$52 million over the FY 2004 base amount for DCYF in FY 2005. This amount includes a doubling of the amount for the Healthy Families program, from \$7.25 million to \$14.5 million, as recommended by the School Readiness Board.

■ Public safety

Keeping the state's physical infrastructure in quality condition also requires continued investment. With the

continued growth in population and attendant growth in Arizona's network of highways comes the requirement to build more roads and maintain them for the safety of motorists.

A major part of highway safety is having an adequate law enforcement presence. The Executive Budget contains new funding of approximately \$2 million for two new Department of Public Safety (DPS) Highway Patrol squads, along with needed support personnel. The Executive Budget also recommends a special five-year pay package for DPS sworn officers. The FY 2005 incremental cost of that plan is about \$3 million. At the close of the fifth year of implementation, the pay plan will bring DPS officer salaries in line with the salaries offered by many of Arizona's local law enforcement agencies.

Forest protection. Arizona forests are suffering from the wilderness equivalent of the perfect storm: unrelenting drought, forest overgrowth stemming from years of policy decisions, and a major infestation of bark beetles. The result: unprecedented fire danger, putting people and property at risk.

In the last three years, Arizonans watched helplessly as mammoth fires burned nearly a million forest acres, ravaged communities in and near forest areas, and destroyed homes and businesses.

While most of our forest lands are federally controlled, we must do all we can as a state to protect people and property from wildland fire. That means making a financial and resource investment in Arizona's future.

Last year, Department of Corrections crews, composed of 20 inmates each, aided in firefighting efforts and worked through the State Land Department to clear brush and other fuels in and around at-risk communities and along evacuation corridors. That proved to be an efficient use of State resources to address a major public safety crisis. Therefore, the Executive Budget for FY 2005 doubles the number of 20-inmate crews, from six to 12,

at a cost of about \$2 million to the State Land Department and \$800,000 to the Department of Corrections.

Given the tremendous loss of property to date and the threat to the residents of our more than 120 forest communities, this is a wise investment in many ways and one the State must make.

■ Economic development

Combining the human, physical and financial resources of the State of Arizona to drive economic development is the job of the Department of Commerce.

The Executive Budget contains four initiatives within the Department, investing approximately \$1.7 million in Arizona's future.

The largest initiative was recommended by the Governor's Task Force for Military Facilities. Military bases provide 83,000 jobs and an economic impact of \$5.7 billion annually in Arizona. The Executive Budget contains \$1 million in start-up funding in FY 2005 to establish the Military Installation Fund, which will support efforts to protect these vital assets – both to the national security and the State's economy – from future waves of base closings.

Other Executive Initiatives for economic development include:

- \$175,800 to support the recommendations of the Governor's Council on Innovation and Technology, including strategies to increase job creation in Arizona's technological sectors;
- \$295,400 for rural community economic health, including direct technical assistance to help those communities find resources that will allow them to upgrade their physical and human infrastructure;
- \$206,700 to market to California companies seeking to relocate to a more business-friendly state.

These initiatives, combined with the ongoing activities of the Department of Commerce, can be the force that pulls together and expands Arizona's physical, human and financial capital so that our state is not just *among* the best places to live and work, but is *the* best.

■ State employees

Any investment in human capital is not complete without investing in the people who deliver the services such as those described above: the employees of the State of Arizona.

The sacrifice that State employees have made over the past years has been enormous. Turnover and vacancies are high, as even the most dedicated staff members find better opportunities elsewhere. In 2001, a multi-year proposal was put on the table to bring State employees up to within 5% of comparable jobs in the private sector; that proposal never came to full fruition. And, while fiscal reality prevents the State from returning to that worthwhile goal in the short term, the Executive Budget provides a \$46 million pay package. This package will allow anyone making less than \$50,000 a

year to receive a \$1,000 salary increase, effective July 1, 2004. Those making \$50,000 or more will receive a 2% increase.

In addition to this amount, the Executive Budget provides \$3 million for sworn DPS officers (further described in the Public Safety section) and approximately \$4 million for State-employed nurses.

■ Efficiency Review

Any recommendation for appropriating additional funds should be preceded by an analysis of how existing funds are spent. To that end, an Efficiency Review process was begun a year ago, with a small central staff and employees from various State agencies committing a portion of their time.

The details of the Efficiency Review process and its results are found elsewhere in this document. However, it is important to point out that \$37 million in cost avoidances and actual hard dollar savings have been found in FY 2004, and a projected \$102.7 million more for FY 2005.

Among the innovative ideas is to propose legislation to allow the Department of Corrections (DOC) to use

the price guidelines of the Arizona Health Care Cost Containment System (AHCCCS) as a starting point in contracting for inmate medical services. Similar legislation was signed into law in 2001 for the Department of Juvenile Corrections, resulting in savings of 32%. It is anticipated that this legislation will save DOC \$9.4 million in FY 2005.

Another innovation is to change, to a set fee schedule, AHCCCS's method of paying for Hospital Outpatient services. The result will be better cost control and an FY 2005 savings of \$10.5 million.

With the State's fiscal condition improving but not yet robust, the innovations and other "better government" measures such as those emerging from the Efficiency Review process will be crucial to maximizing the State's return on its investments in financial, physical and human capital. The interrelationship among the six initiatives described in this section will provide a solid foundation for the State's progress on every front. ■

Each of these initiatives is discussed in more detail in the Budget Message.

IN MEMORY OF CHRISTINE SATO



The Governor's Office of Strategic Planning and Budgeting dedicates this book to the memory of Christine Sato.

Christine began working for the budget office in 1996. During her years as a budget analyst she served with dedication and loyalty. Much of her efforts were dedicated to serving the behavioral and public health needs of Arizona residents. Her insight and persistence helped to make the new Arizona State Hospital a reality, in turn providing assistance, sanctuary and hope to many Arizonans in need.

She will be remembered as a kind and gentle spirit. In a job with inherent pressure and stress, Christine brought a sense of humor and adventure that she shared with her colleagues.

Christine's contributions and her joyful presence enriched many lives. She will be greatly missed. ♥

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Budget Summary

State of Arizona
SOURCES AND USES OF FUNDS
General Fund
In Thousands of Dollars

	<i>FY2003 Actuals</i>	<i>FY2004 Executive Recommendation</i>	<i>FY2005 Executive Recommendation</i>
SOURCES OF FUNDS			
Balance Forward	1,000.0	192,185.0	173,043.2
Base Revenues	6,231,517.6	6,681,400.0	7,130,700.0
<i>Urban Revenue Sharing</i>	(430,564.9)	(365,100.0)	(373,400.0)
Adjusted Revenues	<u>5,800,952.7</u>	<u>6,316,300.0</u>	<u>6,757,300.0</u>
Budget Stabilization Fund			
Budget Stabilization Fund End of Year Transfer			
Enacted Fund Transfers	343,613.2	49,500.0	11,700.0
Asset Sales	0.0		
Tax Amnesty Revenues		68,700.0	4,500.0
Temporary Fiscal Measures (Revenue)		0.0	0.0
Federal Cash Assistance	87,234.1	87,234.1	
Judicial Collections			8,500.0
Fiscal Bridges - Sources of Revenue			277,000.0
REVENUE SUBTOTAL	<u>6,232,800.0</u>	<u>6,713,919.1</u>	<u>7,232,043.2</u>
Ladewig Case	(15,000.0)	0.0	0.0
TOTAL SOURCES OF FUNDS	<u><u>6,217,800.0</u></u>	<u><u>6,713,919.1</u></u>	<u><u>7,232,043.2</u></u>
USES OF FUNDS			
Operating Budgets	6,015,875.3	6,454,770.6	7,182,850.1
46th Legislature, 2nd Special Session		19,182.3	
Regular Session Supplementals		81,384.5	
Full Day Kindergarten			25,500.0
University Pay Package			21,926.8
Employee Pay Packages			31,350.4
FMAP Relief Received in FY2003			
Health Insurance			31,772.2
Fiscal Bridges - Reduction of Uses			(100,000.0)
Total Operating Budgets	6,015,875.3	6,555,337.4	7,193,399.5
Capital Outlay Appropriations	1,742.9	0.0	0.0
Administrative Adjustments	51,197.2	40,507.8	23,000.0
Reversions	(43,200.4)	(54,969.3)	(51,169.3)
USES OF FUNDS	<u>6,025,615.0</u>	<u>6,540,875.9</u>	<u>7,165,230.2</u>
ENDING BALANCE	<u>192,185.0</u>	<u>173,043.2</u>	<u>66,813.0</u>
TOTAL USES OF FUNDS	<u><u>6,217,800.0</u></u>	<u><u>6,713,919.1</u></u>	<u><u>7,232,043.2</u></u>

**STATE OF ARIZONA
GENERAL FUND
REVENUE SUMMARY
FY 2003 THROUGH FY 2005
(in thousands)**

<u>TAXES</u>	Actual FY 2003	Estimate FY 2004	Estimate FY 2005
Corporate Income Tax	389,406.3	475,200.0	510,200.0
Individual Income Tax	2,099,744.2	2,205,600.0	2,420,600.0
Property Taxes	27,175.8	35,600.0	28,600.0
Sales and Use	3,033,877.7	3,229,400.0	3,429,400.0
Luxury Taxes	64,587.0	65,000.0	65,000.0
Insurance Premium Taxes	226,648.8	307,600.0	354,500.0
Vehicle License Taxes	6,556.9	0.0	0.0
Estate Taxes	94,217.9	40,200.0	20,000.0
Other Taxes	646.5	15,800.0	10,300.0
TOTAL TAXES	5,942,861.1	6,374,400.0	6,838,600.0
<u>OTHER REVENUES</u>			
Licenses, Fees & Permits/Misc.	100,000.0	108,400.0	111,900.0
Interest Earnings	12,853.0	13,200.0	13,200.0
Lottery	31,000.0	31,000.0	31,000.0
Transfers & Reimbursements	23,717.7	25,000.0	25,000.0
Disproportionate Share	121,085.8	129,400.0	111,000.0
TOTAL OTHER REVENUES	288,656.5	307,000.0	292,100.0
TOTAL REVENUE	6,231,517.6	6,681,400.0	7,130,700.0
<u>ADJUSTMENTS</u>			
Urban Revenue Sharing	(430,564.9)	(365,100.0)	(373,400.0)
B.S.F. Deposit	0.0	0.0	0.0
GRAND TOTAL REVENUES	5,800,952.7	6,316,300.0	6,757,300.0

General Fund Operating Budgets Summary

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
General Government						
Arizona Department of Administration	22,934.3	23,735.5	27,937.9	0.0	80.0	23,815.5
Office of Administrative Hearings	1,069.6	1,075.9	1,075.9	0.0	0.0	1,075.9
Attorney General - Department of Law	23,038.3	23,378.6	23,694.2	0.0	25.6	23,404.2
Auditor General	10,778.8	11,147.0	11,627.4	0.0	0.0	11,147.0
Department of Commerce	3,643.5	3,568.6	3,568.6	0.0	1,677.9	5,246.5
Governor's Office for Equal Opportunity	212.6	214.4	214.4	0.0	0.0	214.4
State Board of Equalization	543.3	543.4	543.4	543.4	1.2	544.6
Governor's Office of Excellence in Government	1,348.9	0.0	0.0	0.0	0.0	0.0
Office of the Governor	5,097.8	5,573.6	5,573.6	0.0	0.0	5,573.6
House of Representatives	10,305.5	11,147.7	11,147.7	0.0	0.0	11,147.7
Joint Legislative Budget Committee	724.0	2,096.1	2,096.1	0.0	0.0	2,096.1
Judiciary	135,780.8	112,733.1	122,572.7	0.0	0.0	112,733.1
Legislative Council	4,064.8	4,048.2	4,048.2	0.0	0.0	4,048.2
Arizona State Library, Archives & Public Records	6,723.3	6,552.4	6,777.4	0.0	0.0	6,552.4
Personnel Board	281.6	333.0	333.0	333.0	0.0	333.0
Department of Revenue	56,365.7	60,362.4	61,778.9	0.0	357.4	60,719.8
Department of State - Secretary of State	5,389.7	5,183.0	6,914.0	0.0	983.8	6,166.8
Senate	5,954.3	6,169.8	6,169.8	0.0	0.0	6,169.8
Governor's Office of Strategic Planning and Budgeting	1,638.5	1,683.0	1,683.0	0.0	0.0	1,683.0
State Board of Tax Appeals	240.3	273.1	273.3	273.3	0.6	273.9
Office of Tourism	9,001.1	9,000.0	9,000.0	0.0	2,600.0	11,600.0
State Treasurer	7,463.1	5,353.0	5,053.0	0.0	269.3	5,622.3
Commission on Uniform State Laws	36.6	49.6	52.3	0.0	2.7	52.3
General Government Total	312,636.4	294,221.4	312,134.8	1,149.7	5,998.5	300,220.1
Health and Welfare						
Department of Economic Security	420,116.4	462,173.8	860,194.7	0.0	170,493.1	632,666.9
Department of Environmental Quality	22,728.6	22,844.7	23,474.7	0.0	0.0	22,844.7
Arizona Health Care Cost Containment System	590,944.9	679,335.1	971,443.6	0.0	248,751.1	928,086.2
Department of Health Services	298,509.3	317,325.1	417,704.6	0.0	43,812.9	361,138.0
Arizona Commission of Indian Affairs	200.1	201.2	201.0	201.0	0.0	201.0
Arizona Pioneers' Home	285.3	3,637.8	3,680.3	0.0	(550.0)	3,087.8
Arizona Rangers' Pension	12.0	12.3	12.6	12.6	0.0	12.6
Department of Veterans' Services	2,328.5	2,165.1	3,646.2	0.0	168.6	2,333.7
Health and Welfare Total	1,335,125.1	1,487,695.1	2,280,357.7	213.6	462,675.7	1,950,370.9
Inspection & Regulation						
Arizona Department of Agriculture	10,236.7	9,972.1	10,545.2	0.0	198.0	10,170.1
State Banking Department	2,707.2	2,730.4	2,935.2	0.0	182.0	2,912.4
Department of Building and Fire Safety	3,046.1	3,190.6	3,190.6	0.0	12.0	3,202.6
Corporation Commission	4,831.7	4,795.3	4,795.3	0.0	7.6	4,802.9
Department of Insurance	5,719.4	6,205.8	7,301.7	0.0	1.6	6,207.4
Department of Liquor Licenses and Control	2,197.5	2,442.7	2,442.7	0.0	4.0	2,446.7
State Mine Inspector	1,027.3	1,085.4	1,085.4	0.0	0.0	1,085.4
State Board of Nursing	130.7	134.9	134.9	134.9	0.0	134.9
OSHA Review Board	0.0	4.8	4.8	4.8	0.0	4.8
Arizona Department of Racing	2,366.5	2,442.5	2,442.5	0.0	5.0	2,447.5
Radiation Regulatory Agency	1,485.4	1,519.0	1,821.6	0.0	0.0	1,519.0
Department of Real Estate	3,061.4	3,104.9	3,447.5	0.0	113.0	3,217.9

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
Department of Weights and Measures	1,292.1	1,313.7	1,450.0	0.0	112.7	1,426.4
Inspection & Regulation Total	38,102.0	38,942.1	41,597.4	139.7	635.9	39,578.0
Education						
Arizona State University - East Campus	12,425.6	12,425.6	17,870.8	0.0	168.1	12,593.7
Arizona State University - Main Campus	263,293.7	263,293.7	302,581.8	0.0	10,153.9	273,447.6
Arizona State University - West Campus	36,116.5	36,116.5	45,427.9	0.0	3,159.2	39,275.7
Arizona Commission on the Arts	2,073.3	3,800.0	3,800.0	0.0	0.0	3,800.0
State Board for Charter Schools	433.0	683.1	900.1	683.1	0.0	683.1
Arizona Community Colleges	127,502.6	128,308.7	128,308.7	0.0	15,306.3	143,615.0
Arizona State Schools for the Deaf and the Blind	15,173.0	13,835.8	14,362.8	0.0	0.0	13,835.8
Department of Education	2,599,492.2	2,962,135.1	3,401,275.3	0.0	175,637.0	3,137,772.1
Arizona Historical Society	4,192.3	3,367.0	3,548.7	0.0	193.7	3,560.7
Board of Medical Student Loans	283.4	0.0	0.0	0.0	0.0	0.0
Northern Arizona University	110,980.3	110,980.3	125,678.5	0.0	2,550.9	113,531.2
Commission for Postsecondary Education	1,391.3	1,391.3	1,391.3	0.0	0.0	1,391.3
Prescott Historical Society of Arizona	669.9	609.9	645.9	609.9	0.0	609.9
Arizona Board of Regents	7,424.6	7,561.9	8,791.6	0.0	21,928.8	29,490.7
School Facilities Board	39,817.8	22,837.5	280,271.0	0.0	22,493.1	45,330.6
University of Arizona - Health Sciences Center	52,858.4	52,858.4	56,974.5	0.0	953.0	53,811.4
University of Arizona - Main Campus	263,687.9	263,687.9	296,389.6	0.0	6,953.1	270,641.0
Education Total	3,537,815.8	3,883,892.7	4,688,218.5	1,293.0	259,497.1	4,143,389.8
Protection and Safety						
Department of Corrections	574,475.2	605,322.8	835,033.9	0.0	8,261.2	613,584.0
Arizona Criminal Justice Commission	1,394.1	1,302.0	1,302.0	0.0	0.0	1,302.0
Department of Emergency Services and Military Affairs	9,103.3	11,795.9	11,795.9	0.0	250.0	12,045.9
Board of Executive Clemency	898.2	856.5	1,091.3	0.0	27.7	884.2
Department of Juvenile Corrections	63,219.3	64,260.0	63,334.2	0.0	(2,240.0)	62,020.0
Law Enforcement Merit System Council	55.9	56.7	117.5	56.7	0.0	56.7
Department of Public Safety	31,960.4	29,535.6	41,358.9	0.0	(1,833.4)	27,702.2
Protection and Safety Total	681,106.4	713,129.5	954,033.7	56.7	4,465.5	717,595.0
Transportation						
Department of Transportation	62.5	67.7	67.7	0.0	0.0	67.7
Transportation Total	62.5	67.7	67.7	0.0	0.0	67.7
Natural Resources						
Arizona Geological Survey	770.8	778.7	778.7	778.7	0.0	778.7
State Land Department	13,651.1	16,531.6	26,913.8	0.0	2,117.7	18,649.3
Department of Mines and Mineral Resources	639.0	648.3	784.6	648.3	136.3	784.6
Arizona Navigable Stream Adjudication Commission	155.5	157.0	157.0	157.0	0.0	157.0
State Parks Board	20,037.5	22,310.5	28,433.1	0.0	0.0	22,310.5
Department of Water Resources	13,592.2	13,875.3	22,699.0	0.0	0.0	13,875.3
Natural Resources Total	48,846.1	54,301.4	79,766.2	1,584.0	2,254.0	56,555.4
General Fund Operating Total	5,953,694.3	6,472,249.9	8,356,176.0	4,436.7	735,526.7	7,207,776.9

* The Agency Request includes critical issues submitted in the budget request process.

Other FY 2005 appropriations not displayed here but included in the Executive Budget include: Arts Endowment funding, Residential Drug Treatment Center, Basic State Aid rollover, English Learner, School Facilities Board, Water Quality Assurance Revolving Fund, Nuclear Emergency Management and Growing Smarter.

**STATE OF ARIZONA
OTHER APPROPRIATED FUNDS*
REVENUE SUMMARY
FY 2003 THROUGH 2005
(in thousands)**

<u>TAXES</u>	Actual FY 2003	Estimate FY 2004	Estimate FY 2005
Motor Fuel Taxes	672,148.4	615,198.0	655,318.2
Other Taxes	539,693.9	608,825.4	662,117.5
TOTAL TAXES	1,211,842.3	1,224,023.4	1,317,435.7
 <u>OTHER REVENUES</u>			
Licenses, Fees & Permits	253,855.5	274,148.4	288,747.8
Charges for Services	755,669.1	718,210.9	749,797.9
Interest Earnings	62,240.1	65,360.5	65,546.9
Lottery	322,267.0	285,100.0	292,500.0
Fines and Forfeitures	59,965.8	55,201.4	55,465.2
Miscellaneous Revenues	144,292.5	166,169.4	164,637.1
Transfers & Reimbursements	2,473,077.1	2,368,371.9	2,521,218.0
TOTAL OTHER REVENUES	4,071,367.1	3,932,562.5	4,137,912.9
TOTAL REVENUE	5,283,209.4	5,156,585.9	5,455,348.6

* Other Appropriated Funds Revenues includes all revenues of funds which may only be partially subject to statutory or legislative appropriation. The expenditures shown in the "Other Funds Budget Summary" are for the appropriated portion of these funds only and may represent only a small portion of the funds total expenditures.

