Report of the Legislative Budget Committee to the 2016 Kansas Legislature

CHAIRPERSON: Representative Ron Ryckman

VICE-CHAIRPERSON: Senator Ty Masterson

OTHER MEMBERS: Senators Jim Denning and Laura Kelly; Representatives Jerry Henry, Marvin Kleeb, and Sharon Schwartz

STUDY TOPIC

The Legislative Budget Committee is statutorily directed to:

- Compile fiscal information, study and make recommendations on the state budget, revenues and expenditures, the organization and functions of the State, its departments, subdivisions and agencies with a view of reducing the cost of state government and increasing efficiency and economy.

Additionally, the Committee is assigned to:

- Oversee the Statewide Efficiency Study contract authorized by 2015 House Sub. for SB 112.

January 2016

Legislative Budget Committee

Report

Conclusions and Recommendations

The Committee recommends the consultant firm of Alvarez and Marsal Public Sector Services be retained to complete the Kansas Statewide Efficiency Study.

Proposed Legislation: None.

Background

The Legislative Budget Committee is statutorily directed to compile fiscal information. It also is directed to study and make recommendations on the state budget, revenues, expenditures, and the organization and functions of the state, its departments, subdivisions, and agencies with a view of reducing the cost of state government and increasing efficiency and economy.

The Committee's intention was to gather information to gauge where the State stands financially concerning consensus estimates and to formulate ideas for the remaining six months of Fiscal Year (FY) 2015 and going forward into FY 2016.

The Committee was also charged in House Sub. for SB 112 (L. 2015, Ch. 104) with developing a scope statement, drafting a request for proposal, soliciting bids, and negotiating a contract for a Kansas Statewide Efficiency Study. The legislation exempted the legislative and judicial branches of government. The Legislative Coordinating Council was charged with approving the final contract.

Committee Activities

The Committee met August 3, September 17, September 18, and November 9, 2015, to review fiscal information regarding revenues and expenditures and to specifically discuss the revenue estimates and what components comprise the state tax revenue, humans services caseloads, and review proposals for the efficiency study.

State Budget, Revenues, and Expenditures

Legislative Adjustments to Consensus Estimates for FY 2015

Kansas Legislative Research Department (KLRD) staff presented an overview of the legislative adjustments to the Consensus Estimates for FY 2015 through FY 2017 memorandum. The adjustments reflect the fiscal impact of legislation enacted during the 2015 Legislative Session subsequent to the April 20, 2015, Consensus Revenue Estimates. The estimated receipts increased by $1.3 billion for the combined years of FY 2015, FY 2016, and FY 2017. Net transfers increased by $18.7 million attributable to the reduced transfer from the State General Fund (SGF) for bioscience initiatives and transfers from the SGF to the School District Extraordinary Need Fund. The adjusted baseline for FY 2015 was $5.9 billion. The FY 2016 adjustments included revenue from the combined tax package. The SGF increase in total receipts for FY 2016 was $384.4 million. The combined tax package for FY 2017 was estimated to increase the SGF receipts by approximately $404.8 million.

Also noted were the low-income inclusions tax beginning in FY 2016, which generally eliminates all taxable income for wage earners of

$5,000 or less per year filing a single tax return and $12,500 or less per year filing a joint tax return. A review of tax amnesty also was included.

SGF Receipts FY 2015

KLRD staff provided an overview of the SGF receipts for FY 2015. Total receipts for FY 2015 were $15.6 million below the adjusted estimate, which included legislation enacted after the April 20 Consensus Revenue Estimate. The attributable factors were lower-than-estimated retail sales and corporate income taxes. Estimates increased for insurance premium and liquor enforcement taxes. Revenue estimators will continue to closely monitor the sales tax rate increase and base sales and use tax receipts.

Staff stated the actual June 2015 receipts totaled $5.9 billion. Concern was expressed for the public's perception regarding shortfalls within the state budget projections. It was noted revenue estimates are based on current law. April estimates were based on current law and the sales tax increase was not factored into the revenue estimates, though included in the legislative adjustments memorandum. Concern was expressed regarding behavioral changes of the consumer and the impact on state revenue including consumer internet and out-of-state purchases. Staff noted a 3.75 percent long-term sales tax growth rate has been used in projections for a number of years.

MCO Privilege Fee

Staff provided a brief overview of 2015 Senate Sub. for HB 2281 (L. 2015, Ch. 98), which created the Medical Assistance Fee Fund and increased the annual privilege fees paid by every health maintenance organization (HMO) for the reporting period beginning January 1, 2015, and ending December 31, 2017, from 1.0 percent per year to 3.31 percent per year of the total of all premiums, subscription charges, or any other term that may be used to describe the charges made by such organization to enrollees. The privilege fees collected or received by the Insurance Commissioner from July 1, 2015, through June 30, 2018, from HMOs, including the three KanCare Managed Care Organizations (MCOs), and Medicare provider organizations for fees specified in law are to be deposited in the Fund to be expended for Medicaid medical assistance payments only. On and after January 1, 2018, the privilege fee will be 2.0 percent. This adjustment results in a savings of $48 million after adjustments to fund Medicaid and newborn screening programs and the special revenue fund.

Other SGF Impacts

KLRD staff provided an overview of the FY 2015 to FY 2016 SGF reappropriations by agency. The total reappropriation for FY 2016 was $16.3 million, which reflects SGF dollars not spent in FY 2015 and that would be carried over to FY 2016.