Other Appropriated Funds Operating Budgets Summary

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
General Government						
<u>Arizona Department of Administration</u>						
Personnel Division Fund	13,123.7	15,040.7	15,061.1	0.0	(855.6)	14,185.1
Capital Outlay Stabilization	9,778.1	11,178.4	11,300.7	0.0	2.2	11,180.6
Corrections Fund	557.5	628.1	628.1	0.0	1.9	630.0
Air Quality Fund	441.4	475.4	475.4	0.0	98.7	574.1
Special Employee Health	3,910.7	5,308.6	4,773.9	0.0	(532.2)	4,776.4
Technology & Telecommunications Fund	26,794.6	36,372.4	38,990.0	0.0	(1,269.5)	35,102.9
Admin - Motor Pool Revolving	7,076.5	13,376.1	11,913.8	0.0	(1,605.7)	11,770.4
State Surplus Materials Property	2,109.6	4,065.7	4,065.7	0.0	(3,000.2)	1,065.5
Federal Surplus Materials Property	56.7	352.1	352.1	0.0	(265.1)	87.0
Risk Management Fund	78,135.0	95,596.2	93,521.7	0.0	(2,071.9)	93,524.3
Certificate of Participation	268.1	282.6	282.6	0.0	(282.6)	0.0
Agency Total	142,251.9	182,676.3	181,365.1	0.0	(9,780.0)	172,896.3
<u>Office of Administrative Hearings</u>						
AHCCCS Donation Fund	13.8	13.9	13.9	0.0	0.0	13.9
Agency Total	13.8	13.9	13.9	0.0	0.0	13.9
<u>Attorney General - Department of Law</u>						
Consumer Protection/Fraud Revolving Fund	1,432.1	1,855.5	2,855.5	0.0	1,000.0	2,855.5
Attorney General Antitrust Revolving	305.4	170.5	170.5	0.0	0.0	170.5
Attorney General Collection Enforcement	1,977.0	3,769.5	4,065.3	0.0	0.0	3,769.5
Attorney General Agency Services Fund	15,981.5	17,880.3	17,880.3	0.0	0.0	17,880.3
Victim's Rights Implementation	2,850.6	3,185.0	3,185.0	0.0	0.0	3,185.0
Agency Total	22,546.6	26,860.8	28,156.6	0.0	1,000.0	27,860.8
<u>Department of Commerce</u>						
Lottery Fund	212.5	248.2	248.2	0.0	0.0	248.2
Commerce Development Bond Fund	100.1	120.2	120.2	0.0	0.0	120.2
Commerce & Economic Development	2,239.8	2,926.4	2,926.4	0.0	0.0	2,926.4
Oil Overcharge Fund	120.4	156.4	156.4	0.0	0.0	156.4
Agency Total	2,672.8	3,451.2	3,451.2	0.0	0.0	3,451.2
<u>Arizona Exposition & State Fair</u>						
Coliseum & Exposition Center	9,946.3	14,899.8	14,768.4	14,768.4	0.0	14,768.4
Agency Total	9,946.3	14,899.8	14,768.4	14,768.4	0.0	14,768.4
<u>Government Information Technology Agency</u>						
Information Technology Fund	2,247.7	2,507.6	2,460.2	2,460.2	0.0	2,460.2
Agency Total	2,247.7	2,507.6	2,460.2	2,460.2	0.0	2,460.2
<u>Arizona Department of Housing</u>						
Housing Trust Fund	438.8	432.2	400.0	400.0	0.0	400.0
Agency Total	438.8	432.2	400.0	400.0	0.0	400.0
<u>Judiciary</u>						
Supreme Court CJEF Disbursements	5,552.0	9,997.6	9,997.6	0.0	0.0	9,997.6
Judicial Collection - Enhancement	8,678.7	14,691.8	14,691.8	0.0	0.0	14,691.8
Defensive Driving Fund	4,128.8	5,225.3	5,225.3	0.0	0.0	5,225.3
Court Appointed Special Advocate Fund	2,245.3	3,402.7	3,604.6	0.0	0.0	3,402.7
Confidential Intermediary Fund	12.4	428.3	428.3	0.0	0.0	428.3
State Aid to the Courts Fund	1,885.7	1,840.1	1,840.1	0.0	0.0	1,840.1
Agency Total	22,502.9	35,585.8	35,787.7	0.0	0.0	35,585.8

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
<u>Arizona State Library, Archives & Public Records</u>						
Records Services Fund	310.3	426.1	659.8	0.0	0.0	426.1
Agency Total	310.3	426.1	659.8	0.0	0.0	426.1
<u>Arizona State Lottery Commission</u>						
Lottery Fund	51,162.8	48,599.9	49,306.6	49,306.6	(883.4)	48,423.2
Agency Total	51,162.8	48,599.9	49,306.6	49,306.6	(883.4)	48,423.2
<u>Arizona State Retirement System</u>						
Retirement System Appropriated	17,350.5	21,308.9	21,884.5	20,293.7	0.0	20,293.7
LTD Trust Fund	2,405.5	2,616.8	2,897.7	2,897.7	0.0	2,897.7
Agency Total	19,756.0	23,925.7	24,782.2	23,191.4	0.0	23,191.4
<u>Department of Revenue</u>						
DOR Estate & Unclaimed	1,349.6	1,448.2	2,003.4	0.0	0.0	1,448.2
DOR Liability Setoff Fund	371.2	385.8	385.8	0.0	0.0	385.8
Agency Total	1,720.8	1,834.0	2,389.2	0.0	0.0	1,834.0
<u>Department of State - Secretary of State</u>						
Election Systems Improvement Fund	0.0	0.0	9,000.0	0.0	9,000.0	9,000.0
Agency Total	0.0	0.0	9,000.0	0.0	9,000.0	9,000.0
<u>State Boards Office</u>						
Admin - Special Services	272.6	280.9	275.2	275.2	0.0	275.2
Agency Total	272.6	280.9	275.2	275.2	0.0	275.2
<u>Office of Tourism</u>						
Tourism Fund	1,995.2	0.0	0.0	0.0	0.0	0.0
Agency Total	1,995.2	0.0	0.0	0.0	0.0	0.0
General Government Total	277,838.5	341,494.2	352,816.1	90,401.8	(663.4)	340,586.5
Health and Welfare						
<u>Commission for the Deaf and the Hard of Hearing</u>						
Telecommunication for the Deaf	4,697.2	5,190.3	5,130.1	5,130.1	0.0	5,130.1
Agency Total	4,697.2	5,190.3	5,130.1	5,130.1	0.0	5,130.1
<u>Department of Economic Security</u>						
Statewide Cost Allocation Plan Fund	0.0	1,000.0	1,000.0	0.0	0.0	1,000.0
Arizona Job Training Fund	0.0	3,829.4	3,829.4	0.0	0.0	3,829.4
Workforce Investment Grant	45,553.1	48,004.7	48,004.7	0.0	0.0	48,004.7
Temporary Assistance for Needy Families	272,567.0	242,828.1	250,796.8	0.0	(15,197.6)	227,630.5
Child Care Development Fund	103,255.9	126,494.7	94,371.9	0.0	(29,321.3)	97,173.4
Economic Security Special Administration	8.8	2,129.5	2,129.5	0.0	0.0	2,129.5
Economic Security DCSE Administration	10,858.4	12,263.4	12,263.4	0.0	0.0	12,263.4
Domestic Violence Shelter	1,500.0	1,700.0	1,700.0	0.0	0.0	1,700.0
Child Abuse Prevention & Treatment	1,033.8	1,565.7	1,565.7	0.0	0.0	1,565.7
Child/Family Services Training Program	108.3	209.6	209.6	0.0	0.0	209.6
Public Assist Collections	245.4	446.8	446.8	0.0	0.0	446.8
Dept Long-Term Care System	17,459.1	21,240.8	38,540.8	0.0	0.0	21,240.8
Spinal and Head Injuries Trust Fund	1,997.4	2,478.1	2,478.1	0.0	0.0	2,478.1
Utility Assistance Fund	0.0	500.0	500.0	0.0	0.0	500.0
Reed Act Fund	0.0	0.0	9,861.9	0.0	0.0	0.0
Agency Total	454,587.2	464,690.8	467,698.6	0.0	(44,518.9)	420,171.9
<u>Department of Environmental Quality</u>						
DEQ Emissions Inspection	27,694.5	35,693.1	35,693.1	0.0	0.0	35,693.1
Hazardous Waste Management	467.8	695.6	695.6	0.0	0.0	695.6
Air Quality Fund	8,294.8	4,661.0	4,661.0	0.0	500.0	5,161.0
Underground Storage Tank Revolving	5.0	22.0	22.0	0.0	0.0	22.0

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
Recycling Fund	1,531.6	2,091.1	2,091.1	0.0	0.0	2,091.1
Permit Administration	5,095.7	5,384.7	5,384.7	0.0	0.0	5,384.7
Solid Waste Fee Fund	596.3	1,294.8	1,294.8	0.0	0.0	1,294.8
Used Oil Fund	90.6	130.9	130.9	0.0	0.0	130.9
Water Quality Fee Fund	1,601.1	3,736.9	3,736.9	0.0	0.0	3,736.9
Indirect Cost Fund	2,427.8	11,666.9	11,666.9	0.0	0.0	11,666.9
Agency Total	47,805.2	65,377.0	65,377.0	0.0	500.0	65,877.0
<u>Arizona Health Care Cost Containment System</u>						
Emergency Health Services Account	0.0	26,222.8	21,222.8	0.0	24.9	26,247.7
County Contribution Fund	0.0	7,446.5	0.0	0.0	0.0	7,446.5
Children's Health Insurance Program	79,484.7	86,873.9	90,220.9	0.0	7,365.4	94,239.3
AHCCCS Donation Fund	1,196.6	1,772.7	1,772.7	0.0	500.0	2,272.7
Agency Total	80,681.3	122,315.9	113,216.4	0.0	7,890.3	130,206.2
<u>Department of Health Services</u>						
Capital Outlay Stabilization	0.0	1,100.0	1,100.0	0.0	0.0	1,100.0
Child Care Development Fund	0.0	410.8	416.8	0.0	0.0	410.8
Medical Board Fund	0.0	100.0	100.0	0.0	0.0	100.0
Disease Control Research	1,000.0	0.0	0.0	0.0	0.0	0.0
Health Research Fund	0.0	6,500.0	6,500.0	0.0	0.0	6,500.0
Poison Control Fund	1,387.5	1,850.0	2,214.7	0.0	0.0	1,850.0
Lottery Fund	0.0	0.0	(3.9)	0.0	0.0	0.0
Emergency Medical Operating Services	3,216.8	3,810.9	3,880.5	0.0	22.9	3,833.8
Newborn Screening Program Fund	2,828.2	3,718.4	3,729.9	0.0	0.0	3,718.4
Substance Abuse Services Fund	3,350.0	0.0	2,000.0	0.0	2,500.0	2,500.0
Nursing Care Institution Resident Protection Revolving	0.0	38.0	638.0	0.0	600.0	638.0
IGA and ISA Fund	366.4	0.0	69.8	0.0	0.0	0.0
Environmental Laboratory Licensure Revolving	645.7	822.8	836.8	0.0	0.0	822.8
Child Fatality Review Fund	88.4	100.0	102.0	0.0	0.0	100.0
Vital Records Electronic Systems Fund	0.0	1,400.0	0.0	0.0	(1,400.0)	0.0
The Arizona State Hospital Fund	6,605.7	8,300.0	8,300.0	0.0	0.0	8,300.0
DHS State Hospital Land Earnings	632.5	650.0	350.0	0.0	(300.0)	350.0
DHS - Indirect Cost Fund	4,585.7	6,873.3	6,985.9	0.0	26.0	6,899.3
Agency Total	24,706.9	35,674.2	37,220.5	0.0	1,448.9	37,123.1
<u>Arizona Pioneers' Home</u>						
Pioneers' Home State Charitable Earnings	712.4	714.9	714.9	0.0	250.0	964.9
Pioneers' Home Miners' Hospital	4,207.4	1,121.5	1,121.5	0.0	300.0	1,421.5
Agency Total	4,919.8	1,836.4	1,836.4	0.0	550.0	2,386.4
<u>Department of Veterans' Services</u>						
Veterans' Conservatorship Fund	455.6	565.2	669.5	0.0	46.0	611.2
State Home for Veterans Trust	10,278.8	10,991.2	12,090.3	0.0	318.7	11,309.9
State Veterans' Cemetery Fund	43.6	182.7	182.7	0.0	(182.7)	0.0
Agency Total	10,778.0	11,739.1	12,942.5	0.0	182.0	11,921.1
Health and Welfare Total	628,175.6	706,823.7	703,421.5	5,130.1	(33,947.7)	672,815.8
<u>Inspection & Regulation</u>						
<u>State Board of Accountancy</u>						
Accountancy Board	1,598.8	2,122.2	2,113.0	2,113.0	0.0	2,113.0
Agency Total	1,598.8	2,122.2	2,113.0	2,113.0	0.0	2,113.0
<u>Acupuncture Board of Examiners</u>						
Acupuncture Board of Examiners	59.8	75.3	96.8	72.7	9.2	81.9
Agency Total	59.8	75.3	96.8	72.7	9.2	81.9

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
<u>Arizona Department of Agriculture</u>						
Agricultural Consulting/Training Program	62.1	63.7	63.7	0.0	0.0	63.7
Agriculture Commercial Feed	203.3	205.4	205.4	0.0	0.0	205.4
Egg & Egg Product Control Fund	430.0	488.2	637.4	0.0	127.9	616.1
Pesticide Fund	236.8	240.0	240.0	0.0	0.0	240.0
Agriculture Dangerous Plants	21.4	21.4	21.4	0.0	0.0	21.4
Agriculture Seed Law	30.9	50.9	50.9	0.0	0.0	50.9
Livestock Custody Fund	29.5	79.4	79.4	0.0	0.0	79.4
Fertilizer Materials Fund	250.6	257.7	257.7	0.0	0.0	257.7
Citrus, Fruit, & Vegetable Revolving	746.2	1,008.0	1,008.0	0.0	0.0	1,008.0
Aquaculture Fund	5.2	9.2	9.2	0.0	0.0	9.2
AZ Protected Native Plant	152.3	249.6	249.6	0.0	0.0	249.6
Agency Total	2,168.3	2,673.5	2,822.7	0.0	127.9	2,801.4
<u>State Board of Appraisal</u>						
Board of Appraisal Fund	458.6	484.1	474.9	474.9	0.0	474.9
Agency Total	458.6	484.1	474.9	474.9	0.0	474.9
<u>Board of Barber Examiners</u>						
Barber Examiners Board	191.1	221.4	260.4	207.0	13.3	220.3
Agency Total	191.1	221.4	260.4	207.0	13.3	220.3
<u>Board of Behavioral Health Examiners</u>						
Behavioral Health Examiner Fund	611.8	813.8	773.9	771.6	2.3	773.9
Agency Total	611.8	813.8	773.9	771.6	2.3	773.9
<u>State Board of Chiropractic Examiners</u>						
Chiropractic Examiners Board	340.7	450.8	445.7	439.6	6.1	445.7
Agency Total	340.7	450.8	445.7	439.6	6.1	445.7
<u>Corporation Commission</u>						
Utility Regulation Revolving	10,386.7	11,430.9	11,661.9	0.0	2.8	11,433.7
Pipeline Safety Revolving	0.0	0.0	62.6	0.0	62.6	62.6
Securities Regulatory & Enforcement	3,090.4	3,424.0	3,424.0	0.0	0.0	3,424.0
Public Access Fund	1,744.0	1,824.5	2,034.5	0.0	0.0	1,824.5
Securities Investment Management Fund	1,515.8	770.8	770.8	0.0	0.0	770.8
Arizona Arts Trust Fund	43.5	38.8	38.8	0.0	0.0	38.8
Agency Total	16,780.4	17,489.0	17,992.6	0.0	65.4	17,554.4
<u>Board of Cosmetology</u>						
Cosmetology Board	1,469.2	1,538.9	1,504.4	1,504.4	0.0	1,504.4
Agency Total	1,469.2	1,538.9	1,504.4	1,504.4	0.0	1,504.4
<u>State Board of Dental Examiners</u>						
Dental Board Fund	765.3	881.7	908.8	0.0	26.0	907.7
Agency Total	765.3	881.7	908.8	0.0	26.0	907.7
<u>State Board of Dispensing Opticians</u>						
Dispensing Opticians Board	98.7	113.3	99.1	99.1	0.0	99.1
Agency Total	98.7	113.3	99.1	99.1	0.0	99.1
<u>State Board of Funeral Directors & Embalmers</u>						
Funeral Directors & Embalmers	254.0	279.1	273.5	273.5	0.0	273.5
Agency Total	254.0	279.1	273.5	273.5	0.0	273.5
<u>Department of Gaming</u>						
Permanent Tribal-State Compact Fund	3,964.9	1,528.6	1,528.6	0.0	20.9	1,549.5
Arizona Benefits Fund	1,083.9	9,391.4	9,953.1	0.0	121.4	9,512.8
Agency Total	5,048.8	10,920.0	11,481.7	0.0	142.3	11,062.3
<u>Board of Homeopathic Medical Examiners</u>						

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
Homeopathic Medical Examiners	57.9	74.8	76.2	72.9	0.0	72.9
Agency Total	57.9	74.8	76.2	72.9	0.0	72.9
<u>Industrial Commission of Arizona</u>						
Industrial Commission Administration Fund	14,967.6	16,498.8	16,094.5	16,094.5	0.0	16,094.5
Agency Total	14,967.6	16,498.8	16,094.5	16,094.5	0.0	16,094.5
<u>Arizona Medical Board</u>						
Medical Examiners Board	4,696.2	4,752.2	4,926.9	4,591.2	114.3	4,705.5
Agency Total	4,696.2	4,752.2	4,926.9	4,591.2	114.3	4,705.5
<u>Naturopathic Physicians Board of Medical Examiners</u>						
Naturopathic Board	212.8	291.7	518.8	213.4	201.2	414.6
Agency Total	212.8	291.7	518.8	213.4	201.2	414.6
<u>State Board of Nursing</u>						
Nursing Board	3,079.6	3,105.6	2,578.7	2,578.7	189.8	2,768.5
Agency Total	3,079.6	3,105.6	2,578.7	2,578.7	189.8	2,768.5
<u>Nursing Care Ins. Admin. Examiners</u>						
Nursing Care Institution Administrators/ACHMC	335.9	361.7	353.4	353.4	0.0	353.4
Agency Total	335.9	361.7	353.4	353.4	0.0	353.4
<u>Board of Occupational Therapy Examiners</u>						
Occupational Therapy Fund	158.4	213.7	208.9	208.9	0.0	208.9
Agency Total	158.4	213.7	208.9	208.9	0.0	208.9
<u>State Board of Optometry</u>						
Board of Optometry Fund	143.8	163.4	179.7	153.4	12.8	166.2
Agency Total	143.8	163.4	179.7	153.4	12.8	166.2
<u>Arizona Board of Osteopathic Examiners</u>						
Osteopathic Examiners Board	317.8	466.9	478.5	434.0	44.5	478.5
Agency Total	317.8	466.9	478.5	434.0	44.5	478.5
<u>Arizona State Board of Pharmacy</u>						
Pharmacy Board	1,153.6	1,347.7	1,315.7	1,315.7	0.0	1,315.7
Agency Total	1,153.6	1,347.7	1,315.7	1,315.7	0.0	1,315.7
<u>Board of Physical Therapy Examiners</u>						
Physical Therapy Fund	232.1	237.1	258.6	230.6	27.0	257.6
Agency Total	232.1	237.1	258.6	230.6	27.0	257.6
<u>State Board of Podiatry Examiners</u>						
Podiatry Examiners Board	89.3	104.6	102.4	102.4	0.0	102.4
Agency Total	89.3	104.6	102.4	102.4	0.0	102.4
<u>State Board for Private Postsecondary Education</u>						
Private Postsecondary Education	243.1	258.6	245.7	245.7	0.0	245.7
Agency Total	243.1	258.6	245.7	245.7	0.0	245.7
<u>State Board of Psychologist Examiners</u>						
Psychologist Examiners Board	259.8	319.9	314.5	314.5	0.0	314.5
Agency Total	259.8	319.9	314.5	314.5	0.0	314.5
<u>Arizona Department of Racing</u>						
Racing Commission County Fairs/Breeders Award	36.1	75.5	75.5	0.0	(18.8)	56.7
County Fair Racing	279.0	362.5	362.5	0.0	(13.1)	349.4
Agency Total	315.1	438.0	438.0	0.0	(31.9)	406.1
<u>Radiation Regulatory Agency</u>						
State Radiologic Technologist Certification	210.9	239.9	239.9	0.0	0.0	239.9
Agency Total	210.9	239.9	239.9	0.0	0.0	239.9

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
<u>Registrar of Contractors</u>						
Registrar of Contractors Fund	9,047.5	10,024.5	9,075.7	9,075.7	0.0	9,075.7
Agency Total	9,047.5	10,024.5	9,075.7	9,075.7	0.0	9,075.7
<u>Residential Utility Consumer Office</u>						
Residential Utility Consumer Office Revolving	953.2	1,145.7	1,108.2	1,108.2	0.0	1,108.2
Agency Total	953.2	1,145.7	1,108.2	1,108.2	0.0	1,108.2
<u>Board of Respiratory Care Examiners</u>						
Board of Respiratory Care Examiners	156.0	198.6	190.6	190.6	0.0	190.6
Agency Total	156.0	198.6	190.6	190.6	0.0	190.6
<u>Structural Pest Control Commission</u>						
Structural Pest Control	1,836.9	1,875.6	1,841.9	1,841.9	0.0	1,841.9
Agency Total	1,836.9	1,875.6	1,841.9	1,841.9	0.0	1,841.9
<u>State Board of Technical Registration</u>						
Technical Registration Board	1,176.3	1,333.7	1,306.5	1,306.5	0.0	1,306.5
Agency Total	1,176.3	1,333.7	1,306.5	1,306.5	0.0	1,306.5
<u>State Veterinary Medical Examining Board</u>						
Veterinary Medical Examiners Board	342.8	391.1	384.2	384.2	0.0	384.2
Agency Total	342.8	391.1	384.2	384.2	0.0	384.2
<u>Department of Weights and Measures</u>						
Air Quality Fund	1,091.3	1,228.0	1,233.5	0.0	12.1	1,240.1
Agency Total	1,091.3	1,228.0	1,233.5	0.0	12.1	1,240.1
Inspection & Regulation Total	70,923.4	83,134.9	82,718.5	46,772.2	962.3	81,604.6
Education						
<u>Arizona State University - East Campus</u>						
ASU Collections - Appropriations	6,051.6	7,113.0	8,872.6	0.0	1,759.6	8,872.6
Technology and Research Initiative Fund	2,000.0	2,000.0	2,000.0	0.0	0.0	2,000.0
Agency Total	8,051.6	9,113.0	10,872.6	0.0	1,759.6	10,872.6
<u>Arizona State University - Main Campus</u>						
ASU Collections - Appropriations	123,088.8	129,824.2	140,200.0	0.0	10,176.1	140,000.3
Agency Total	123,088.8	129,824.2	140,200.0	0.0	10,176.1	140,000.3
<u>Arizona State University - West Campus</u>						
ASU Collections - Appropriations	6,431.3	6,639.6	11,936.5	0.0	5,296.9	11,936.5
Technology and Research Initiative Fund	1,600.0	1,600.0	1,600.0	0.0	0.0	1,600.0
Agency Total	8,031.3	8,239.6	13,536.5	0.0	5,296.9	13,536.5
<u>Arizona State Schools for the Deaf and the Blind</u>						
Telecommunications Excise Tax Fund	0.0	1,878.4	1,878.4	0.0	77.0	1,955.4
Schools for the Deaf & Blind Fund	11,416.9	12,592.7	13,636.1	0.0	351.1	12,943.8
Agency Total	11,416.9	14,471.1	15,514.5	0.0	428.1	14,899.2
<u>Department of Education</u>						
Teacher Certification Fund	1,300.4	1,535.0	1,635.0	0.0	100.0	1,635.0
School Accountability Fund	4,942.1	6,915.2	6,915.2	0.0	0.0	6,915.2
Public Institutions Permanent School Earnings	70,263.0	59,761.1	59,761.1	0.0	(11,251.7)	48,509.4
Agency Total	76,505.5	68,211.3	68,311.3	0.0	(11,151.7)	57,059.6
<u>Board of Medical Student Loans</u>						
Medical Examiners Board	0.0	283.4	283.4	283.4	0.0	283.4
Medical Student Loan Fund	13.2	47.2	13.2	13.2	0.0	13.2
Agency Total	13.2	330.6	296.6	296.6	0.0	296.6
<u>Northern Arizona University</u>						
NAU Collections - Appropriations	25,566.6	26,189.7	30,550.6	0.0	7,955.0	34,144.7

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
Agency Total	25,566.6	26,189.7	30,550.6	0.0	7,955.0	34,144.7
<u>Commission for Postsecondary Education</u>						
Postsecondary Education Fund	2,122.9	2,797.1	2,948.2	0.0	60.0	2,857.1
Agency Total	2,122.9	2,797.1	2,948.2	0.0	60.0	2,857.1
<u>University of Arizona - Health Sciences Center</u>						
U of A College of Medical - Collect/Appropriated	9,100.6	7,889.9	10,884.6	0.0	2,994.7	10,884.6
Poison Control Fund	92.0	0.0	0.0	0.0	0.0	0.0
Agency Total	9,192.6	7,889.9	10,884.6	0.0	2,994.7	10,884.6
<u>University of Arizona - Main Campus</u>						
U of A Main Campus - Collect/Appropriated	89,127.5	94,997.5	102,874.5	0.0	7,877.0	102,874.5
Agency Total	89,127.5	94,997.5	102,874.5	0.0	7,877.0	102,874.5
Education Total	353,116.9	362,064.0	395,989.4	296.6	25,395.7	387,425.7
Protection and Safety						
<u>Automobile Theft Authority</u>						
Automobile Theft Authority Fund	3,902.5	4,038.2	4,521.5	4,121.5	400.0	4,521.5
Agency Total	3,902.5	4,038.2	4,521.5	4,121.5	400.0	4,521.5
<u>Department of Corrections</u>						
Corrections Fund	17,159.0	38,353.9	0.0	0.0	(9,709.2)	28,644.7
State Education Fund for Correctional Education	1,708.7	2,122.2	2,122.2	0.0	(584.4)	1,537.8
DOC - Alcohol Abuse Treatment	424.5	449.3	449.3	0.0	0.0	449.3
Penitentiary Land Earnings	1,203.5	869.2	869.2	0.0	0.0	869.2
State Charitable, Penal & Reformatory Land Earnings	442.9	570.0	570.0	0.0	0.0	570.0
Prison Construction and Operations Fund	0.0	250.0	0.0	0.0	9,750.0	10,000.0
Agency Total	20,938.6	42,614.6	4,010.7	0.0	(543.6)	42,071.0
<u>Arizona Criminal Justice Commission</u>						
Criminal Justice Enhancement Fund	448.6	561.3	536.3	0.0	(25.0)	536.3
Victims Compensation and Assistance Fund	2,812.7	2,900.0	3,900.0	0.0	1,000.0	3,900.0
State Aid to County Attorneys Fund	850.5	706.5	706.5	0.0	0.0	706.5
State Aid to Indigent Defense Fund	807.6	670.8	670.8	0.0	0.0	670.8
Agency Total	4,919.4	4,838.6	5,813.6	0.0	975.0	5,813.6
<u>Arizona Drug and Gang Prevention Resource Center</u>						
Drug and Gang Prevention Fund	259.8	262.0	254.8	254.8	0.0	254.8
Intergovernmental Agreements and Grants Fund	795.9	1,209.6	1,197.5	1,197.5	0.0	1,197.5
Agency Total	1,055.7	1,471.6	1,452.3	1,452.3	0.0	1,452.3
<u>Department of Emergency Services and Military Affairs</u>						
Emergency Response Fund	132.7	132.7	132.7	0.0	0.0	132.7
Agency Total	132.7	132.7	132.7	0.0	0.0	132.7
<u>Department of Juvenile Corrections</u>						
Juvenile Corrections CJEF Distribution	426.3	585.3	585.3	0.0	0.0	585.3
Juvenile Education Fund	3,668.6	2,755.9	2,659.0	0.0	(146.4)	2,609.5
Endowments/land Earnings	360.0	360.0	360.0	0.0	0.0	360.0
Agency Total	4,454.9	3,701.2	3,604.3	0.0	(146.4)	3,554.8
<u>Department of Public Safety</u>						
State Highway Fund	28,266.6	30,151.4	34,339.3	0.0	(30,151.4)	0.0
Arizona Highway Patrol Fund	13,390.0	16,429.9	22,265.4	0.0	2,568.7	18,998.6
Safety Enforcement and Transportation Infrastructure	1,128.7	1,192.8	1,192.8	0.0	0.0	1,192.8
Crime Laboratory Assessment	3,732.3	4,424.7	3,857.8	0.0	(566.9)	3,857.8
Auto Fingerprint Identification	1,799.0	2,194.9	2,194.9	0.0	0.0	2,194.9
DNA Identification System Fund	429.1	2,525.1	2,525.1	0.0	0.0	2,525.1

	FY 2003 Expenditures	FY 2004 Appropriation	FY 2005 Agency Request*	FY 2005 Appropriation	Executive Issues and Adjustments	FY 2005 Executive Recommendation
County Transportation Contribution Fund	0.0	8,206.8	9,663.6	0.0	4,800.0	13,006.8
Sex Offender Monitoring Fund	0.0	331.0	331.0	0.0	0.0	331.0
Fingerprint Clearance Card Fund	24.4	268.7	0.0	0.0	(268.7)	0.0
Board of Fingerprinting	35.9	0.0	0.0	0.0	0.0	0.0
Motorcycle Safety Fund	10.1	80.0	80.0	0.0	0.0	80.0
ADOT Highway User Fund	51,842.0	48,698.0	56,938.1	0.0	31,719.8	80,417.8
Criminal Justice Enhancement Fund	2,197.0	2,297.2	2,297.2	0.0	0.0	2,297.2
Agency Total	102,855.1	116,800.5	135,685.2	0.0	8,101.5	124,902.0
Protection and Safety Total	138,258.9	173,597.4	155,220.3	5,573.8	8,786.5	182,447.9
Transportation						
<u>Department of Transportation</u>						
State Aviation Fund	3,281.8	1,896.1	1,898.5	0.0	2.4	1,898.5
State Highway Fund	262,711.9	329,913.6	340,424.5	0.0	10,256.5	340,170.1
Transportation Department Equipment Fund	30,216.6	32,518.7	36,953.4	0.0	1,000.0	33,518.7
Safety Enforcement and Transportation Infrastructure	1,945.4	2,545.7	2,652.6	0.0	113.4	2,659.1
Air Quality Fund	51.1	55.7	55.7	0.0	0.0	55.7
Vehicle Inspection & Title Enforcement	1,008.1	1,119.4	1,241.0	0.0	45.8	1,165.2
Motor Vehicle Liability Insurance Enforcement	1,011.0	1,100.6	1,334.4	0.0	117.5	1,218.1
ADOT Highway User Fund	648.2	383.3	383.3	0.0	0.0	383.3
Agency Total	300,874.1	369,533.1	384,943.4	0.0	11,535.6	381,068.7
Transportation Total	300,874.1	369,533.1	384,943.4	0.0	11,535.6	381,068.7
Natural Resources						
<u>Arizona Game & Fish Department</u>						
Game & Fish Fund	19,731.9	23,282.3	22,372.7	22,372.7	0.0	22,372.7
Game & Fish Watercraft License	2,431.0	2,140.8	2,086.8	2,086.8	0.0	2,086.8
Game/Non-Game Fund	232.0	293.4	289.6	289.6	0.0	289.6
Waterfowl Conservation	23.7	43.4	43.5	43.5	0.0	43.5
Wildlife Endowment Fund	8.3	16.0	16.0	16.0	0.0	16.0
Agency Total	22,426.9	25,775.9	24,808.6	24,808.6	0.0	24,808.6
<u>State Land Department</u>						
Environmental Special Plate Fund	629.8	490.0	250.0	0.0	(240.0)	250.0
Heritage Fund	3,663.5	0.0	0.0	0.0	0.0	0.0
Agency Total	4,293.3	490.0	250.0	0.0	(240.0)	250.0
<u>State Parks Board</u>						
Reservation Fund	181.0	298.7	307.7	0.0	0.0	298.7
Boating Safety Fund	1,116.9	1,092.7	1,092.7	0.0	0.0	1,092.7
State Parks Enhancement	5,269.8	10,117.9	10,461.6	0.0	0.0	10,117.9
Off-Highway Vehicle Recreation	351.7	0.0	0.0	0.0	0.0	0.0
Arizona Game & Fish Commission Heritage Fund	6,073.0	0.0	0.0	0.0	0.0	0.0
Land Conservation Fund	0.0	700.0	700.0	0.0	(700.0)	0.0
Agency Total	12,992.4	12,209.3	12,562.0	0.0	(700.0)	11,509.3
Natural Resources Total	39,712.6	38,475.2	37,620.6	24,808.6	(940.0)	36,567.9
Other Appropriated Funds Operating Total	1,808,900.0	2,075,122.5	2,112,729.8	172,983.1	11,129.0	2,082,517.1

* The Agency Request includes critical issues submitted in the budget request process.

FY 2005 Executive Recommendation: Expenditure Growth Breakdown

<i>Initiative / Agency</i>	<i>FY2004 Appropriation</i>	<i>Population, Enrollment, or Caseload Requirements</i>	<i>Loss of Other Funding Source</i>	<i>Statutory, Court, Other Mandated Obligation</i>	<i>Annualization</i>	<i>General Fund Savings</i>	<i>Pay Parity</i>	<i>Executive Initiative</i>	<i>FY2005 Executive Recommendation</i>
Full Day Kindergarten								25,500,000	25,500,000
University Pay Plan							21,926,800		21,926,800
State Employee Pay Package							31,350,400		31,350,400
Health Insurance				31,772,200					31,772,200
Dept. of Education	2,962,135,100	175,637,000							3,137,772,100
AHCCCS	679,335,100	179,063,000	81,490,700	(1,322,900)		(10,479,700)			928,086,200
Dept. of Corrections	605,322,800			6,093,500	11,748,300	(10,384,900)		804,300	613,584,000
Dept. of Economic Security	462,173,800	62,521,100	47,613,200	7,150,500	20,295,100			32,913,200	632,666,900
Dept. of Health Services	317,325,100	16,161,500	21,130,600	5,523,300	25,000			972,500	361,138,000
Univ. of Arizona-Main Campus	263,687,900	3,386,700					3,566,400		270,641,000
Arizona State Univ.-Main Campus	263,293,700	10,153,900							273,447,600
Community Colleges	128,308,700	15,306,300							143,615,000
Northern Arizona Univ.	110,980,300						2,550,900		113,531,200
Univ. of Arizona-Health Sciences Ctr	52,858,400	238,100					714,900		53,811,400
Arizona State Univ.-West Campus	36,116,500	3,159,200							39,275,700
School Facilities Board	22,837,500			22,493,100					45,330,600
State Land Department	16,531,600			134,800				1,982,900	18,649,300
Arizona State Univ.-East Campus	12,425,600			168,100					12,593,700
Office of Tourism	9,000,000			2,600,000					11,600,000
Secretary of State	5,183,000			983,800					6,166,800
Department of Commerce	3,568,600							1,677,900	5,246,500
All Other Agencies	521,166,200	(1,707,600)		2,812,800	(4,647,800)	(1,929,800)			515,693,800
	6,472,249,900	463,919,200	150,234,500	78,409,200	27,420,600	(22,794,400)	60,109,400	63,850,800	7,293,399,200
Percent of growth over base		7.2%	2.3%	1.2%	0.4%	-0.4%	0.9%	1.0%	
Percent of overall growth	\$ (821,149,300)	56.5%	18.3%	9.5%	3.3%	-2.8%	7.3%	7.8%	



Budget Message

Leading the way back to prosperity

As the nation's economy improves, Arizona should continue to outperform all but a handful of states

THE NATIONAL AND local economies should continue to improve in fiscal Years 2004 and 2005. Arizona has clearly out-performed the national economy on most fronts, but we are still falling short of our own level of expected performance, in part because weaker economic behavior, nationally and internationally, has acted as a drag on the Arizona economy.

■ The national outlook

The economy grew much more rapidly in the third quarter of calendar year 2003 than it did in the first two quarters. The fourth quarter growth should be more modest, leading to an annual real GDP growth for the year of about 3%.

Employment is improving on a month over month basis, but it is still not above the levels seen last year at this time. The best third-quarter news was the jump in business investment, which suggests that businesses are finally spending again.

In 2004, the economy should be firing on all cylinders with GDP growth eclipsing the 4% mark.

Consumer spending. Consumers, who carried the economy during the recession and early recovery, will provide less of a boost during the next several quarters. They were able to keep spending primarily because of the refinancing boom and, more recently, the rebate checks from the federal government. Those phenomena have passed, but rising employment and incomes should help consumers keep spending — albeit at a slightly lower rate of increase.

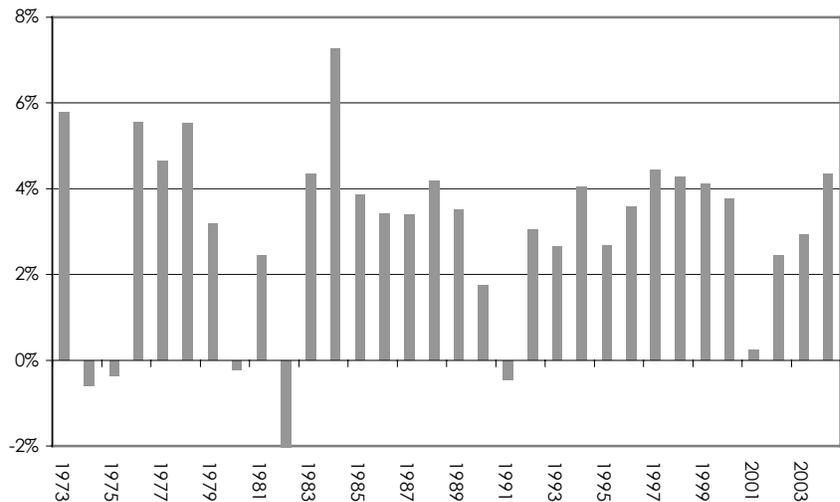
The refinancing boom is over because interest rates have hit bottom. By mid-2004 the Federal Reserve is ex-

pected to have started a gradual increasing of the federal funds rate. The Federal Reserve is also mindful that 2004 is an election year, and interest rate increases close to the election are unlikely.

The 10-year Treasury note, which is the longest-term government security

that the U.S. Treasury uses to finance the national debt, has already put upward pressure on mortgage rates as the government's borrowing needs expand. However, rates remain near historic lows, providing easy access to credit markets for consumers of durables, homes and other "big ticket" items so

U.S. Real Gross Domestic Product (GDP)



S&P 500 Index Average



that consumption spending will continue to help sustain the economy. We cannot expect the economy simply to “rocket” out of a business cycle trough in the same manner as in previous recessions.

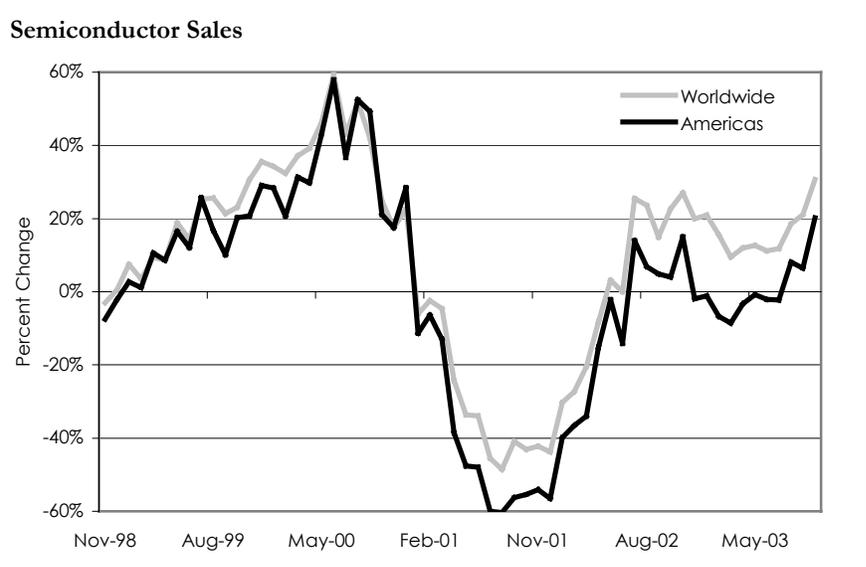
Business spending. The economy will get most of its boost from increased business spending and the possibility that exports will gain on imports, allowing for some reduction in the trade deficit.

Strategically, many companies will switch from protecting profits to increasing market share. The majority of the increase in business spending so far has been in computers and software (*see chart*), and that trend will continue. Spending on plant or new facilities will lag at least until capacity utilization rises back to normal levels.

The spending that will be most welcome will be spending on new employees. Job creation is necessary for continued expansion, and if present trends continue, job growth will be positive on a year over year basis starting in calendar 2004. National GDP grows of 4% will result in the creation of about 200,000 payroll jobs per month.

Risks. One of the biggest barriers to increased business spending during most of the recovery has been the level of uncertainty about terrorism, both domestically and internationally. Businesses could well change their minds about spending if another large-scale attack is carried out. Tourism and travel in general would also be severely impacted and might not recover as quickly as in the aftermath of 9-11.

The weak economies of most of our major trading partners are also a potential pitfall for our economy. The dollar has been falling significantly versus most other major currencies, which was to be expected given our large trade deficit and low interest rates. Thus we should expect exports to be encouraged and imports to be discouraged, which should be a net boost to the economy.



However, many of our major trading partners have economic problems and may not increase their imports of U.S. goods as much as projected. The negative impact of a weaker dollar on U.S. imports would only make matters worse.

It is also possible that the Federal Reserve may wait too long to raise interest rates to sustain a recovery with minimal inflation, which would pressure them to raise rates more sharply and to a higher level when the belated hike does occur. If forced to raise rates too quickly, the Fed runs the risk of pushing the country toward another recession.

Consumers appear particularly sensitive to interest rates now because of high debt burdens and the relatively low levels of home equity in the wake of the refinance boom. Consumers did not stop spending during the last recession, which made the downturn relatively mild, but they would sharply curtail spending if another recession followed too closely on the heels of the first.

■ The Arizona economy

The forecast growth assumptions for Arizona personal income, employment and population growth, along with national GDP, follow.

Population growth, which is primarily a result of demographic and economic factors, is likely to bottom out significantly higher than the level seen in the last several cycles. During the last three years, Arizona maintained a significant level of population inflows and did not experience as much population outflow as normal. Construction workers formed a large part of the outflow during past cycles, but that did not happen this time around.

Personal income growth is expected to benefit from the improving employment picture, because of more people working and because of wage increases for current employees. Larger companies will be slow to resume the large bonus payments that were popular in the 1990s, but recent months have seen a distinct increase in the pace of estimated payments from the State’s corporate sector.

Employment growth should continue to accelerate, reaching a level in 2004 more in keeping with what we have come to expect from the Arizona economy. While the pace of job growth to date has been disappointing in some respects, Arizona has done quite well in comparison to the rest of the nation. Since April 2003, our state has been among the top ten job-growth states in every month except one, although our employment growth was negative for

some of those months. Arizona has also had year-over-year job growth since last July, while the U.S. economy has yet to turn positive year over year.

Arizona was hit hard in the last recession because so many of the state's export industries — those that bring money into the region from outside — are tied to business spending. Tourism, particularly in the urban areas, is heavily skewed to business travel. Manufacturing, which is heavily high tech, is also tied to business spending as a result of the massive levels of investment by firms in productivity tools. The forecast rise in business spending on the national level should benefit Arizona significantly, as should any boost from a weaker dollar.

Real estate. The standout performer for the real estate sector has been single-family housing, which has defied predictions of a downturn for the last several years, primarily because of unusually low interest rates.

On the positive side, the sector helped to blunt the local impact of the national economic downturn; conversely, when the recovery occurs there will be little corresponding boost for the economy, as there will be no pent-up demand for housing. But the value proposition for home seekers remains very positive, with home values continuing to appreciate at or above the average rate of inflation, and interest rates staying low by historical standards. Even a 100 basis-point increase in interest rates projected by many economists will leave borrowing costs at a very moderate level by historical standards.

Commercial real estate. The picture for much of commercial real estate is very different, although here again low interest rates have had a positive impact.

During the economic downturn in the early 1990s, vacancy rates were high, and higher interest rates meant that many properties did not break even. It is much easier for properties to break even when interest rates, and thus payments, are low. However, significant increases in commercial con-

struction are not expected to occur until after 2005.

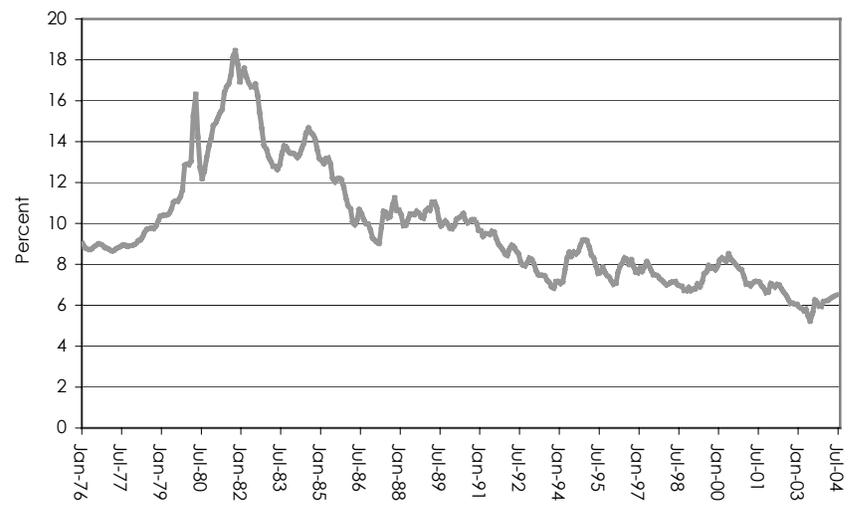
Risks. The biggest risk for the Arizona economy is that the U.S. economy will not grow as fast as expected. Arizona is also exposed to the same risks as the nation at large with respect to the export picture.

Like all states, Arizona is exposed to the repercussions of geopolitical shocks. Fortunately, a relatively high share of Arizona exports head to Asia, and that region is doing relatively well. Further, many of our Asian exports are assembled into products that are then

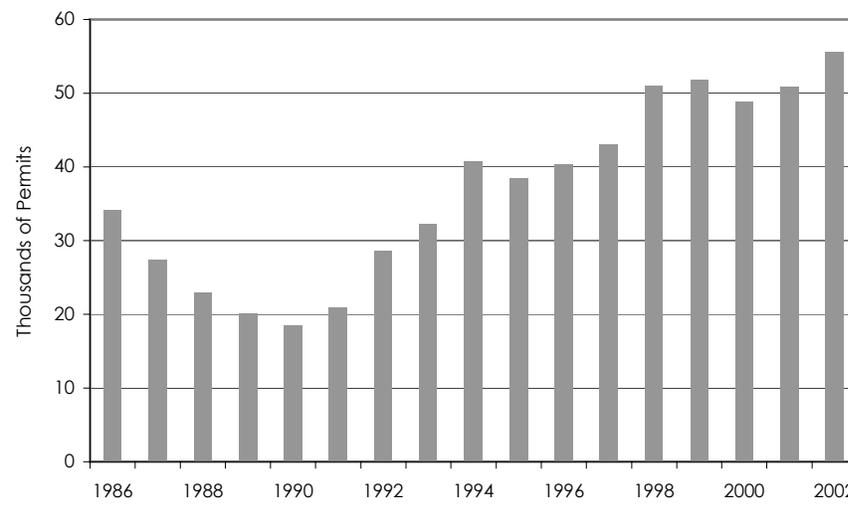
imported into the U.S., where consumer demand is generally higher than in most countries.

Arizona could also be sensitive to the rise in interest rates that is expected in 2004 and 2005. Single-family home construction has been unusually strong because of low interest rates, and while rates are not expected to rise enough to choke off home sales, higher rates will undoubtedly have some negative impact. The scenario in which the Federal Reserve misjudges the situation and has to raise rates much higher later would hit Arizona hard.

Mortgage Rates



Arizona Single Family Home Building Permits



■ Estimating revenues

THE REVENUE ESTIMATING PROCESS used by Arizona's Executive Branch is collaborative and ongoing. The participants meet monthly to discuss and debate the merits of a variety of economic assumptions and the General Fund revenues resulting from those assumptions. The participants include the Economic Research and Analysis Section of the Department of Revenue, the Arizona State University College of Business, the Bank One Economic Outlook Center at ASU, the Department of Economic Security Research Administration, and the economists and management of the Governor's Office of Strategic Planning and Budgeting.

General parameters. OSPB uses a roundtable discussion to arrive at its General Fund revenue forecasts. There are no assumed or directed economic parameters, although the Arizona Blue Chip Consensus values are often used as a

Participants in the process

- Economic Research and Analysis Section of the Department of Revenue
- Arizona State University College of Business
- Bank One Economic Outlook Center at ASU
- Department of Economic Security Research Administration
- Governor's Office of Strategic Planning and Budgeting

starting point for Arizona-specific variables and the Global Insight, Inc., forecast is used to assess national variables.

The group discusses alternative assumptions for use in their various models. The influence of each parameter in the revenue models depends on the structure of the model used by each participant, and is not

predetermined or prescribed by OSPB. This process maintains each participant's independence in the forecasting process.

Reaching a forecast. The discussion begins with the Arizona economic scene, with emphasis on employment data. DES employment surveys provide the best information and an interpretation of factors underlying the publicized employment statistics. Those factors include unemployment filings, employment system wages, and benchmarking activities.

From there, the group discusses the national scene. The Bank One Economic Outlook Center tracks all of the state and national time series. (Some of these series include national car sales, national semiconductor billings, national and Arizona exports, and national and Arizona retail sales.) The Center maintains contacts throughout the U.S. to stay current on the strength of various sectors and regions of the economy.

This information stimulates a discussion of where the Blue Chip Panel thinks the national and Arizona economies

are heading and where the OSPB group thinks the economies are heading.

Transaction Privilege Tax. The Department of Revenue and ASU use a similar process to prepare forecasts for Transaction Privilege Tax (TPT) revenues. The models project growth rates for the various classes of TPT collections based on the economic assumptions each has applied. The TPT classes include, but are not necessarily limited to:

- retail sales,
- contracting (construction),
- utilities,
- hotels and motels, and
- restaurants and bars.

Individual Income Tax. Department of Revenue (DOR) economists are a valuable resource to the Executive forecasting process because they have access to the individual taxpayer data that provides detailed insight into taxpayer behavior. While confidentiality restrictions prevent DOR from disclosing taxpayer-specific information, aggregated information is invaluable in providing an understanding of what taxpayers are actually doing that impacts the ebb and flow of the State's revenue streams. This is particularly valuable during the annual heavy processing season in April.

ASU's contributions in individual income tax forecasting are valuable in other areas, specifically in analyzing the historical individual income tax data abstracts provided by the Department of Revenue. This analysis provides a strong foundation of understanding of what has happened to the distribution of taxpayers and their liabilities across income strata over time. From that base, ASU extrapolates (a) growth in tax filers by income strata and (b) changes to their tax liabilities that formulate the main tenet of ASU's individual income tax forecast. The ASU process then blends in capital gains assumptions, any institutional factors such as tax law changes, and other elements to the base forecast to arrive at a final forecast.

Corporate Income Tax. DOR economists are a valuable resource to this part of the process as well because, as is the case with the individual income tax, they have access to statutorily confidential corporate taxpayer data. This information indicates how businesses may be applying refunds to estimated payments or how estimated payment levels are changing. This behavior is particularly telling; providing an understanding of what taxpayers are actually doing relative to their perceived tax liability. Additionally, since the 40 to 50 largest corporate taxpayers represent a significant portion of the General Fund's corporate income tax inflow, knowing what is specifically happening to those corporate taxpayers makes DOR's input all the more valuable.

ASU's process in forecasting corporate income taxes incorporates Gross Domestic Product information, corporate

profitability data prorated to Arizona, and a variety of market measures and indices.

Blending the forecasts. OSPB blends the forecasts for the three revenue sources (which constitute 94% of the inflow into the General Fund) to derive its recommended position. The blending of the forecasts is as much art as science; while the individual forecasts are the result of the specific economic assumptions of the individual participants, the blended values are a composite and as such do not directly tie to a specific set of economic assumptions.

The blending process considers the changes from the previous forecasts from each model and includes an analysis of why and how each may have changed. This process is followed for the transaction privilege tax, the individual income tax, and the corporate income tax.

Other revenue categories. The process for the smaller taxes and revenues that flow into the General Fund is much more dependent on discussions with the analysts inside the agencies administering a particular tax. For example, OSPB relies on the Department of Insurance projections for the Insurance Premium Tax, the Treasurer's Office estimates for Interest Earnings, and the State Lottery for its projections.

Public release of revenue estimates. While monthly adjustments may be made to the internal forecasts, OSPB does not regularly formally change its forecasts. Progress against forecasts is tracked on a monthly basis as data become available. However, a trend must be significant and irrevocable before a forecast is formally revised. ■

Improving performance through Efficiency Review

The ER process targets practical, sensible ways to cut costs and achieve more responsive service

IN JANUARY 2003, the Executive instituted an Efficiency Review (ER) program designed to improve the performance and efficiency of State government. The ER mission is to find practical and sensible ways for State agencies and State government as a whole to reduce costs, cut bureaucracy, eliminate duplication and improve customer service.

To accomplish this, ER takes a two-pronged approach: (1) identifying and developing Statewide strategic issues, and (2) involving individual agencies in identifying and implementing agency-specific efficiency solutions.

■ Cost cutting

The Statewide solutions revealed so far through ER offer significant cost savings and cost avoidance opportunities.

In its initial report in April 2003, the ER team reported on Statewide strategic issues that could broadly impact multiple State agencies and programs and offered the best opportunity for improving the efficiency of State government. The ER team:

- selected ten Statewide issues that appeared to offer the highest potential for cost savings or cost avoidance for the State as a whole;
- conducted further research on each Statewide issue; and
- made a number of recommendations to achieve potential savings by changing the way the State conducts business.

As most, if not all, of these recommendations involve long-term, large-scale projects, the majority of the potential savings would not be realized until fiscal year 2006 and later.

■ Issues and findings

Following are summary descriptions of the ten Statewide issues.

Health and Behavioral Health. The State needs to aggressively pursue opportunities to control the cost of providing health and behavioral health services. In the short term, savings can be achieved by modifying payment methodologies, reducing the cost of prescription drugs, and

streamlining eligibility. Over the longer term, the State's fragmented and redundant system for administering and delivering services needs to be redesigned to improve service delivery.

Procurement. The State needs to develop an automated, integrated procurement system that involves all State agencies and generates useful purchasing information that can be used to manage procurement on a Statewide basis. Development of an integrated electronic system will allow the State to aggregate its buying power, reduce or eliminate duplicative contracts for similar products and services, and strategically manage its spending.

Employee Benefits. The State could achieve savings by converting from commercial health insurance for State employees to a self-insurance model.

Overpayment Recoveries. Overpayments to vendors for goods and services purchased by State agencies are not uncommon. Agencies should perform annual audits of their paid accounts in order to identify and recover those overpayments.

Statewide Training. Training provided to State employees should be consolidated in order to achieve increased efficiency and cost savings.

Energy. State agencies need to continue efforts to reduce energy demand and to implement energy saving ideas.

Consultant Cost Control. The State spends approximately \$100 million per year on consultants. Some consultants are necessary to provide services that the State is unable to obtain or provide otherwise; others perform functions that are either non-essential or could be performed internally. Consultant contracts should be reviewed to identify and eliminate those that do not provide vital services to the State.

Leasing/Space Utilization. The State can save money by consolidating leased office space, co-locating offices, and consolidating lease negotiation and oversight responsibilities. Additionally, the State can reduce its leased office space by increasing its use of technology and allowing customers to conduct their business over the phone or Internet rather than at a State office.

FY 2004 Estimated Efficiency Savings and Cost Avoidances

Agency	Estimated Savings and Cost Avoidances
AHCCCS	\$ 2,409,000
Corrections, Dept. of	2,200,551
Economic Security, Dept. of	16,300,000
Health Services, Dept. of	3,754,327
Game and Fish Department	1,450,624
Juvenile Corrections, Dept. of	496,200
Public Safety, Dept. of	132,000
Revenue, Dept. of	405,746
Transportation, Dept. of	1,731,700
Other Executive Agencies	<u>5,492,226</u>
TOTAL	\$ 34,372,374

Printing and Mail Operations. The State can realize savings by utilizing modern technology to provide reports, applications, forms and other documents in electronic format, rather than paper format, whenever possible. Additionally, the State can save money by consolidating mail operations that are currently conducted by multiple State agencies.

Fleet Management. Savings can be realized by reducing the size of the State’s vehicle fleet and by consolidating fleet management responsibilities.

■ **Cost avoidance**

The agency-specific component of ER expanded in May 2003 with the addition of six new agencies to the three original pilot agencies. As a result, ER teams have been ac-

tively engaged in generating ideas to save money, avoid costs, and improve service in the following nine agencies:

- Department of Corrections
- Department of Economic Security
- Department of Revenue
- Department of Health Services
- Arizona Health Care Cost Containment System
- Department of Juvenile Corrections
- Department of Public Safety
- Department of Transportation
- Department of Game and Fish

At some other agencies, directors and managers are unofficially conducting their own ER projects.

The nine agencies officially participating in the ER project collectively received more than 7,500 suggestions from their employees and selected a number of those suggestions for further research and possible implementation. Agencies have implemented, or plan to implement, many of the suggestions in FY 2004. Other suggestions are for more long-term solutions, and agencies plan to implement them in future fiscal years.

As a result of ER team activities, and in response to the Governor’s Executive Order, agencies estimate that they will save, or avoid costs of, more than \$34 million from all funding sources in FY 2004. These are not savings that can be reverted at the end of the current fiscal year, however, as the agencies have used their ER savings to offset other budget shortfalls, such as employee health insurance premiums and pension contributions. These ER savings will, however, help to reduce the agencies’ future budget requirements, as most of the savings identified are recurring savings and will carry forward to future years.

As the above table shows, most of the savings and cost avoidances have been generated by the nine agencies actively participating in the ER effort. ■

Fiscal bridges a valuable, appropriate strategy

A strengthening economy and strides toward better government alleviate the need for harsh decisions and crippling actions

ECONOMIC INDICATORS FOR Arizona are sending strong signals that the State's economy is in a distinct recovery mode (see "The Economy").

For the last few years, the State's elected leaders and professional management have grappled with the "fiscal gap" between base revenues for the General Fund¹ and base expenditures in order to meet critical State obligations in public safety, education, health care, etc.

Fiscal bridges. As the economy expands and spending discipline continues to be applied, the gap has narrowed from as high as \$1 billion for FY 2004 to about \$300 million for FY 2005. Until the economy fully recovers and the State's efficiency initiatives take effect, "fiscal bridges" continue to be needed to ensure that essential State functions continue to be funded.

The fiscal bridges discussed below are financially sound and justifiable for all Arizonans to ensure that:

- child care is available to working parents;
- Full Day Kindergarten is phased in over five years;
- 100% of reported cases of child abuse and neglect are investigated;
- quality is built into the system for child care and preschool programs;
- people and property are protected from forest fires;
- Arizona's education system, from preschool through college, equips our students to compete in their chosen occu-



pation in the knowledge-based economy; and

- the benefits of investing in human capital are returned to Arizona taxpayers at an exponential rate.

■ K-12 rollover: \$100 million

In 1988, as today, the State faced a deficit situation. As a partial resolution to the deficit, Governor Mofford proposed and the Legislature enacted a one-month payment deferral of Basic Aid to school districts. That mechanism has become known as the "K-12 rollover." Since that time, both Democratic and Republican administrations have used that budget technique, when necessary, as an appropriate temporary solution to temporary fiscal pressures.

Implementation of a K-12 rollover means that the final month(s) apportionment of Basic State Aid and Additional State Aid to the school districts would be delayed into the subsequent fiscal year. In order to balance the State's budget in Fiscal Years 1988 through 1994, Governors Mofford and Symington used the K-12 rollover by deferring both the State's June payment and then a portion of May's payments to school districts.

Law 2002, Second Regular Session, Chapter 330 deferred the payment of \$191 million of State aid from June 15, 2003, to July 1, 2003, thereby moving the equivalent of one month's State aid obligation from the FY 2003 budget to FY 2004 budget.

The Executive proposes deferring a \$100 million portion of the May payment in addition to the existing June payment deferral of \$191 million. To make certain that school districts, and most importantly classrooms, are not adversely impacted by the deferred payment, funding would be provided to offset any interest costs that the districts might incur. Increasing the deferral from the June payment to a deferral of the June payment and a portion of May payment is identical to the efforts employed by previous administrations during difficult fiscal times.

The K-12 rollover enacted in the late 1980s was reversed in the FY 1995 budget, when Arizona's economy was producing revenue in a full recovery mode. There were no adverse affects to school districts or the State from the use of an approximate 1½ months' K-12 rollover. It is a short-term accounting strategy that is effectively painless to employ and reversible when the economy recovers.

■ VLT transfer: \$118 million

The Vehicle License Tax (VLT) is assessed against all vehicle owners that use the State's public road system. In FY 2005, VLT revenues are estimated to be \$319.2 million. Proceeds from the VLT are used by the State (44.9%) and the counties and municipalities (55.1%) for construction and maintenance of the road system.

¹ Made up of sales, income, insurance premium, and luxury taxes.

To address the FY 2005 budget deficit, the Executive proposes a one-time, \$118 million transfer of VLT proceeds to the General Fund. To ensure that local governments are not impacted, the Executive proposes that the transfer come exclusively from the State's portion of the VLT revenues.

In addition to ensuring that local governments will not be impacted, the Executive thoroughly reviewed any potential impacts upon the capital construction program that maintains the State's highway system. After lengthy discussions with the Department of Transportation (ADOT) and an examination of the Five-Year Transportation Facilities Construction Program, it was determined by ADOT and the Executive that the VLT funds on a one-time basis would have virtually no impact on ADOT's ability to meet the State's highway construction objectives.

■ **Withholding tax: \$76 million**

In spring 2003, the federal government passed the Federal Tax Relief Act, reducing taxpayers' federal tax liability by adjusting downward the federal withholding rates. Since Arizona's individual income tax withholdings are based on a percentage of the federal withholdings, a reduction in federal income taxes triggers a decline in State revenues. In light of the State's budget crisis, the Legislature determined that a tax cut was not prudent and that the State's tax rates should be adjusted to compensate for the federal change.

During the 2003 legislative session, the Legislature passed Chapter 263,

with the goal of maintaining Arizona's current tax revenue at the same level as prior to the federal change. Unfortunately, there was a technical error that produced two unintended consequences:

- The State lost an estimated \$76 million in revenues when it could least afford to do so.
- Taxpayers who have become accustomed to, and often budget for, receiving refunds will either have to write a check to the State when they file their income tax return for 2003 or receive a smaller refund than they expected.

To resolve this error, the Executive recommends adjusting Arizona's withholding rates to adequately compensate for the federal tax change. This will net to the State in FY 2005 a one-time amount of \$76 million, and taxpayers will not have to be concerned in the future about the effects of under-withholding.

■ **State Comp Fund asset transaction: \$50 million**

To close the FY 2003 budget deficit, legislation from the 2003 First Special Session provided for transferring \$50 million from the State Compensation Fund (SCF) to the State General Fund. The bill also directed the Department of Administration (DOA) to enter into a lease-purchase agreement with the SCF to transfer \$50 million worth of State properties to the SCF and provide for a reasonable rate of return on the \$50 million transfer.

This sale/leaseback transaction was to occur within 30 days of the effective date of the act, at rates advantageous to both parties; however, it became apparent shortly after the Special Session that the SCF was unwilling to initiate the transaction until the passage of legislation that would protect the SCF when the State is looking for funds in a future economic downturn.

The bill that would have provided this protection, H.B. 2195, passed both houses of the Legislature in the 2003 Regular Session but was not scheduled for a final vote. As a result, the transfer of funds, the property transfer, and the agreement on rates of return have not been realized, and the SCF has filed a legal challenge to the constitutionality of the mandated transfer. The Arizona Attorney General's office is representing the State in this matter.

If agreement can be reached on legislation to provide assurance or protection to the SCF that their assets will not be expropriated by the State during economic downturns, the transaction involving the transfer of \$50 million of assets to the SCF with favorable rates of return will be permitted to go forward.

■ **Conclusion**

While the State's fiscal condition continues to carry more than its share of planning challenges, it is the Executive's view that the fiscal bridges described above are again an appropriate response to what will prove to be short-lived fiscal pressures. ■

The appropriate use of debt

While avoiding debt is, in general, a sound policy, the prudent application of debt mechanisms under certain conditions can be quite beneficial

THE EXECUTIVE BUDGET recognizes the importance of providing funding for new school construction, the Deficiencies Correction program, new prison beds and the settlement arising from *Ladewig v. State of Arizona*.

It is the consensus recommendation of the State's financial advisors that it is appropriate to use debt in certain circumstances, for example:

- when the State is experiencing a shortfall in revenues;
- when interest rates are low;
- for funding the cost of projects with long useful lives;
- for financing extraordinary, non-recurring expenditures;
- for enabling the State to craft a responsible multi-year solution to the State's fiscal recovery.

The use of debt to finance capital assets is also appropriate in high-growth states such as Arizona, where the cost of the asset can be spread across the many citizens who will benefit.

With interest rates near historic lows, using debt to pay for the Deficiencies Correction program, build new schools, add prisons beds and pay the *Ladewig* settlement is an appropriate ingredient of the Executive's multi-year strategy to ensure the State's recovery from its recent fiscal difficulties.

■ Deficiencies Correction: \$100 million

The STUDENTS FIRST legislation required the School Facilities Board (SFB) to adopt rules establishing minimum school facility adequacy guidelines to enable students to achieve academic standards.

After the guidelines were adopted, the SFB identified the work required to bring all schools up to minimum standards through the Deficiencies Correction program by June 30, 2004. Since 1998, \$800 million in Proposition 301 revenue bonds, \$247.1 million in State Trust Land revenue bonds, and \$20 million in Qualified Zone Academy bonds have been issued for Deficiencies Correction.

In Laws 2003, First Special Session, Chapter 1, the June 30, 2004 timeline was changed for three districts – Mesa Unified, Tucson Unified and Glendale Union – in which \$100 million of previously appropriated General Fund dollars was transferred from the Deficiencies Correction Fund back to the General Fund. This occurred during FY 2003 and consequently delayed until June 30, 2005, the completion of those districts' projects. Laws 2003, First Special Session, Chapter 2 advance-appropriated \$100 million in FY 2005 from the General Fund to the Deficiencies Correction Fund to meet this need.

Due to the State's fiscal challenges and a favorable bond market, the Executive recommends that, in lieu of the \$100 million from the General Fund in FY 2005, the School Facilities Board issue an additional \$100 million in State School Trust revenue bonds. Debt service payments from State Trust Land earnings for these bonds will not begin until FY 2006.

■ New School: \$250 million

STUDENTS FIRST also established a centralized school finance system that placed on State government the primary responsibility for new school

capital funding, through the New School facilities program.

For the first four fiscal years of the New School facilities program, the State was able to cash fund its obligation from the General Fund. However, starting in FY 2003, the State could no longer meet the costs of the program on a cash financing basis. The Legislature authorized the SFB to enter into a lease-to-own financing arrangement, funded through the issuance of certificates of participation. (A.R.S. § 15-2006 allows the SFB to enter into lease-to-own transactions up to a maximum of \$200 million dollars in any fiscal year.) Debt service on the certificates of participation are payable from the General Fund.

For FY 2005, the Executive recommends \$250 million in lease-to-own authority (an addition of \$50 million over the Board's existing statutory authority). Since lease-to-own transactions represent long-term financing, there are no FY 2005 General Fund costs associated with the \$250 million issuance in FY 2005. (In FY 2006, the anticipated lease payment associated with this issuance is estimated to be \$12 million.)

■ Ladewig settlement: \$128 million

In 1990, Helen Ladewig challenged the constitutionality of the relative treatment of dividends from companies doing more than half of their business in Arizona compared with those doing less than half of their business in Arizona. Specifically, State law provided a dividend deduction from individual income for dividends received from Arizona corporations.

This differential treatment was held to be unconstitutional under the commerce clause of the U.S. Constitution. The tax court also permitted the case to become a class action.

On September 20, 2002, a proposed \$350 million class-action settlement was filed in Maricopa County Superior Court to refund tax payments on dividends that an estimated 675,000 taxpayers reported between 1986 through 1989. Under this settlement, the Department of Revenue is calculating an estimated refund for each of these taxpayers, to be produced on or before March 2004. Taxpayers will be able to appeal this calculation.

The payments are due to be made in four equal installments: the first two in August 2004, the third on July 20, 2005, and the last on July 21, 2006. Current estimates are that, in FY 2005, \$128 million in costs will be incurred, including payments to plaintiffs, attorneys' fees, and \$3.3 million for Department of Revenue administrative costs. However, as the Department of Revenue reviews its records, the plaintiffs' payments figure is expected to be refined.

After consultation with the State's financial advisors, the Executive recommends that the State finance its FY 2005 *Ladewig* settlement obligation through the sale and leaseback of selected State assets. (A sale-leaseback involves selling public facilities and leasing them back such that the State reacquires ownership.)

The proceeds from the sale will serve as revenue to the *Ladewig* Administration Fund, from which pay-

ments to claimants and support for administrative costs will be drawn.

Specifically, the Executive recommends that the Director of the Department of Administration be authorized to proceed with the sale of unencumbered real and personal property owned by the State. The amount to be sold would have an aggregate fair market value equal to or greater than the estimated \$128 million in FY 2005 costs of the *Ladewig* settlement. The Executive recommends that the proceeds be deposited in the non-appropriated *Ladewig* Administration Fund for disbursement by the Department of Revenue for both administrative costs and payments to plaintiffs and attorneys. The Executive further recommends that the leaseback be structured over a short-to-intermediate term, with payments to be made from the General Fund. Given that the obligation was incurred over a number of years, the repayment should occur over a number of years.

The State has successfully utilized asset sale and leaseback financing for extraordinary, one-time expenditures. The assets selected for sale will be sold at their appraised value and then leased back according to a lease-purchase agreement structured so that the first lease-purchase payment will not be due until FY 2006.

■ **Prison Construction: \$39 million**

Laws 2003, Second Special Session, Chapter 5 authorized the Department of Administration to issue a certificate of participation for 1,000 prison beds. That authority was granted in late 2003,

and as this recommendation went to print the Department of Corrections was still studying the best expansion of beds. However, the addition of 1,000 public level-one beds was the best estimate at that time.

The Executive recommends the construction of 500 level-1 beds on the existing Perryville Prison site scheduled to open November 1, 2004, and another 500 level-1 beds on the existing Tucson Prison site scheduled to open on December 1, 2004. As soon as this or a more definitive plan is completed, it will be forwarded to the Legislature for consideration.

■ **Debt levels**

According to *Moody's Investors Service 2002 State Debt Medians Report*, Arizona's debt levels are relatively low. Net tax-supported debt as a percentage of personal income is only 1.9% in Arizona, compared with the nationwide average level of 2.7%.

Current debt service payments of \$56.9 million are estimated to be due from the State General Fund in FY 2005, representing less than 0.8% of the \$7.2 billion FY 2005 Executive recommendation from the State General Fund. Funding new school construction, prison construction, and *Ladewig* payments at Executive recommendation levels will increase State General Fund total indebtedness from \$966 million to \$1.4 billion. The Executive recommendation provides a cost-effective, financially sound approach to addressing the State's needs, with no anticipated increase in FY 2005 debt service payments. ■

A sharper focus on Arizona students

Going beyond full statutory funding, the Executive Recommendation responds to modern demands on – and opportunities for – public education

THE IMPORTANCE OF EXCELLENCE in public education long ago ceased to be a viable topic for debate. Virtually all responsible citizens who recognize their stake in the health of our society readily acknowledge the correlation between a well educated public and the critical goals of economic vitality, public safety, and a high quality of life.

As evidence of this widely held view, most of Arizona’s business leaders have provided aggressive support and advocacy for excellence in public education, in partnership with State government and education professionals and policymakers.

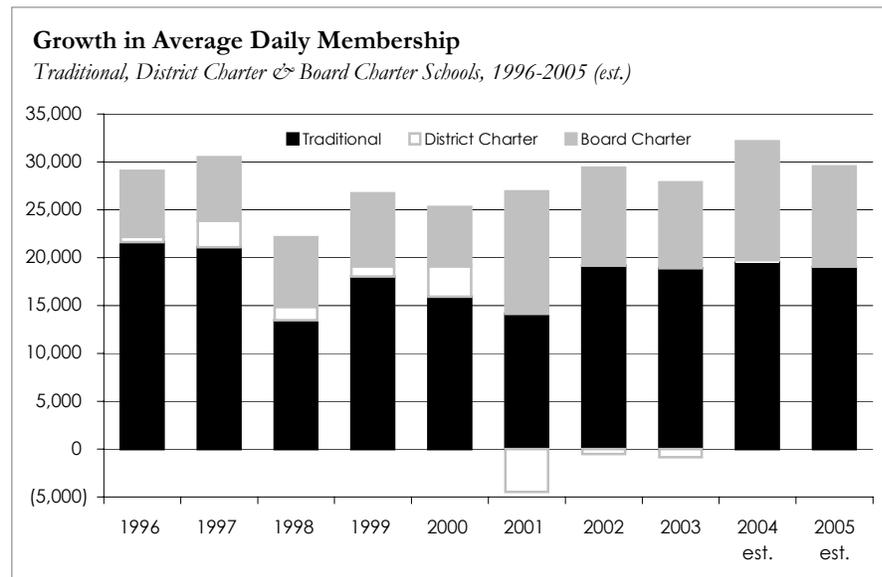
Two completed initiatives affirm the Executive’s ongoing commitment to Arizona’s youngest citizens.

First, in 2003 the Governor challenged Arizona’s public schools to shift to the classroom five cents of every education dollar that had been earmarked for administrative purposes. The result: an astounding \$100 million redirected by 142 school districts, making more resources directly available to teachers and students.

To emphasize the value of reading literacy, the Governor’s Office, through private donations and with the support of county school superintendents, distributed to all 80,000 first graders in Arizona’s public schools their own copy of the children’s book *This House Is Made of Mud*. The Governor has pledged to ensure that all first graders receive a book as long as she is Governor.

■ K-12 education

The Executive Budget Recommendation for FY 2005 reaffirms State government’s essential role in providing educational excellence for current



and future Arizonans at all grade levels, starting with K-12 education.

Voluntary Full Day Kindergarten. Scientific research has confirmed that full-day kindergarten attendance has both academic and social benefits for at-risk pupils, particularly in the area of reading readiness.

Governor Napolitano’s pledge to ensure that every child in Arizona can read by the third grade begins with her proposal to phase-in a voluntary Full Day Kindergarten program in Arizona in five years. The Governor’s phase-in plan includes a first-year, \$25.5 million pledge that will target all Arizona public schools in which at least 90% of students participate in free or reduced-cost lunch programs. This will ensure that our most needy, at-risk students are among the first to benefit. In the four subsequent years, all of Arizona’s public schools will receive funding for voluntary Full Day Kindergarten.

The Governor believes that, in order to be successful, pre-kindergarten

students must be healthy and ready to learn. Thus, the Executive Recommendation includes funding for ten positions in the Department of Health Services to provide needed technical assistance to private child care centers in Arizona. In addition, to provide greater access to childcare assistance for low income families, the Executive Budget includes approximately \$24 million to help shorten the 7,200-child waiting list in the Department of Economic Security. *(This recommendation is addressed in greater detail in the “Health & Welfare” section of the Budget Message.)*

Basic State Aid. The largest formula funding program for K-12 education, Basic State Aid provides financial assistance to school districts and charter schools for their maintenance and operations needs.

For Fiscal Year 2005, the Governor’s \$153.4 million recommendation fully funds student growth in traditional and charter schools. Overall district student growth is expected to rise

by 19,016, and enrollment at board- and district-sponsored charter schools is projected to increase by 10,516.

The Governor's recommendation for this program is based on the following growth assumptions in FY 2004:

- 3.1% in new students,
- 2.2% in traditional students,
- 13% in charter students,
- 8.5% for net assessed valuation, and
- 2% for inflation.

FY 2004 supplemental. In December 2003, the Department of Education notified the Executive of a potential \$27.6 million budget shortfall. While the Executive budget recommendation does include a "placeholder" for a potential \$27.6 supplemental for formula program shortfalls in FY 2004, it should be noted that, until the final student count of the year (which occurs on or around the 100th day of the school year), it is not certain if a supplemental will be needed.

The Department's \$27.6 million estimate includes \$8.3 million in FY 2003 underpayments to school districts; \$8 million due to anticipated growth; \$12.9 in unrealized local tax revenues; and \$2.4 million needed to address the AIMS testing program. These amounts are offset by surplus amounts in the Optional Performance Incentive, Additional State Aid, and Special Education Voucher programs.

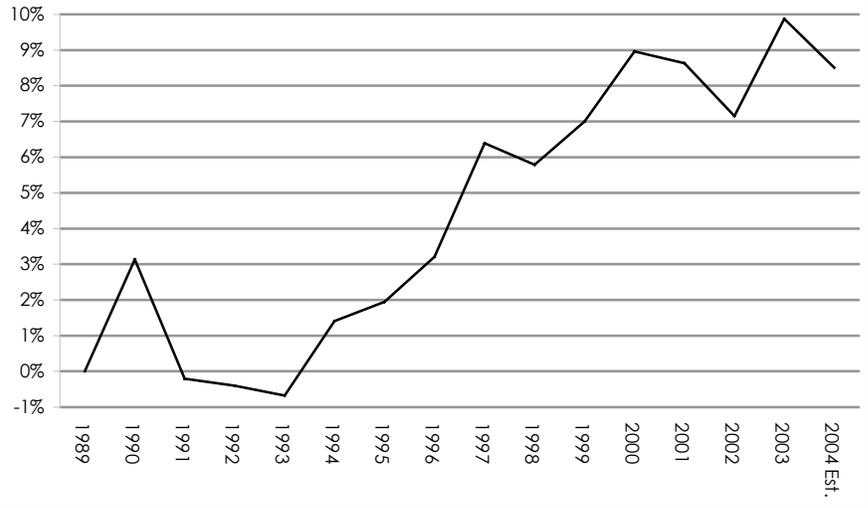
FY 2003 Underpayment ²	(\$8,384,900)
Student/Program Growth ³	(8,005,700)
NAV	(12,949,700)
OPIP	120,000
Additional State Aid.....	3,596,100
Special Education	443,900
AIMS.....	<u>(2,406,300)</u>
<i>Total:</i>	(27,586,600)

Other statutory programs. The Executive Recommendation includes \$20.6 million for the Additional State

² Net amount (assumes \$6 million in overpayments due to SAIS errors).

³ This is the aggregate for all programs under the Basic State Aid program.

Growth in Net Assessed Valuation



Aid program, which provides relief to residential property owners toward the local obligation of funding public schools, and \$1.5 million for new resources to special education programs.

■ **Achievement testing**

On November 17, 2003, the State Board of Education approved the Superintendent's plan to "blend" the AIMS and Stanford test into an AIMS-embedded, norm-referenced test to be administered each spring. The Arizona Department of Education intends to issue a request for proposal in late January 2004, with the expectation of awarding a contract by April.

Since the cost of the blended test has yet to be determined, the Executive recommends deferring any allocation of additional monies for the achievement testing program until the contract is awarded. This will allow any appropriation of dollars to be based on actual costs and prevents a premature release of funding levels that may skew the procurement process.

Certification investigations. Responding to citizen requests for more accountability involving teacher and administrator misconduct, the Governor has recommended an additional full-time Certification Investigator position at the State Board of Education.

The primary responsibility of this position is to investigate alleged immoral and unprofessional conduct of a certificate holder of the Board. In addition, the recommended \$100,000 will allow for more legal services through the Attorney General's Office to manage cases brought for review.

New construction. In FY 2004, \$250 million in lease-to-own financing has been used to build Arizona schools. In FY 2005, the Executive recommends the same amount for the new construction program.

Since lease-to-own transactions represent long-term financing, there are no FY 2005 General Fund costs associated with the \$250 million issuance in FY 2005. (In FY 2006, the anticipated lease payment associated with this issuance is estimated to be \$12 million.)

However, in FY 2005 there are lease payments that must be made for the \$400 million lease-to-own transactions issued in FY 2003, and \$250 million anticipated in FY 2004. In FY 2005, the Executive recommends an additional \$22.5 million to the existing \$21.6 million appropriation, for a total of \$44.1 million in General Fund for lease payments.

Building Renewal. Due to the ongoing litigation related to the Building Renewal program, the Executive

has recommended suspension of the program in FY 2005.

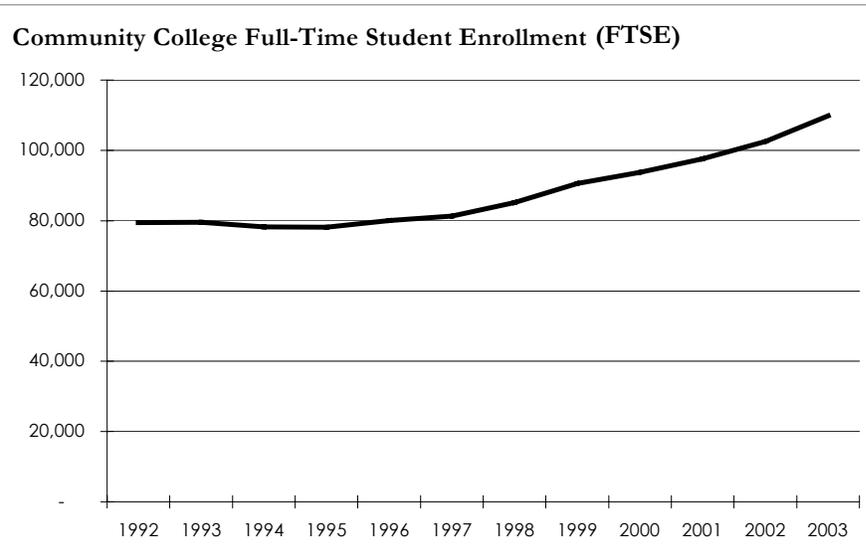
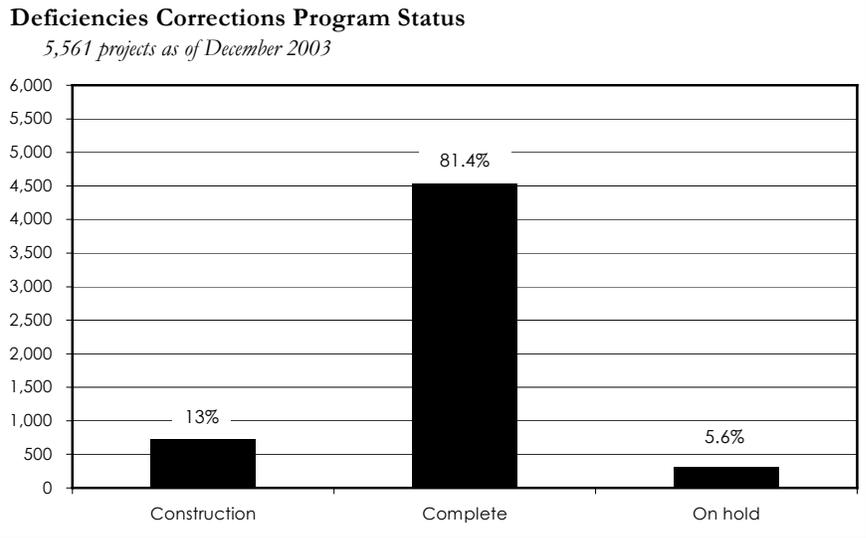
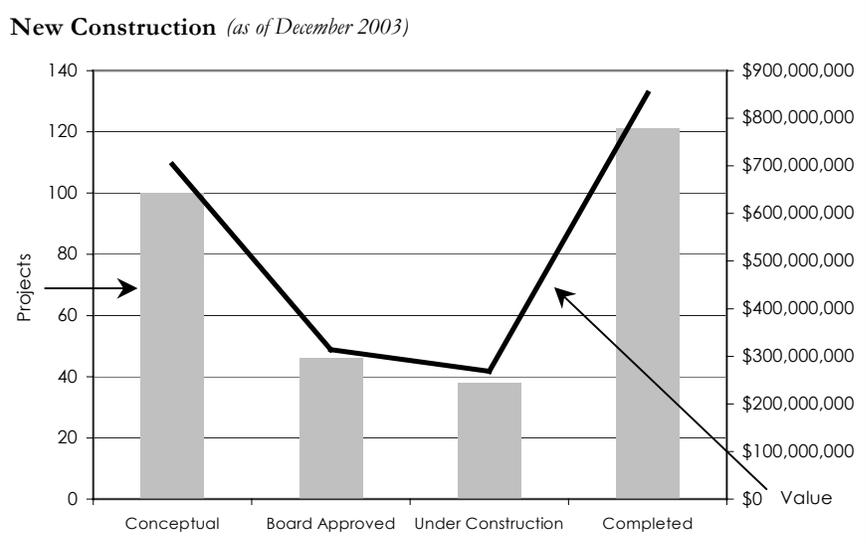
Deficiencies Correction. STUDENTS FIRST requires that the School Facilities Board establish minimum facility guidelines for Arizona district schools and address any deficiencies discovered by June 30, 2004. In Laws 2003, First Special Session, Chapter 1, this timeline was changed for three districts – Mesa Unified, Tucson Unified and Glendale Union – in which \$100 million was transferred from the Deficiencies Correction Fund to the General Fund in FY 2003, and delayed the completion of these districts’ projects to June 30, 2005. Laws 2003, First Special Session, Chapter 2 advance-appropriated \$100 million in FY 2005 from the General Fund to the Deficiencies Correction Fund.

The Executive recommends that, in lieu of the \$100 million from the General Fund, the School Facilities Board issue an additional \$100 million in State Trust Lands revenue bonds. In FY 2004, the Board received bonding authority of \$247.1 million, with the funding stream identified as “State Trust Land earnings.” Debt service payments for these bonds will not be made until FY 2006.

Community colleges

Arizona’s community colleges have become centers for higher educational opportunity and welcome all who desire to learn new skills and enhance existing skills. In FY 2003, the community colleges experienced student growth of over 7% (see chart at right). In response to that enrollment explosion, the Executive recommendation includes an additional \$15.3 million for formula programs:

- \$7.6 million for operating,
- \$3.4 million for capital outlay, and
- \$4.3 million for equalization aid.



■ Universities

Higher education is the fuel for economic growth and must not be impaired by shortsighted decisions. Despite the State's fiscal challenges, funding for the universities not only remains intact – it grows. While other states are imposing enrollment caps and laying off faculty, the Executive recommendation invests in the state's labor force and enhances Arizona's ability to compete globally for business relocation and development.

For those and other important reasons, the Executive Recommendation reflects a General Fund increase to the universities of \$45.9 million, distributed as follows:

Pay package. To enhance faculty and staff retention, the Executive recommends \$21.9 million for a pay package for university employees. The pay package is to be allocated by the Board of Regents to the individual campuses in a manner to be determined by the Board.

Enrollment growth. In response to expected enrollment growth of 1.6% – 1,606 full-time equivalent students – from fall 2003 to fall 2004, the Executive recommends \$12.9 million, in accordance with the traditional 22:1 formula.

Additionally, the Executive recommends \$4 million for Arizona State University – \$3.5 million for the main campus and \$500,000 for ASU West – to partially fund FY 2004 enrollment growth. While the two campuses' combined enrollment grew by almost 2,000 between fall 2002 and fall 2003, no enrollment growth was funded in FY 2004. The Executive recommendation should help fill the large funding gap created last year.

This is the first year that enrollment growth is funded for the ASU West campus, which recently surpassed 5,000 enrollment.

New facilities support. ASU-East has not reached the 5,000 enrollment mark needed to trigger the 22:1 formula, but it has recently added six

buildings comprising almost 100,000 square feet. The Executive recommends \$168,100 to help support those new facilities.

Faculty retention. The Executive recommends \$5.8 million to help the University of Arizona and Northern Arizona University retain quality faculty members. A recent study indicated that it would cost about \$179 million to bring university employees' to the average salary of their peers. While the Executive is recommending far less than this amount, the additional funds should help the universities retain top faculty members who attract research grants and provide the best education for students.

Nursing program. Approximately \$1 million of the recommended increase is for expansion of the nursing program at Northern Arizona University. The recommended expansion is part of a strategic plan to double the output of the nursing program in five years, to help address Arizona's nursing shortage. ■

Relief in sight

The expected economic recovery should ease the demand for human services and lessen the pressure on the General Fund

PREDICTABLY, DIFFICULT ECONOMIC times affect the financially vulnerable first. When the economy slows, incomes drop, jobs are lost, savings evaporate and health coverage vanishes, placing greater demands for State human services at the very time that the State's revenues, too, are slowed.

That scenario played out during the economic slowdown of the last few years, straining the State's ability to care for the neediest Arizonans and testing the ingenuity of elected officials and policymakers.

Fortunately, the apparent burgeoning economic recovery should offer some relief to State agencies during the next fiscal year, as the expected demand for health and welfare services becomes easier to bear.

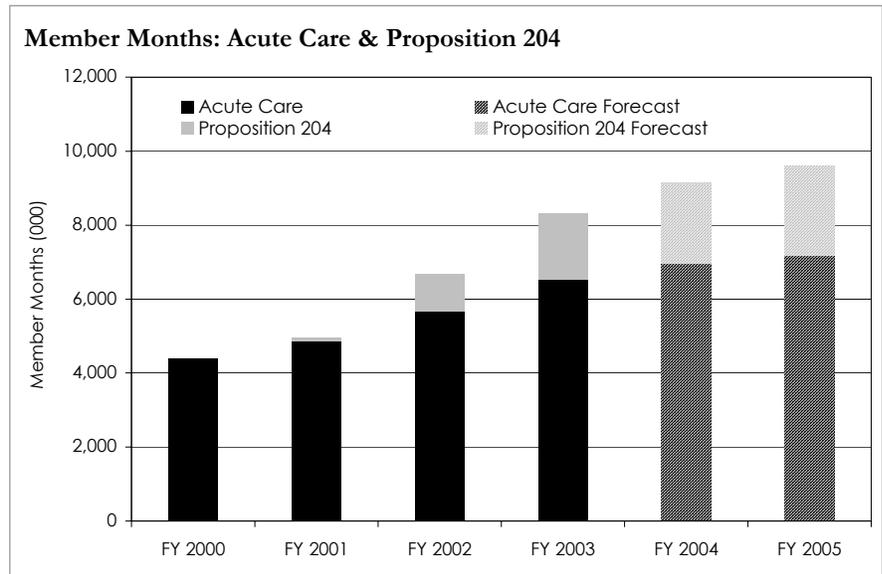
That is not to say, however, that we are out of the woods, and meeting the health care needs of qualifying Arizona children and adults continues to require creativity and prudent decision-making.

■ Health care

Providing health and welfare services is one of the principal drivers of the State's budget. For example, approximately 17% of Arizona's population — or over 960,000 people — depend on the State's Medicaid program, AHCCCS, for their health care needs.

FMAP replacement. One of the two main emphases of the Executive recommendation for Fiscal Year 2005 is replacement of the enhanced Federal Medical Assistance Percentage (FMAP) that the State received during FY 2004.

Under the Jobs and Growth Tax Relief Reconciliation Act of 2003, each state received an additional 2.95% to its FMAP — an increase that translated into direct savings for financially



strapped state governments. However, that increase was temporary and is not available for FY 2005; consequently, the Executive recommendation includes an additional \$79 million to accommodate FMAP's return to its normal level.

Capitation rate inflation. The second major focus of the Executive recommendation deals with capitation rate inflation.

The FY 2004 budget assumed capitation rate growth of 7%: 5% for medical inflation and 2% for the premium tax. As AHCCCS renegotiated its contracts, however, the capitation rates grew by 13%, or almost double what was anticipated in the current budget. The capitation rate differential, from budgeted to actual, will require an estimated \$18.7 million FY 2004 supplemental appropriation. For FY 2005, the Executive recommendation anticipates further inflation in the capitation rates at the beginning of the next contract period.

The Executive recommendation includes \$143 million for capitation rate inflation: \$99.3 million to fill the gap between the budgeted rates and current rates, and \$43.7 million for a 6% projected increase during FY 2005.

Acute Care. With over 760,000 Arizonans enrolled, Acute Care is AHCCCS's largest member component. The Acute Care population increased by 15% in FY 2003, due primarily to 22% growth in the Temporary Assistance to Needy Families (TANF) population, adding 61,000 individuals to the AHCCCS rolls. However, in recent months Acute Care member growth has slowed and, ultimately, declined; in fact, there was zero net growth between June and November 2003.

While this recent trend is encouraging, the Executive recommendation anticipates net caseload growth of 6.8% for FY 2004, slowing to 2.9% during FY 2005.

Proposition 204. Voter approval of Proposition 204, which extended Medicaid eligibility to Arizonans under 100% of the Federal Poverty Level (FPL), sparked dramatic growth in AHCCCS enrollment and resulting expenditures.

Funding for Proposition 204 was originally intended to come from settlement monies received as part of the 1998 tobacco manufacturers lawsuit. When costs attributable to Proposition 204 exceeded the Tobacco Settlement revenues, the funding burden was eased by:

- voter approval of Proposition 303, which increased the tax on tobacco products, providing \$60 million in additional FY 2003 revenues, plus an anticipated \$134 million in FY 2004 and \$131 million in FY 2005; and
- two negotiated waivers of federal requirements under the Health Insurance Flexibility and Accountability (HIFA) legislation. Arizona received two waivers to help fund Proposition 204 and provide additional coverage to those in need.

KIDSCARE Parents. Under the HIFA waivers, Arizona can utilize enhanced federal participation to pay for a selected Proposition 204 group, providing direct savings for the General Fund. The waivers also allow Arizona to expand coverage to the parents of KIDSCARE or Medicaid-eligible children.

The coverage of KIDSCARE parents is legislated to end on June 30, 2004; consequently, the Executive recommendation includes \$7.3 million to fund the KIDSCARE PARENTS program through FY 2005. By continuing this program, the State will qualify to receive enhanced funds for Proposition 204; in return for the \$7.3 million expended, the State will save \$7.2 million under Proposition 204, allowing approximately 11,400 parents to receive health care coverage for a net cost of just over \$100,000.

Conclusion. In total, with all federal and State fund sources combined, the Executive recommendation is poised to add \$500 million for health care for needy Arizonans.

■ **Mental health**

After three years of steady growth, Title XIX enrollment appears to have reached its peak in October 2003 at 1,009,648 enrollees. Based on this recent data, the Executive expects FY 2004 cases to decline at an annualized rate of 0.77%, with no growth expected in FY 2005. The estimated cost to the General Fund of the FY 2005 caseload increase is expected to be \$28.9 million.

The Executive is also recommending a supplemental appropriation for FY 2004 of \$5.8 million General Fund. Proposition 204, which, as was noted above, provides care for individuals up to 100% of the Federal Poverty Level, continues to be the fastest growing component of the Title XIX Behavioral Health Services caseload.

The FY 2004 Proposition 204 caseload is expected to grow at 6.7%, while the FY 2005 caseload is forecast to rise by 4%. These growth rates compare favorably to the FY 2003 Proposition 204 growth rate of 32.4%.

Inpatient care. During 2003, the new facilities at the Arizona State Hospital were opened to provide inpatient

care. The new hospital's state-of-the-art design was conducive to effective treatment.

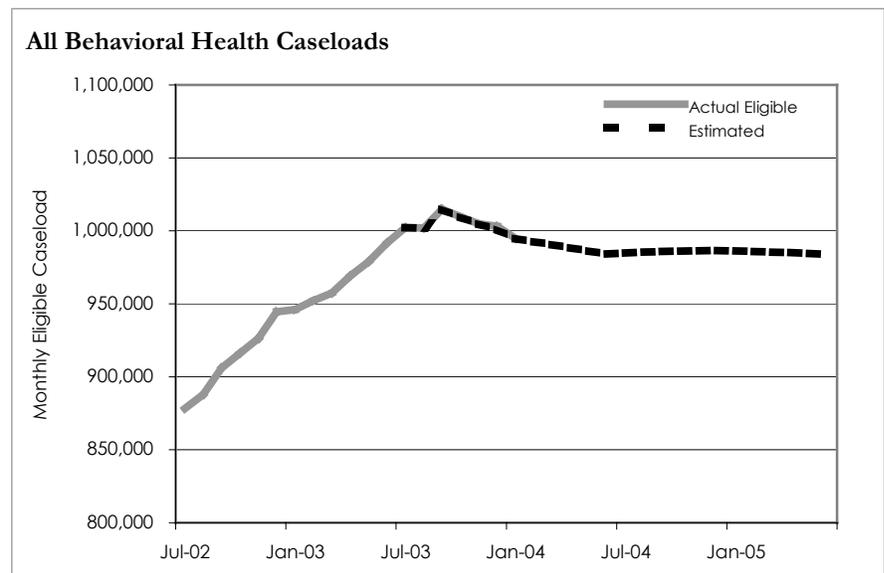
The facility estimates that the hepatitis C virus (HCV) infects approximately 91 patients within the hospital. The Executive recommends \$2.5 million for diagnostic and pharmaceutical costs of HCV treatment. Additionally, to meet the rapidly increasing costs of atypical drugs for the treatment of mental illness, the Executive recommends the addition of \$128,300 in FY 2004 and \$265,000 in FY 2005.

■ **Assurance & Licensure Services.**

The Governor's proposed Early Education Initiative provides for the addition of 15.0 new FTE in the Division of Assurance and Licensure Services. The proposal will add specialists in childcare licensure and early childhood development.

Childcare centers in Arizona have provided much needed access to early childhood learning and school readiness. In order for these early education programs to be successful, they must provide a safe, healthy and conducive environment to learning for the child.

During FY 2003, the Department licensed and monitored approximately 2,426 childcare facilities. To provide for this continued health and safety monitoring of childcare facilities, the Executive recommends the addition of



\$294,700 General Fund and 5.0 FTE childcare licensure surveyors to investigate complaints, reduce the backlog for license renewals, and conduct timely annual surveys as mandated by law.

In addition to the five new surveyors, the Executive recommends \$677,800 General Fund and 10.0 FTE to provide training and technical assistance to childcare staff and administrators of childcare centers. These early childhood development specialists will provide training and technical assistance to childcare staff and administrators to assist them in the operation, administration and development of high quality and fiscally responsible early childhood education programs. Additionally, they will conduct assessments and environmental rating scales that evaluate individual programs to help consumers make informed decisions on childcare.

Prevention, education, and direct care. Preventive care remains a top priority at DHS, and the HEALTH START program exemplifies the State's commitment to critical health and educational services.

HEALTH START participants are women and children; the program's major goals include improving birth outcomes, reducing childhood diseases, and improving preventive healthcare. The Executive recommends the addition of \$226,600 General Fund to provide continuation funding for HEALTH START at \$1 million for FY 2005.

Vaccinations. Ten years ago, Arizona ranked in the bottom 10% of states in complying with recommended vaccinations. Today, it is a national leader.

In spite of the State's recent achievements, Arizona remains vulnerable to rising vaccination costs and notch groups that may not otherwise qualify for preventive care without additional funds.

The Executive recommendation provides an additional \$2.5 million for vaccinations for underinsured children and high-risk, uninsured adults, i.e., those who are not covered by federal

programs or through private health insurance and who are at risk of contracting life-threatening, vaccine-preventable diseases.

Pediatric physicians recommend that childhood immunizations be completed between six and 23 months of age. The per-child cost to fully immunize a child by age two has, in ten years, increased by 540%, from \$68 to \$435, and federal monies for vaccines have not been sufficient to meet Arizona's needs.

Additional cost pressures have resulted from a 4% annual increase in the newborn population and changes in childhood vaccination practices in the last ten years. For example, until 1997 the Centers for Disease Control (CDC) had recommended that all children up to 24 months of age receive vaccination for hepatitis A; now, the CDC strongly recommends that all children up to 18 years of age receive that vaccine.

DHS estimates that 27% of chronically ill adult Arizonans are uninsured and in need of vaccination against influenza and pneumococcal. These vaccine-preventable diseases could reduce the risk of unnecessary death and the risk of hospitalization that would likely become part of the AHCCCS caseload.

Rehabilitative services. The Children's Rehabilitative Services Title XIX program continues its successful path after shifting to a capitated payment methodology in July 2000. Although enrollment remains relatively level at 2% annualized growth, an inflationary increase of 4.9% has been provided.

For FY 2004, the Executive recommends a \$128,300 General Fund supplemental appropriation to cover anticipated caseload increases. For FY 2005, the Executive recommends an increase of \$3,419,700 General Fund for caseload and medical inflationary increases.

■ Assistance for children

In meeting the needs of Arizona children, the Executive recommendation provides critical support in the ar-

reas of Child Protective Services, Child Care, and Adoption Services.

Child Protective Services. The recommendation for CPS includes a \$27.5 million General Fund increase, including:

- \$12 million to fund enough caseworkers to achieve a 100% CPS investigation rate and meet Child Welfare League of America (CWLA) staffing standards;
- \$4 million for Children Services rate increases, including a foster care rate increase;
- \$2.7 million to provide salary increases for CPS staff;
- \$4.2 million to cover shortfalls in the Division of Children, Youth and Families operating budget and the Children Services special line item;
- \$2.6 million to replace TANF funds that are transferred to the Social Services block grant (SSBG);
- \$2 million for Attorney General legal services; and
- \$100,000 for information technology equipment.

CPS case managers. The recommendation provides 239 additional case managers and related staff by the end of FY 2005 — 94 to help investigate 100% of the calls to the CPS hotline that are classified as appropriate for investigation, and 145 to meet CWLA staffing standards.

Children Services rate increases. During the Second Special Session at the end of 2003, the Legislature provided funding for a Foster Care rate increase. Those funds have to be annualized in FY 2005, for which the Executive recommendation includes \$2.5 million. The Department of Economic Security will also renegotiate rates for Children Services placements for FY 2005. The Executive provides \$1.5 million to provide a 4% rate increase.

CPS salary increases. Current compensation for CPS employees is a barrier to recruiting and retaining quali-

fied, professional staff. Recognizing the importance of that issue, the Legislature provided, also during the Second Special Session, funding for compensation and classification adjustments for CPS staff. Those funds also must be annualized in FY 2005.

FY 2004 shortfalls. The Second Special Session also addressed shortfalls that DES identified in the operating budget of the Division of Children, Youth and Families and the Children Services special line item. Because both of those shortfalls carry forward into FY 2005, the Executive recommendation includes \$4.2 million in needed funding: \$3.1 million for the operating budget shortfall and \$1.1 million for the Children Services special line item.

TANF transfer. One of the more complicated technical adjustments involves the transfer of TANF monies to SSBG in order to supplement funding for Children Services. The federal government allows states to transfer up to 10% of their TANF block grant to SSBG. For FY 2004, the Legislature appropriated \$25.3 million of TANF funds for this purpose, including transfers from both the FY 2003 and FY 2004 TANF block grants.

The Executive recommends decreasing the SSBG expenditures that result from these transfers from \$25.3 million in FY 2004 to \$22.6 million in FY 2005. There would be corresponding increases in the General Fund so that no net reduction in funding would result from decreases in the amount transferred.

Other funding needs. The recommendation would add \$2 million from the General Fund for 31 additional attorneys and support staff to provide legal services for the Division of Children, Youth and Families.

The Executive also recommends \$103,400 General Fund for information technology equipment for the Division of Children, Youth and Families.

Child care caseloads. For FY 2005, the Executive recommends an

increase of \$53.5 million General Fund for the low-income working, TANF-related and Transitional Child Care programs. This total includes \$29.3 million in General Fund monies to replace Child Care and Development Fund (CCDF) monies. These CCDF monies are one-time funds that will not be available in FY 2005. The recommendation would also shorten the child care waiting list. *(This recommendation is also addressed in the Education section of the Budget Message.)*

The FY 2005 appropriation will provide:

- 28,262 children of low-income working parents an average subsidy of \$311 per child per month;
- 6,819 children an average of \$299 per month for TANF-related child care; and
- 9,037 children an average of \$303 per month in the Transitional Child Care program.

Adoption Services. For FY 2005, the recommendation includes a \$7.8 million General fund increase for Adoption Services. The Executive anticipates an 8.8% caseload increase in FY 2004 and an 8.1% increase in FY 2005. The appropriation would provide services to an average of 7,625 children. The recommendation is a 38.3% increase over the \$20.3 million appropriation for FY 2004.

■ Assistance for families, adults

The Executive recommendation includes significant changes in the appropriation for the federal Temporary Assistance for Needy Families block grant (TANF). The proposal includes reductions because the \$243 million appropriation for TANF is \$15 million higher than the amount of TANF funds that the Executive expects to be able to draw down from the federal government in FY 2004.

For FY 2005, the Executive is proposing reductions totaling \$15 million,

and Arizona would also spend its entire TANF reserve by the end of FY 2004. The Executive replaced all of those TANF reductions with General Fund monies. The TANF changes include reductions for children services, cash assistance and the TANF transfer to SSBG.

The recommendation also includes \$10 million General Fund in FY 2005 to cover caseload growth in the cash assistance program.

Other funding increases. The Executive recommends \$14.3 million from the General Fund to provide increases in funding for:

- Healthy Families,
- substance abuse treatment, and
- permanent guardianship.

Healthy Families. The Executive recommendation doubles the amount of funding that is available for Healthy Families. In FY 2004, Healthy Families was funded in part with Tobacco Settlement funds, but DES will not receive any additional Tobacco Settlement monies in FY 2005. The FY 2005 recommendation includes an increase of \$8.7 million General Fund. DES's total expenditures for Healthy Families would increase to \$14.5 million.

Substance abuse treatment. The FY 2005 recommendation includes \$3 million General Fund for substance abuse treatment. The recommendation would maintain funding for the program at \$5 million. DES will use part of the \$14.9 million General Fund that the Governor line-item vetoed to cover these expenditures in FY 2004.

Permanent guardianship. For FY 2005, the Executive recommends an increase of \$2.5 million General Fund for permanent guardianship. Total funds for the program would be \$3.5 million, which would cover an average of 1,100 clients each month. The Executive anticipates an 18% increase in the caseload in FY 2005. ■

Executive initiatives target recidivism

With the State's prison population exceeding capacity, reducing the number of inmates who return to prison must be a top priority

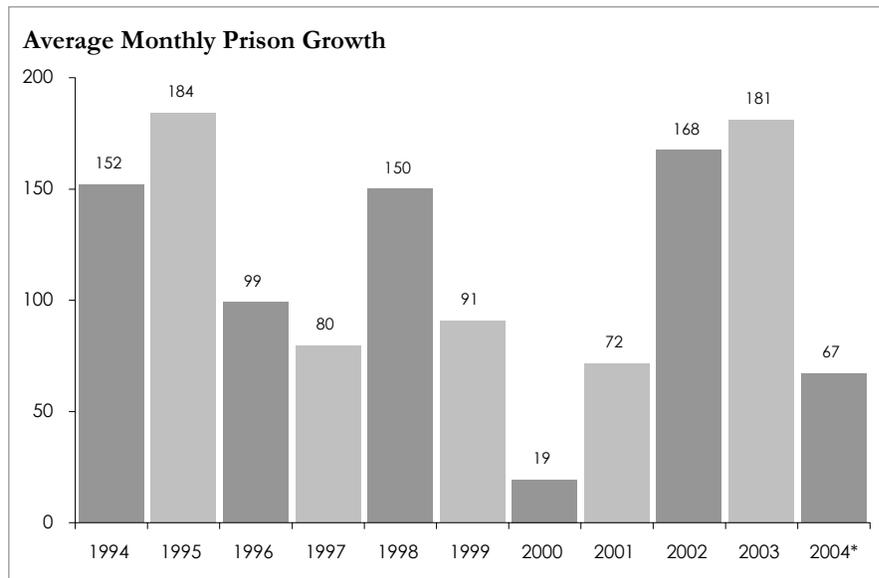
FOR THE SECOND straight year, the adult prison population during FY 2003 experienced high net growth, averaging 181 inmates per month. The volatile growth rates of recent years (*see chart*) make it more difficult than usual to accurately predict the size of the prison population, but it is safe to assume that the State will continue to house more and more inmates. The size of the increase can be a manageable issue, however, provided that the State seizes certain opportunities aimed at better preparing inmates for their return to society.

Prison construction. The recent rapid growth has caused severe overcrowding. By the end of FY 2003, the prison population exceeded the system's designed capacity by more than 4,100 inmates.

The Governor's call for a special legislative session in October 2003 resulted in funding for additional prison beds: roughly 2,100 permanent beds, plus 2,100 provisional beds that can be used while permanent facilities are being built. These beds will compliment the scheduled opening of the new 1,400-bed private prison near Kingman, scheduled to open in stages during the next 12 months. The special session also provided funding to recruit and retain correctional officers.

Recidivism reduction. Since the June 2003 appointment of a new director, the Department of Corrections has focused on reducing recidivism rates and better preparing inmates for their release from prison. Some of the first steps toward these goals are found in several Executive Budget recommendations:

- better substance abuse and sex offender treatment;



- expanding the number of inmate firefighting crews for wild fires;
- improving the methods of dealing with technical violators of probation and parole; and
- utilization of minimum-security, level-one beds.

Substance abuse treatment. The Department's study of the last ten years' recidivism rates among released inmates reveals that inmates who complete substance abuse treatment are 31% less likely than non-participants to return to prison during the three-year period following their release. Those who completed substance abuse treatment had a recidivism rate of 14.3% compared to 19.7% for those who do not participate in treatment programs.

Sex offender treatment. The same recidivism study indicates that inmates who complete sex offender treatment are 44% less likely to return to prison than those who do not. Only 11% of

those who complete the program are re-incarcerated, while non-participants return at a 19.7% rate. The Executive recommends increasing the capacity of the sex offender treatment program to 458 inmates from the current capacity of 110 inmates.

Firefighter training. The Department's recidivism study further reveals that inmates who complete a work program, such as fire fighting, are 25% less likely to be returned to prison than inmates who are not involved in programming. Consistent with that finding, and to expand the State's capacity to protect the public from devastating wild fires, the Governor proposes that the number of inmate crews trained to fight wild land fires be doubled, from the six crews operating in July 2003 to 12 crews, as soon as possible. That would increase from 120 to 240 the number of inmates fighting fires. When not actually fighting fires, the crews would be used to reduce potential fire damage risks by clearing heavy vegeta-

tion near developed residential and commercial areas.

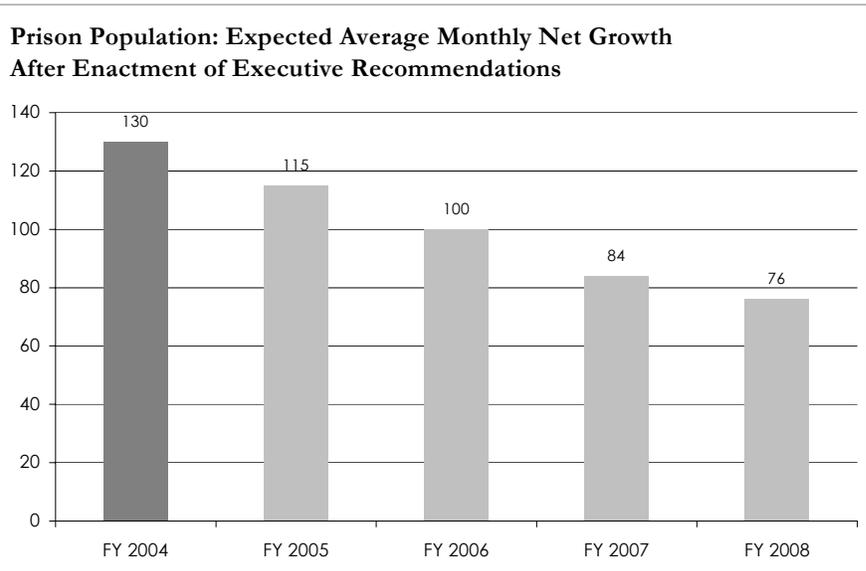
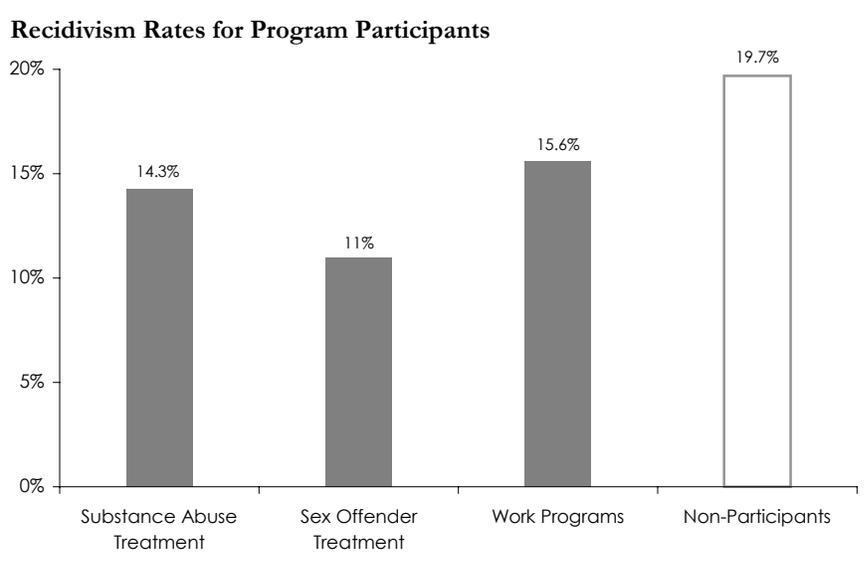
Parole violations. A large portion of the prison population consists of technical violators of probation or parole. Specifically, approximately a third of all male inmates and half of all female inmates admitted to the prisons in FY 2003 were probation or parole violators, and the Executive recommends a new option for dealing with these inmates.

Currently, violators who miss meetings with probation officers, fail drug tests, or fail to meet some other condition of their sentences can be sent to prison for the full length of their original probation or parole terms, regardless of how much time remains on their original terms. The Executive recommends a new sanction option that would allow trial court judges to sentence technical violators to a swift and certain prison term with an intense focus on the problems that caused the probation or parole violation. The problem that brought the inmate back to prison is more likely to be corrected than under the existing sentencing options, and the amount of time spent in prison will be shortened, thus relieving part of the need for prison construction.

Level-one beds. Another strategy recommended by the Executive is to better equip offenders to return to society through the use of level-one beds.

Inmates are classified as security risks on a scale of one to five: Level-five inmates are the most dangerous and require the tightest security; conversely, level-one inmates need the least supervision. Level-one inmates often work away from the prison during the day, after which they return for programming in preparation for their release.

Because the prison system has no level-one housing, level-one inmates are housed in level-two or level-three facilities. The Executive bed plan contains 1,000 new level-one beds, which would offer two important benefits:



- utilizing level-one facilities would save the State approximately \$22 million in construction costs for a 1,000-bed level-2 facility and another \$15 million each year in operating costs; and
- a level-one facility is the most effective environment for preparing inmates for release.

The total impact of the recommended changes on the prison population's growth rate over the next four years is shown in the chart immediately above.

Health care. In an effort to reduce high cost of inmate health care, the Executive is proposing legislation that would allow the Department of Corrections to use the AHCCCS rates as guidelines when paying for health care services to providers outside of the Department. Similar legislation was enacted in 2001 for the Department of Juvenile Corrections, which saved 32% on its outside services in FY 2003. The expected savings to the Department of Corrections in FY 2005 is \$9.4 million.

Pharmacy consolidation. Each of the State's prisons has its own pharmacy. The Executive recommends

consolidating the prison pharmacies into two regional, automated pharmacies that would shrink-wrap dosages for individual inmates and ship them to the prisons. Because the dosages are shrink-wrapped, delivering them to inmates does not require an on-site pharmacist. This change will save \$225,500 in FY 2005.

■ Juvenile corrections

After experiencing significant increases from 1996 to mid-1998, when the average daily population rose from 538 to 1,037, the Department of Juvenile Corrections (DJC) has seen a decline in its secure care population. The average daily population dropped from 936 in FY 2001 to:

- 839 in FY 2002,
- 797 in FY 2003, and
- 706 during the first half of FY 2004.

DJC forecasts an average daily population of 700 in FY 2005. The Department attributes some of the decrease to a parole violator program, instituted in February 2001, that has reduced the average length of stay for parole violators from seven months to about 45 days. Parole violators go through this program instead of repeating the standard secure care program that already failed to correct the juvenile's behavior.

Bed reduction. As a result of the population decline, the Executive recommends reducing the funded bed capacity from 818 to 743, for a savings of \$1.7 million. The decline in population also allows DJC to move the parole violator center from the Sunrise facility in Buckeye to the Adobe Mountain facility in north Phoenix. The move brings the juveniles closer to employment and educational opportunities

and vacates the Sunrise facility, which will save the State \$732,400.

Suicide prevention. Three juveniles committed suicide while in secure care between April 2002 and April 2003, and DJC has aggressively made physical modifications to help prevent further occurrences.

In addition to the physical changes, the Executive is recommending \$200,000 to improve the training of Department personnel. The recommended funding will provide first aid and crisis intervention training for all staff and will provide two additional weeks of training for new recruits.

■ Law enforcement

Public safety is one of government's fundamental responsibilities. Despite the recent budget crisis, the Executive recommendation provides for modest funding increases for targeted programs that increase the security of Arizona's citizens.

Highway Patrol officers and pay. Laws 2001, Chapter 1 provided for an additional 116 Highway Patrol officers in FYs 2002 and 2003. Since that time, however, Arizona has seen a:

- 21% growth in metropolitan highway miles,
- 16% increase in yearly miles traveled,
- 14% increase in collisions on DPS-patrolled highways, and
- a 12% drop in traffic violator stops.

As Arizona and its highway system grow, the State needs to fund additional Highway Patrol officers to police this system. The Executive recommends two additional squads of Highway Patrol officers along with needed support personnel. Each squad of 7.0 FTE officers includes 1.0 FTE sergeant, and the recommendation in-

cludes one dispatcher, one computer support position, a records position, and an automotive technician.

Further, the Executive recommends \$3 million – in addition to the Statewide pay package – to begin the process of bringing DPS officers' pay closer to market level. Additionally, the recommendation includes funding for the 58 officers hired in FY 2002 under Laws 2001, Chapter 1 to be promoted to the next step in the DPS three-tiered pay-step system.

Helicopters and equipment. DPS helicopters are aging; while three helicopters have been funded for replacement in recent years, by FY 2005 the two remaining helicopters will exceed the 10,000 flight-hour replacement standard. The oldest helicopter will have an estimated 12,000 flight hours by the beginning of FY 2005, and the Executive recommends replacing it by appropriating funds for the first year of a three-year lease-purchase. The Executive also recommends continuing the second year of the three-year lease-purchase for the helicopter replaced in FY 2004.

Other equipment is in need of replacement as well. The Executive proposes replacing the analog technology Arizona Criminal Justice Information System (ACJIS) with current technology to allow photographs, fingerprints and other digital data to be downloaded and transmitted by DPS and all other Arizona law enforcement agencies.

Finally, the Executive recommends continuing the third year of a four-year replacement of Mobile Data Terminals with Mobile Data Computers in Highway Patrol field units, as well as continuing to replace Livescan automatic fingerprint machines in booking stations across the state. ■

Transportation planning key to prosperity

A reliable, expanding transportation network is a prerequisite for economic vitality

AS WE SEEK to stimulate and sustain economic growth and enhance Arizona's quality of life, it is essential that the State continues to provide a reliable transportation network. The Executive proposes a multi-faceted strategy to enhance highway safety and mobility, reduce congestion and grow our economy.

Ensuring an effective highway system involves at least three components: building the necessary facilities, preserving that infrastructure, and operating the system effectively and efficiently.

To help State government fulfill that mission, the Executive Recommendation provides an operating budget of \$381 million and 4,658 positions – an increase of \$11.4 million and 53 positions over FY 2004. The recommended budget will enable the Department of Transportation (ADOT) to:

- carry out its \$3.9 billion Five-Year Transportation Facilities Construction Program for Fiscal Years 2004 through 2008, and
- Complete the Maricopa Regional Freeway System by the accelerated date of December 31, 2007.

■ Funding sources

ADOT's operating and construction budgets are primarily funded from the Federal Highway Trust Fund, the State Highway User Revenue Fund (HURF), bond proceeds, and the Maricopa County Transportation Excise Tax, which is deposited into the Regional Area Revolving Fund (RARF).

More than half (50.5%) of the monies flowing into HURF are shared

FY 2005 ADOT Financial Plan <i>(Dollars in millions)</i>		
S O U R C E S		
HURF	\$446	26%
Federal Funds	\$394	23%
RARF	\$297	17%
Bonds	\$220	13%
Other	\$204	12%
HELP Fund	\$139	8%
U S E S		
Capital Budget	\$903	53%
Debt Service	\$406	24%
Highways	\$146	9%
Maintenance	\$104	6%
MVD	\$89	5%
Administration	\$38	2%
Magazine	\$10	1%
Aeronautics	\$2	0%

with cities and counties, while the balance remains with the State.

Since the excise tax is collected from Maricopa County residents only, RARF monies are exclusively dedicated to the Maricopa Regional Freeway System. In FY 2005, HURF is projected to receive \$1.2 billion, an increase of 4.3% over FY 2004. The RARF is projected to receive \$305 million in FY 2005, an increase of 10.1% over FY 2004.

For FY 2005, the Executive increases funding for mission critical operating programs to provide:

- \$7.7 million and 11 additional FTE positions to improve highway safety and maintenance;
- \$495,200 and 12 additional FTE positions to build capacity and improve traffic control and safety at Arizona's international and domestic ports of entry;
- \$2 million for the maintenance and replacement of outdated field equipment; and

- \$1 million and 12 additional FTE positions to continue e-government and customer service improvements initiated by the Motor Vehicle Division.

For FY 2005, the Executive also proposes a one-time, \$118 million transfer of Vehicle License Tax (VLT) receipts from HURF to the General Fund. To accommodate this one-time use of the VLT for the General Fund and ensure the integrity of the Highway Construction program, the Executive recommends a combination of innovative funding mechanisms, including use of bonding capacity, grant anticipation notes, and cost recovery.

■ Highway construction

The State Transportation Board has approved a \$3.9 billion highway construction program as part of the Five-Year Transportation Facilities Construction Program for Fiscal Years 2004 through 2008. Included in the program are transportation corridors under both the National Highway System and the Statewide system. Funding for the five-year program includes approximately:

- \$972 million for freeway and expressway construction in Maricopa County, funded partially from the Regional Area Road Fund;
- \$1.9 billion for system improvements, including \$211 million to advance freeway and expressway construction in Maricopa County;
- \$744 million for system preservation; and
- \$350 million for system management.

The Maricopa Regional Freeway System was originally planned for

completion in 2014, but through the prudent use of innovative revenue bonding mechanisms, an accelerated construction program is scheduled for completion in December 2007.

In these difficult economic times, meeting the challenge of this accelerated construction program will require judicious management of cash raised through the leveraging of State and federal resources. The Governor will work to establish an integrated State-wide transportation system that will provide a safe, reliable and efficient network of highways.

■ **Transportation planning**

While the current framework for Statewide and metropolitan transportation planning has served its purpose, further improvements are necessary. Significant changes in the transportation planning process must be made to provide comprehensive, multi-modal planning at both State transportation levels and within metropolitan planning organizations.

The changes sought will strengthen public and stakeholder involvement and establish multi-modal planning processes that take into account a broad array of factors, including community input and goals, economic development, improved access to transportation facilities, and environmental quality and protection.

In December 2003, ADOT announced the creation of a Public Transportation Division to facilitate federal and State transit programs. Effective State coordination can untangle these transportation webs and provide broader and better transportation access and service without major new transportation investments. ADOT's initiative is an important step to prepare for the State's growth and give citizens more choices in how they travel.

While ADOT has long been involved in supporting urban, rural and special needs transit programs, the new planning entity will better position ADOT to support public transit planning around Arizona, further its ties with urban and rural regional partners, and facilitate the development of transit programs across jurisdictions and regions. Transit is part of the multi-modal solution needed to maximize the effectiveness of Arizona's transportation system.

■ **Regional Transportation Plan**

For the past few decades, metropolitan Phoenix has been one of the fastest-growing areas in the nation. The number of vehicles on roads is at an all-time high, and the number of miles driven by motorists is increasing every year. These trends are expected to continue requiring investment deci-

sions on infrastructure development and maintenance, congestion management, air quality management, and safety. It is imperative to ensure that needed funding be extended and available to address transportation infrastructure needs and sustain a strong economy.

In 1985, Maricopa County voters approved Proposition 300 to establish a 0.5% sales tax for construction of controlled access highways. While these revenues have been critical in the development of the regional freeway network, many transportation challenges remain ahead. Ongoing demands for transportation improvements in the region, along with the commitment to continue to reduce congestion and grow the economy, underscores the need to extend this funding source into the future.

In spring 2003, the Legislature and the Governor enacted H.B. 2292 to guide the development of the Regional Transportation Plan (RTP), in anticipation of an election to extend the transportation funding for the metropolitan region. The RTP is a comprehensive, performance-based, multi-modal, coordinated regional plan, covering the period through Fiscal Year 2026. ■

Recommended FTE increases

The net increase of 1,004.0 FTE is comprised of two components: (13.0) FTE reduced through technical changes to the appropriations base, and 1,017.0 FTE resulting from newly funded or eliminated programs

IN THE SECOND year of the FY 2004-05 biennium, many small General Fund agencies and most other fund agencies have already received FY 2005 budgets. In addition to the 17 annually appropriated agencies, many larger, predominately General Fund agencies did not receive FY 2005 appropriations due to the State's fiscal challenges.

In the following analysis of full-time equivalent (FTE) positions, the FY 2005 recommendation includes all 130 State agencies. As reported in the FY 2005 budget detail that follows, the net increase in positions of 1,004.0 FTE is comprised of two components:

- a net reduction of (13.0) FTE through technical changes to the appropriation base, and
- a net increase of 1,017.0 FTE resulting from newly funded or eliminated programs

■ **FY 2005: FTE technical changes**

Health Services, Dept. of 15.8 FTE
Net increase of 16.8 FTE for program transfers from AHCCCS and DPS; elimination of (1.0) FTE not funded.

Veteran's Services, Dept. of.....(4.0)
Transfers (4.0) FTE to a non-appropriated funding source.

Public Safety, Dept. of.....(4.0)
Transfers (5.0) FTE to a non-appropriated funding source; 1.0 FTE for program transfer from DHS.

State Board of Nursing.....(7.0)
Elimination of (7.0) FTE positions temporarily authorized to reduce case backlog

AHCCCS(13.8)
Transfers (13.8) FTE to DHS

FTE Change From Prior Year by Area of Government
 FY 2004 - FY 2005

ALL APPROPRIATED FUNDS

Area of Government	FY 2004 FTE <i>Budgeted</i>	FY 2005 FTE <i>Recommended</i>	FY 2005 FTE <i>Change</i>
General Government	4,366.8	4,388.3	21.5
Health and Welfare	7,810.5	8,268.0	457.5
Inspection and Regulation	1,828.0	1,831.0	3.0
Education	16,088.3	16,317.3	229.0
Protection and Safety	13,308.7	13,534.7	226.0
Transportation	4,605.0	4,658.0	53.0
Natural Resources	905.2	919.2	14.0
Total	48,912.5	49,916.5	1,004.0

FTE Change From Prior Year by Area of Government
 FY 2004 - FY 2005

GENERAL FUND

Area of Government	FY 2004 FTE <i>Budgeted</i>	FY 2005 FTE <i>Recommended</i>	FY 2005 FTE <i>Change</i>
General Government	2,800.5	2,809.5	9.0
Health and Welfare	5,620.9	6,067.3	446.4
Inspection and Regulation	724.3	726.3	2.0
Education	15,712.4	15,939.4	227.0
Protection and Safety	11,770.6	11,984.6	214.0
Transportation	2.0	2.0	0.0
Natural Resources	425.4	439.4	14.0
Total	37,056.1	37,968.5	912.4

FTE Change From Prior Year by Area of Government
 FY 2004 - FY 2005

OTHER APPROPRIATED FUNDS

Area of Government	FY 2004 FTE <i>Budgeted</i>	FY 2005 FTE <i>Recommended</i>	FY 2005 FTE <i>Change</i>
General Government	1,566.3	1,578.8	12.5
Health and Welfare	2,189.6	2,200.7	11.1
Inspection and Regulation	1,103.7	1,104.7	1.0
Education	375.9	377.9	2.0
Protection and Safety	1,538.1	1,550.1	12.0
Transportation	4,603.0	4,656.0	53.0
Natural Resources	479.8	479.8	0.0
Total	11,856.4	11,948.0	91.6

■ FY 2005: new FTE positions

FTE totals were adjusted to reflect only programs that were newly funded or eliminated in FY 2005. Thus, information presented here may differ from individual agency operating budget recommendations and from tables in other sections of the Executive Recommendation. The specific adjustments are detailed below, by agency.

The Executive Budget provides an aggregate increase of 1,017.0 FTE for all budget units, the majority concentrated in specific, high-priority programs of State government. The increases are necessary to:

- ensure that CPS has the personnel necessary to protect Arizona’s children;
- adequately staff Arizona’s prisons;
- respond to student growth at Arizona’s public universities; and
- handle growing caseloads at AHCCCS eligibility determination offices.

Following is an itemized listing, by agency, of the Executive’s recommendation for increased FTE positions:

Economic Security,
 Dept. of 361.5 FTE
361.5 FTE for CPS caseworkers, Job Opportunities and Basic Skills personnel, long-term care caseworkers, and attorney staffing

Corrections, Dept. of 276.0
276.0 FTE to restore last year’s legislative reductions and to staff programs aimed at reducing recidivism.

Universities 227.0
175.4 FTE at Arizona State University’s campuses and 47.6 FTE at the University of Arizona’s campuses to accommodate enrollment growth; and 4.0 FTE at Northern Arizona University to expand the nursing program

AHCCCS 78.0
78.0 FTE for eligibility staff to meet caseload growth

Transportation, Dept. of 53.0
53.0 FTE to improve port-of-entry operations, highway maintenance, MVD customer service, and registration/ insurance enforcement

Public Safety, Dept. of 20.0
20.0 FTE for highway patrol officers

Health Services, Dept. of 16.0
16.0 FTE for child care licensure surveyors and new State lab operations

State Land Department 14.0
14.0 FTE for inmate fuel treatment crews

Administration, Dept. of 12.5
12.5 FTE to facilitate the move to self-insurance for medical coverage

Commerce, Dept. of 7.0
7.0 FTE to enhance rural economic assistance, support business innovation and recruit California-based businesses

Veteran’s Services, Dept. of 4.0
4.0 FTE for additional benefits counselors and fiduciary program personnel

Naturopathic Physicians Board 3.0
3.0 FTE for licensure and inspection related to the newly created Massage Therapy Board

Agriculture, Dept. of 3.0
3.0 FTE for the egg inspection program to meet an increased demand for service

State Banking Department 2.0
2.0 FTE for financial institution examiners

Corporation Commission 2.0
2.0 FTE to reflect a funding shift from outside services to personal services and employee related expenses

State Treasurer 2.0
2.0 FTE to establish long-term local government investment pools

Education, Dept. of 1.0
1.0 FTE for a Certification Investigator

Commission for Postsecondary Education 1.0
1.0 FTE to manage the financial responsibilities of the Family College Savings Plan Trust

Board of Executive Clemency (1.0)
Reduction of (1.0) FTE to combine chair and executive director positions

Juvenile Corrections, Dept. of (65.0)
Reductions of (44.0) FTE due to population decline and (21.0) FTE to move the parole violator center

FY 2005 Executive Recommendation: FTE Growth Breakdown

FY2005 Executive Recommendation- FTE Growth Breakdown

Initiative / Agency	FY2004 Appropriation	Population, Enrollment, or Caseload Requirements	Loss of Other Funding Source	Statutory, Court, Other Mandated Obligation	Annualization	General Fund Savings	Pay Parity	Executive Initiative	FY2005 Executive Recommendation
AHCCCS	1,409.3	78.0		(13.8)					1,473.5
Dept. of Corrections	10,025.4			287.0		(29.0)		18.0	10,301.4
Dept. of Economic Security	2,389.3	58.5		130.0	173.0				2,750.8
Dept. of Health Services	1,476.4			14.8				15.0	1,506.2
Univ. of Arizona-Main Campus	5,461.5	44.5							5,506.0
Arizona State Univ.-Main Campus	6,016.0	133.7							6,149.7
Northern Arizona Univ.	2,060.7						4.0		2,064.7
Univ. of Arizona-Health Sciences Ctr	639.2	3.1							642.3
Arizona State Univ.-West Campus	655.0	41.7							696.7
State Land Department	174.4							14.0	188.4
Department of Commerce	64.9							7.0	71.9
All Other Agencies	6,684.0	(41.0)	0.0	7.0	1.0	(34.1)	0.0	0.0	(67.1)
	37,056.1	318.5	0.0	425.0	174.0	(63.1)	4.0	54.0	37,968.5
Percent of growth over base		0.86%	0.00%	1.15%	0.47%	-0.17%	0.01%	0.15%	
Percent of overall growth		34.9%	0.0%	46.6%	19.1%	-6.9%	0.4%	5.9%	

Proposed legislative changes

The following changes are a prerequisite for successfully implementing the Executive Budget Recommendation

ISSUE	CITATION	COMMENT
Department of Administration		
Surplus Property Management	<i>A.R.S. § 41-2606</i>	The Executive recommends that the “Due to Other Funds” portion of the Surplus Property Management Program budget be given non-appropriated status.
Bus Subsidy Funding	<i>A.R.S. §§ 41-101.03 and 49-588</i>	ADEQ and ADOA have agreed to provide an additional \$100,000 to administer the bus subsidy portion of the State Employee Travel Reduction program. The Executive recommends \$100,000 be transferred from the Clean Air In Lieu Fee Account (in the Air Quality Fund).
AHCCCS		
Change Outpatient Hospital Reimbursement	<i>A.R.S. § 36-2903.01(H)(3)</i>	Hospital Outpatient services are reimbursed by AHCCCS on a cost-to-charge ratio. Currently, hospitals statewide receive an average of about 34% of their billed charges to AHCCCS for outpatient services. However, there are no controls on how much the hospitals can charge. The Executive recommends the payment methodology be changed to an established fee schedule to better contain hospital outpatient service costs.
County Acute Care Contribution	<i>Laws 2003, Chapter 265, §§ 44 and 45</i>	There are two session laws related to County Contributions for Acute Care services within AHCCCS totaling \$73.1 million. The Executive recommendation continues the Acute Care County Contribution at this level.
Disproportionate Share Hospital Payments: Amend FY 2003-2004 Appropriation	<i>Laws 2003, Chapter 262, Section 7 (General Appropriations Act for FY 2003-2004)</i>	The Executive recommends that the FY 2004 Disproportionate Share Hospital payments be increased from \$136.9 million to \$154.6 million and provides for changes to county operated hospitals from the level assumed in the General Appropriations Act (Supplemental Appropriations Bill provision).
County Expenditure Limitations: Disproportionate Share, FY 2004-2005	<i>Similar to Laws 2003, Chapter 265, Section 48; also complies with the requirements of Arizona Constitution, Article IX, Section 20</i>	The Executive recommendation directs the Economic Estimates Commission to increase the base limit for FY 2005 for each county that received a Disproportionate Share Hospital payment by the base limit it was decreased in FY 2004.
County Expenditure Limitations, Disproportionate Share Payments: FY 2004-2005 Adjustment Formula	<i>Similar to Laws 2003, Chapter 265, Section 47; also, Arizona Constitution, Article IX, Section 20(3)(f)</i>	The Executive recommendation directs the Economic Estimates Commission to decrease the base limit in the calculation of the county expenditure limits of each county in which the county hospital receives State and federal Disproportionate Share Hospital Program payments in FY 2005.
Disproportionate Share Hospital Payment: FY 2004-2005	<i>Modify General Appropriation Act footnote</i>	The Executive recommendation establishes the FY 2005 Disproportionate Share Hospital payments to be \$141.4 million and provides guidance on the level of payments to private hospitals, county operated hospitals and the Arizona State Hospital.

ISSUE	CITATION	COMMENT
County Withholdings for the Disproportionate Share Hospital Program: FY 2004	<i>Laws 2003, Chapter 265, Section 46</i>	The Executive recommends increasing withholdings from \$78 million to \$95.8 million to reflect increased Disproportionate Share Hospital Program payments resulting from the federal Medicare Reform Act.
County Withholdings for the Disproportionate Share Hospital Program: FY 2005	<i>Laws 2003, Chapter 265, Section 46</i>	The Executive recommendation establishes FY 2005 county withholdings of Transaction Privilege Tax revenue sharing payments to affected counties for the Disproportionate Share Hospital Program to be \$82.6 million.
Health Care Group Administrative Costs	<i>A.R.S. §§ 36-2912(H)(3) and 36-2913(C)(8)</i>	The Executive recommends changing current statute to allow AHCCCS Health Care Group administrative costs to be based on 6% of premiums paid. As the program grows, administrative costs will not need to be appropriated from the Donations Fund.
Maricopa & Pima Counties ALTCS Contributions	<i>A.R.S. § 11-292</i>	The ALTCS statutes require the State to pay 50% of the costs associated with ALTCS program growth in each county. However, for the past two fiscal years Maricopa and Pima counties have been responsible for 100% of their growth. The Executive recommendation assumes this continued funding through FY 2005.
KidsCare Parents Program Continuation	<i>A.R.S. § 36-2981.01 (retained-repealed effective 6/30); A.R.S. § 36-2983 (restore parents language within)</i>	This program is legislated to end June 30, 2004. The Executive recommendation would continue it through FY 2005 and beyond.
County Hold Harmless	<i>Modify General Appropriations Act footnote</i>	The county hold-harmless appropriation is in session law that ends after FY 2004. The Executive recommendation continues the appropriation.

Arizona Historical Society

Fees	<i>A.R.S. § 41-823(B)</i>	The Arizona Historical Society's FY 2004 budget included a funding decrease of (\$290,000). The Society was expected to recoup this reduction by instituting admission fees. The Society has begun charging admission fees to its museums; however, statute precludes the Society from charging fees for access to other collections, such as the library. The Executive recommends amending this statute to give the Society the flexibility to implement these fees if the Board deems it necessary.
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Attorney General

Interagency Service Agreements	<i>Modify General Appropriation Act footnote</i>	The General Appropriations Act included a footnote that appropriated an additional \$370,000 and 5.0 FTE positions from the Interagency Service Agreements Fund for new or expanded interagency service agreements. The Executive recommends expanding the amount by \$430,000 and 6.0 FTE positions for a total of \$800,000 and 11.0 FTE.
Collection Enforcement Revolving Fund	<i>A.R.S. § 41-191.03</i>	In FY 2005, the Executive recommends continuing language from Laws 2003, Chapter 263, Section 90 which allowed the Attorney General to use monies in the collection enforcement revolving fund for operating expenses.

State Board for Charter Schools

Charter School Sponsorship	<i>Laws 2003, Chapter 264, Section 20.</i>	The Executive recommends that the State Board of Education's (SBE) transferred responsibilities of charter school sponsorship, which occurred in FY 2004, remain with the State Board for Charter Schools (SBCS) in FY 2005. New statutory language must be added to allow the moratorium on SBE charter school sponsorship to continue into FY 2005, as well as to allow the SBE to contract with the SBCS for the oversight of the charters that were transferred from SBE to SBCS in FY 2004.
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ISSUE	CITATION	COMMENT
Community Colleges		
Community College Funding Formulas	<i>A.R.S. §§ 15-1464, 15-1466, and 15-1468.</i>	For FY 2005, the Executive recommends a notwithstanding clause for the formula statutes for Community College Operating State Aid, Capital Outlay State Aid, and Equalization Aid and specify that the amounts shall be the amounts appropriated in the General Appropriations Act.
Department of Corrections		
Probation Violations: Intermediate Sanctions	<i>A.R.S. §§ 13-709 and 13-901</i>	If a probationer violates the terms of probation but does not commit a new felony, the Executive recommends that the courts be allowed to impose intermediate sanctions, defined as “a term of imprisonment in a State prison of up to 180 days.” Intermediate sanctions may include risk and need assessments to address the causes of the probation violations and to develop supervision and service strategies that reduce the likelihood that probation will be revoked or that the probationer will reoffend.
Inmate Health Care: AHCCCS Rates	<i>New Session Law</i>	If an inmate requires health care services that the Department of Corrections or a private provider that contracts with the Department cannot provide, the Executive recommends that the Department pay for services from a provider such that the amount owed by the Department does not exceed the rates used by AHCCCS plus 55%.
Schools for the Deaf and Blind		
Excess Voucher Funds	<i>Modify General Appropriations Act footnote</i>	The Executive recommends that the General Appropriations Act footnotes that allow the Arizona School for the Deaf and the Blind to expend endowment and non-endowment monies in excess of its appropriation for the Arizona Schools for the Deaf and the Blind be updated to reflect FY 2005 projected amounts.
Department of Economic Security		
Spinal & Head Injuries Trust Fund	<i>Modify General Appropriation Act footnote</i>	The amount in the following footnote needs to be updated to \$2,478,100: “All spinal and head injuries trust fund receipts received by the department of economic security in excess of \$2,379,000 are appropriated to the independent living rehabilitation services special line item. Before the expenditure of any spinal and head injuries trust fund receipts in excess of \$2,379,000, the department of economic security shall submit the intended use of the monies for review by the joint legislative budget committee.”
Workforce Investment Act funds	<i>Modify General Appropriation Act footnote</i>	The amount in the following footnote needs to be updated to \$48,004,700: “All federal workforce investment act funds that are received by the state in excess of \$47,960,700 are appropriated to the workforce investment act programs special line item. Excess monies may not be spent until a proposed expenditure plan for the excess monies has been reviewed by the joint legislative budget committee.”
Department of Education		
School Accountability Fund	<i>A.R.S. § 15-241</i>	The Executive proposes that the School Accountability Fund be established permanently in statute to avoid end-of-year reconciliation issues that are caused due to the Fund’s status as a sub-account of the General Fund.
Teacher Certification Fund	<i>A.R.S. § 15-531</i>	The Executive proposes that the Teacher Certification Fund be established permanently in statute to avoid end-of-year fund reconciliation issues that are caused due to the Fund’s status as a sub-account of the General Fund.

ISSUE	CITATION	COMMENT
2% Inflation Increase	<i>A.R.S. §§ 15-185(B)(4), 15-901, and 15-945</i>	For FY 2005, the Executive recommends that amounts currently specified in statute for base level (including additional school day), transportation route mile funding and additional assistance for charter schools be adjusted to reflect the 2% inflation increase as required in A.R.S. § 15-901.01 and as approved by voters in Proposition 301.
K-12 Rollover	<i>New Session Law</i>	The Executive recommendation for FY 2005 to extend the existing \$191 million K-12 rollover and to add an additional \$100 million requires new session law to provide the following: (a) A.R.S. § 15-973 be notwithstanding; (b) defer \$291 million from the June 15, 2005, State Aid payment and a portion of the May 15, 2005, payment until July 1, 2005; (c) advance-appropriate \$291 million for the July 1 payment in FY 2006; and (d) allow for districts to recoup interest charges related to issuing warrants.
Basic State Aid: Reduction in Trust Land Earnings	<i>Modify General Appropriations Act Footnote</i>	The Executive estimates that FY 2005 income generated from the Permanent State School Fund will be \$48.5 million. The projected amount is (\$11.3 million) less than the FY 2004 appropriated levels. The decrease is due mainly to monies reserved to pay debt service on \$247.1 million in Deficiencies Correction revenue bonds issued by the School Facilities Board. A footnote that specifies the amount derived from the Fund for basic State support to school districts must be updated to reflect the new FY 2005 appropriation.

Department of Environmental Quality

Reduce Water Quality Assurance Revolving Fund Transfer from Corporate Income Tax	<i>A.R.S. § 49-282(B)</i>	The Executive recommendation reduces the amount transferred from the Corporate Income Tax. While A.R.S. § 49-282 provides that the WQARF receives \$15 million annually, for FY 2005 the recommendation decreases this amount by (\$5 million).
FY 2004: Operating Cost Reimbursement	<i>A.R.S. § 49-1051</i>	For FY 2004, the Executive recommends transferring \$500,000 from the Underground Storage Tanks (UST) State Assurance Account to the Water Quality Assurance Revolving Fund (WQARF) as reimbursement for expenditures incurred by WQARF for the Department's operations.
State Assurance Account	<i>A.R.S. § 49-1051(B)(2)</i>	In order for the Department to implement business improvements and investments in key environmental programs, the Executive recommends lifting the managerial restrictions found in A.R.S. § 49-1051 and authorizing the Department to use funds from the State Assurance Fund (SAF) to integrate the SAF and Underground Storage Tank (UST) databases into a single Oracle database, and to administer the UST leak prevention program and the used oil management, quality control and quality assurance program.

Board of Executive Clemency

Combine Executive Director and Chair Positions	<i>A.R.S. §§ 31-401 and 31-402</i>	As an efficiency savings, the Executive recommends combining the Chair and Executive Director positions at the Board of Executive Clemency.
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Department of Health Services

Restoration to Competency	<i>A.R.S. § 13-4512</i>	The Executive recommendation provides for the continued county contribution for restoration-to-competency costs at 86% of established costs and the deposit of proceeds in the Arizona State Hospital Fund.
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ISSUE	CITATION	COMMENT
Land Department		
Natural Resource Conservation District Funding	<i>Modify General Appropriation Act footnote</i>	Currently, the NRCs are funded from the Environmental Special Plate Fund, which will not be able to fully support the NRCs in FY 2005. The Executive recommends part of the funding — \$150,000 — be shifted to the General Fund. This footnote will allow the NRCs to maintain their current funding level by promoting the environmental special license plate.
State Parks Board		
State Lake Improvement Fund: State Operations	<i>A.R.S. § 5-382</i>	For FY 2005, the Executive recommends authorizing the Arizona State Parks Board to use up to \$700,000 from the State Lake Improvement Fund for parks operations. In FY 2004, the Legislature approved \$700,000 for State Parks operations from the Land Conservation Fund. The Governor vetoed this appropriation to protect the integrity of the Land Conservation Fund and to allow the utilization of the Fund for the purposes intended as approved by voters in the Growing Smarter Act.
Off-Highway Vehicle Recreation Fund: Use for Operation of Parks	<i>A.R.S. § 28-1176</i>	For FY 2005, the Executive recommends continuing a similar provision adopted in Section 74 of Laws 2003, Chapter 263, which allowed the Arizona State Parks Board to use up to \$692,100 from the OHV Recreation Fund for parks operations. This amount is due to prior funding shift from the General Fund to the OHV Recreation Fund.
Prescott Historical Society		
Admission Fees	<i>A.R.S. § 41-833(A)</i>	The Prescott Historical Society's FY 2004 and FY 2005 budgets included an aggregate funding decrease of (\$120,000). The Society was expected to recoup the reduction by instituting admission fees. However, A.R.S. § 41-833(A) precludes the Society from charging for admission. The Executive recommends amending the statute to allow the Society to collect admission fees.
Department of Public Safety		
HURF/Highway Fund DPS Expenditure Limits	<i>A.R.S. §§ 28-6537 and 28-6993</i>	In order to appropriate amounts recommended in the Executive budget, these two sections should be deferred in FY 2005.
CJEF Distribution to General Fund Redirected to Crime Lab Assessment Fund	<i>A.R.S. §§ 41-2401(D)(11) and 41-2415(C)</i>	The Executive recommends continuing the policy, from the last biennium, of redirecting to the Crime Laboratory Assessment Fund the 9% Criminal Justice Enhancement Fund distribution that normally would go to the General Fund.
Board of Regents		
Student Financial Aid Trust Fund	<i>A.R.S. § 15-1642</i>	Statute requires the General Fund to match Student Financial Aid surcharge fees collected for the Student Financial Aid Trust Fund. The Executive is not recommending the increase in funding required by statute but is recommending continuing the FY 2004 level of funding.
Department of Revenue		
Change Withholding Rates	<i>A.R.S. § 43-401</i>	The Executive recommends amending statute to change the percentage of federal withholding that is withheld for State purposes so that the dollar amount withheld by the State matches the pre-federal tax cut level.

ISSUE	CITATION	COMMENT
School Facilities Board		
Lease to Own Fund	<i>A.R.S. § 15-2004</i>	Beginning in FY 2004, the Executive recommends that the Lease to Own Fund managed by the School Facilities Board for financing new construction programs be modified to be a non-lapsing fund.
New Construction Lease to Own Authority	<i>A.R.S. § 15-2006</i>	In FY 2005, the Executive recommends an additional \$50 million in lease to own authority for the School Facilities Board for new school construction. Since current statute limits the School Facilities Board to \$200 million annually, a notwithstanding provision is needed to allow for the additional authority.
Deficiencies Correction Revenue Bonding	<i>New Session Law</i>	For FY 2005, the Executive recommends that, in lieu of a General Fund appropriation of \$100 million (advance appropriated in FY 2004), the School Facilities Board revenue bond for \$100 million for Deficiencies Correction. Statutory language is needed to authorize the bonding authority and to permit the use of these monies for the Deficiencies Correction program.
Suspend Building Renewal Formula	<i>A.R.S. § 15-2031</i>	The Executive recommends that the Building Renewal formula be suspended in FY 2005 pending the outcome of the settlement of the ongoing litigation concerning the Building Renewal program.
Department of Transportation		
Vehicle License Tax Distribution	<i>A.R.S. § 28-5808</i>	The Executive recommendation includes a transfer of \$118 million from the Vehicle License Tax to the General Fund in FY 2005.
State Compensation Fund		
State Compensation Fund	<i>New Session Law</i>	The Executive recommends any statutory changes necessary to implement the sale and leaseback of \$50 million in State assets to the State Compensation Fund.
Treasurer		
Justice of the Peace Compensation	<i>A.R.S. § 22-117(B)</i>	The Executive recommends maintaining the practice established in Laws 2003, Chapter 263 that the State pays 38.5% — instead of the statutory 40% — of the salary of each Justice of the Peace.
Long-term Local Government Investment Pools	<i>Adds section 41-177</i>	The Executive recommends statutory language providing for Long-term Local Government Investment Pools (LGIPs) established by the State Treasurer. The first \$500,000 in investment fees received by the State Treasurer from the LGIPs would be deposited in the newly established, non-appropriated Long-term Local Government Investment Pool Fund for the Treasurer's use. Any amounts received in excess of \$500,000 would be deposited in the General Fund.
Universities		
Optional Retirement System Appropriation Contribution Rate	<i>A.R.S. § 15-1628(C)</i>	The Executive recommends amending this statute to permit the appropriations to the Universities to include the Optional Retirement Plan contribution rate at 7% even when the ASRS contribution is lower.
Department of Water Resources		
Water Protection Fund	<i>A.R.S. § 45-2112</i>	There is a statutory appropriation of \$5 million from the General Fund for the Water Protection Fund. The Executive is not recommending this appropriation.
Water Resources Fund Shift	<i>A.R.S. §§ 45-615 and 45-1212.01</i>	The Executive recommends shifting some costs from the Water Banking Fund to the Conservation and Augmentation Fund and the Dam Repair Fund. Legislation is required to allow these Funds to be used for operations.



Capital Outlay

Maintaining the State's infrastructure

The FY 2005 Executive Budget provides for a number of necessary capital projects throughout Arizona

THE EXECUTIVE BUDGET recognizes the importance of capital projects to Arizona, even in challenging fiscal times.

■ Agency requests

State agency requests for Capital Outlay funding for FY 2005 total \$926.5 million, which includes \$642.5 million in General Fund requests and \$284.0 million in Other Appropriated Funds.

Agency capital requests from the General Fund include:

- \$514.8 million from the Department of Corrections (DOC);
- \$5 million from the Department of Administration (ADOA);
- \$3.5 million from the Universities;
- \$75.8 million from ADOA and the Universities' Building Renewal;
- \$15.2 million from the Department of Juvenile Corrections (DJC); and
- an aggregate \$26.6 million from the Department of Public Safety (DPS), Department of Economic Security (DES), Department of Health Services (DHS), and Arizona School for the Deaf and the Blind.

Other Fund requests consisted of:

- \$266.9 million from the Department of Transportation (ADOT), the majority of which is for highway construction;
- \$12.2 million total from the Department of Game and the Fish and the State Parks Board; and
- \$4.9 million from various funds for Building Renewal.

■ Building Renewal

The FY 2005 Executive Budget provides \$6,697,500 for Building Renewal, as outlined in TABLE I. Though no General Fund monies are recommended, the Executive proposes appropriating \$3 million from the Capital Outlay Stabilization Fund for ADOA Building Renewal. The Executive also recommends 2.0 FTE positions to supervise ADOA FY 2005 Building Renewal projects.

Additionally, the Executive recommends \$2 million from the State Highway Fund for Building Renewal for the ADOT Building System. The Executive recommends 100%

of Building Renewal formula funding for "Other Fund" agencies, including Game and Fish and the Lottery.

■ Department of Corrections

During the recent special session, Laws 2003, Second Special Session, Chapter 5 granted authority to ADOA to issue a Certificate of Participation (COP) for 1,000 beds. Due to the late nature of the Special Session, DOC was still studying the best expansion of beds as this document went to print, but the addition of 1,000 public level-one beds was the best estimate.

The Executive recommends the construction of 500 level-1 beds on the existing Perryville Prison site scheduled to open November 1, 2004, and another 500 level-1 beds on the existing Tucson Prison site scheduled to open on December 1, 2004. As soon as a definitive plan is completed, it will be forwarded to the Legislature for consideration.

■ Other Funds

As is detailed in TABLE I, several Game and Fish Department projects are recommended as part of the FY 2005 Executive Capital Outlay Budget. This agency has a dedicated source of funds that can be used solely for projects that support its mission.

Also, the DPS Highway Patrol Fund has one project for which monies from a similar revolving fund may be used.

The majority of the funding is recommended for ADOT for its Highway Construction program. The State Transportation Board has specific responsibility for establishing project priorities. Historically, the Legislature has provided a lump-sum appropriation for the statewide Highway Construction program.

Highway Patrol Fund

Remote Officer Housing..... \$360,000

Since FY1998 DPS has not received funding for replacement of trailers in which officers assigned to remote areas live. The Executive recommends replacement of three trailers in Ajo that were built in 1960, 1967 and 1971.

Game and Fish Fund

Game and Fish Facilities Improvements \$230,000

The Executive recommendation provides \$230,000 for facilities improvements to the Canyon Creek Fish Hatchery. This appropriation will allow the purchase of a clarifier to improve the

quality of water being discharged into Canyon Creek. The recommendation includes \$30,000 for preventive maintenance, emergency repairs, and safety issues such as fire alarm replacement.

Game and Fish Capital Improvement Fund

Bellemont Shooting Range Development\$800,000

The Executive recommendation provides \$800,000 to complete the first phase of the shooting range at Bellemont, near Flagstaff. This phase includes wildlife fencing, a public range, a trap and skeet range, and a pistol range. This project has been under development since 1995, in cooperation with the Northern Arizona Shooters Association, and has previously received \$1.5 million for fencing, road construction, and the main 50-station shooting range.

Lake Havasu Shooting Range\$300,000

The Executive recommends an appropriation of \$300,000 for a shooting range in the Lake Havasu area. With this appropriation and a previously appropriated \$300,000, the Department plans to provide perimeter fencing, gravel roads, utilities, and five shooting areas. The facility will include public, pistol, practical pistol, trap and skeet, and sporting clays ranges.

Deer Valley Headquarters Paving\$50,000

The Executive recommendation provides \$50,000 to pave the area around modular buildings at Deer Valley North headquarters. This project will help limit dust to comply with City of Phoenix air quality requirements.

Regional Office Shade Canopies.....\$150,000

The Executive recommendation provides \$150,000 for canopies that will provide covered storage for Department property and snow protection for employee vehicles.

Region VI Security System\$30,000

The Executive recommendation provides \$30,000 to install a security system for the Mesa Regional Office storage lot.

Silver Creek Hatchery Fence and Road Resurfacing\$80,000

The Executive recommendation provides \$80,000 to pave the roads and provide fencing to keep predators out of the Silver Creek fish hatchery.

Sierra Vista Shooting Range Improvements..... \$55,000

The Executive recommendation provides \$55,000 to improve water delivery and restroom facilities at the Sierra Vista Shooting Range.

State Highway Fund — ADOT Building System

Highway Construction.....\$85,581,000

The FY 2005 Executive Budget includes \$85.6 million for highway construction from the State Highway Fund.

Highway Construction, Controlled-Access.....\$67,939,000

The Highway User Revenue Fund (HURF) formula earmarks a specific percentage of funds for the construction of controlled access roads in Maricopa and Pima counties. The Executive recommends that the estimate of available monies be utilized for this purpose.

Debt Service.....\$86,863,000

The Executive recommends \$86.9 million for debt service payments associated with the issuance of revenue bonds.

State Aviation Fund — ADOT Building System

Airport Planning and Development\$21,000,000

The FY 2005 Executive Budget includes \$21 million for development and construction of State and local airports.

■ **Debt service**

The Arizona Constitution places a \$350,000 ceiling on the level of General Obligation debt that the State may incur. However, State government has relied on COPs and revenue bonds to fund numerous construction projects. TABLE II provides a summary of the projects that have been funded through debt instruments.

ADOT has the authority to issue up to \$1.3 billion in bonds against the Highway User Revenue Fund (HURF). The bond payments are enforceable only from HURF.

TABLE I

OTHER FUND CAPITAL OUTLAY

FY 2005 Recommendation

Building Renewal		Fund	Recommendation
	ADOA	COSF	3,000,000
	ADOT-Highway Fund	State Highway	2,000,000
	ADOT-Aviation	Aviation	65,900
	State Fair Board	Enterprise	1,247,400
	Game & Fish	Game and Fish	343,000
	Lottery	Lottery	41,200
		Subtotal Building Renewal	6,697,500
Capital Projects			
DPS	Remote Officer Housing	Highway Patrol Fund	360,000
Game & Fish	Facility Improvements	Game and Fish Fund	230,000
Game & Fish	Bellemont Shooting Range Development	G&F CIP Fund	800,000
Game & Fish	Lake Havasu Shooting Range	G&F CIP Fund	300,000
Game & Fish	Deer Valley Headquarters Paving	G&F CIP Fund	50,000
Game & Fish	Regional Office Shade Canopies	G&F CIP Fund	150,000
Game & Fish	Region VI Security System	G&F CIP Fund	30,000
Game & Fish	Silver Creek Hatchery Fencing and Road	G&F CIP Fund	80,000
Game & Fish	Sierra Vista Shooting Range Improvements	G&F CIP Fund	55,000
ADOT	Airport Planning and Development	State Aviation	21,000,000
ADOT	Highway Construction	State Highway	85,581,000
ADOT	Controlled-Access Highways	State Highway	67,939,000
ADOT	Debt Service	State Highway	86,863,000
		Subtotal Capital Projects	263,438,000
		Total FY 2005 Other Funds	270,135,500

TABLE II
COPs AND REVENUE BONDS

	<i>Original Issue</i>	<i>FY05 Payment</i>	<i>Outstanding Balances 7-1-03</i>
Systems with General Fund Involvement			
<i>ADOA Building System COP's</i>			
2000 IDA (PLTO)	89,775,000	5,309,500	89,775,000
2001 IDA (PLTO)	29,895,000	1,642,700	29,895,000
1993B	31,250,000	2,526,400	18,265,000
2001A	56,480,000	9,126,600	55,225,000
2002A	63,270,000	4,607,700	57,680,000
2002B	75,295,000	7,716,700	75,295,000
Subtotal	345,965,000	30,929,600	326,135,000
<i>BOR-University Research Infrastructure*</i>	367,200,000	-	367,200,000
<i>SFB School Construction</i>			
Lease-to-Own	372,730,000	33,393,300	372,730,000
Bonds	820,000,000	65,884,700	750,685,000
Subtotal	1,192,730,000	99,278,000	1,123,415,000
General Fund Subtotal	983,403,400	56,913,800	966,237,000
Systems Entirely Other Fund			
<i>Board of Regents Lease Purchase</i>			
University of Arizona - Various	325,530,000	22,547,600	225,610,000
Arizona State University - Various	298,931,000	13,217,500	269,983,000
Subtotal	624,461,000	35,765,100	495,593,000
<i>Board of Regents Revenue Bonds</i>			
University of Arizona - Various	333,289,300	23,526,200	304,856,200
Arizona State University - Various	165,990,000	28,370,100	138,830,000
Northern Arizona University - Various	116,620,000	12,575,700	101,645,000
Subtotal	615,899,300	64,472,000	545,331,200
<i>Department of Transportation</i>			
Board Funding Obligations (BFO's)	200,000,000	-	200,000,000
Grant Anticipation Notes (GAN's)	182,295,000	54,400,900	169,145,000
HURF Bonds	1,159,345,000	97,510,000	932,700,000
Subtotal	1,541,640,000	151,910,900	1,301,845,000
General Fund	983,403,400	56,913,800	966,237,000
Other Funds	3,516,269,400	270,696,500	3,018,209,600
Federal Funds	188,222,500	54,745,300	175,072,500
Total	4,687,895,300	382,355,600	4,159,519,100

*The universities have not yet issued this debt, the first \$183.6 million is expected to be issued in May/June 2004. The first payment is expected from the GF in FY 2008.

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