Staff stated this amount would reflect additional expenditures in FY 2016. The approved budget was $6.3 billion, which would increase expenditures by $16.3 million. It was noted the reappropriation amount was less than the amount in past years, which in part is due to the timing of receipts for payment. The reappropriation of funds does not reflect reduced funding to agencies, as the payments are authorized.

Staff also provided an overview of the FY 2016 SGF Expenditure Reduction and Fund Transfer Plan. This information reflects the Governor's adjustments to the approved budget with SGF expenditure reductions of $38.4 million and revenue transfers to the SGF in the amount of $24.1 million for a total of $62.6 million. Of this amount, $17.7 million will be revised in the FY 2016 budget to reflect the federal match for the State Children's Health Insurance Program. The revenue transfer of $1.9 million for the Performance Incentive Grants was line-item vetoed and will not be reduced through allotment authority. This line item was included in the Governor's $50 million reduction plan. The revenue transfers to the SGF total $24.1 million. The total SGF reductions and transfer amount is $62.6 million. It was noted legislation passed authorizing additional flexibility for the Governor, but there was no requirement for a reduction of $50 million to the approved budget.

SGF Receipts Current Fiscal Year

KLRD staff provided an overview of the SGF receipts. The total SGF receipts from taxes for July and August were approximately $35 million below estimates, with the largest reduction being in corporate taxes due to High Performance Incentive Program refunds. The individual income tax was down approximately $1.4 million; however, the first-quarter receipts should reflect a better projection. Another area of concern was the severance tax, which was $2.5 million lower than projected, due to lower prices for gas and oil, which may be ongoing. Insurance premium taxes were lower than projected, with an unanticipated refund of approximately $2.5 million. The positive net transfers were due to actions taken by the Governor increasing transfers into the SGF.

KLRD staff provided an overview of the SGF Profile for FY 2014–FY 2017. This reflects the Governor's revenue adjustments, reappropriation, expenditure adjustments, and cost savings. The ending balance for FY 2015 is $71.5 million, and the estimated ending balances are $77.9 million for FY 2016 and $189.5 million for FY 2017.

KLRD staff also provided an update on the current SGF receipts after the new November revenue estimates. The total SGF receipts through November were above the estimates by $14.6 million, or 0.6 percent. The component of SGF receipts from taxes only was $8.1 million, or 0.4 percent, above the estimate. Staff noted a large portion of the estimated $384.4 million in additional FY 2016 receipts attributable to tax law changes is not expected to materialize until the later part of FY 2016. In addition, staff noted the November estimates lowered the expected tax receipts for FY 2016 by $181.2 million.

After the November estimates were released, KLRD staff provided an update of the SGF Profile for FY 2014–FY 2017. This reflects the Governor's revenue adjustments, reappropriation, expenditure adjustments, and cost savings as well as the Governor's November reductions of $105.4 million. The ending balance for FY 2015 is $71.5 million, the FY 2016 ending balance is estimated at $5.6 million, and there is an estimated zero balance for FY 2017.

SGF Revenue Estimate

KLRD staff reported on the SGF Revenue Estimate for FY 2016 and FY 2017. It was noted the revenue shortfall was due mainly to the decrease in sales tax revenues and not income tax reductions. The overall estimate for FY 2016 and FY 2017 was decreased by a combined $353.6 million.

For FY 2016, the estimate was decreased by $159.1 million, or 2.5 percent, below the previous estimate made in April and subsequently adjusted for the legislation enacted in the 2015 Session. The revised estimate for $6.166 billion is 4.0 percent above the final FY 2015 receipts.

The revised estimate for FY 2017 is $6.286 billion, which is $194.5 million, or 3.0 percent, below the previous estimate. The amount of total taxes is estimated to increase by 2.8 percent in FY 2017, following a 5.7 percent increase in FY 2016.

Governor's November Allotment Plan

A representative from the Kansas Division of the Budget explained the allotment plan released on November 6, which included budget cuts and fund transfers to close the $118 million shortfall in the projected budget. The plan included $56.9 million in additional Kansas Department of Transportation transfers and a Children's Initiative Fund Encumbrance Change under the special authority afforded under 2015 Senate Sub. for HB 2135 (L. 2015, Ch. 103).

Under the Governor's regular allotment authority, the plan included a reduction of $25.1 million for revised Medicaid estimates, a reduction of $15.7 million for revised KPERS K-12 estimates, and a reduction of $11.8 million in other various transfers and adjustments.

The plan also calls for an additional $14.3 million in transfers to the SGF in FY 2016, which will be included in a rescission bill for the 2016 Session.

Human Services Caseloads

KLRD staff explained the human services caseload impacts detailed in the Fall 2015 Human Services Consensus Caseload Estimates for FY 2016 and FY 2017.

The FY 2016 estimate for human services caseload expenditures is $3.0 billion, including $1.1 billion from the SGF. The estimate is an all-funds increase of $48.9 million and a SGF increase of $16.6 million above the FY 2016 approved amount.

The estimate for Temporary Assistance for Families caseloads is the same as the FY 2016 approved amount. The number of individuals estimated to receive cash assistance benefits from the Temporary Assistance for Needy Families program is expected to continue to decline due to a combination of lower applications for assistance and an increase in the rate of denials of the applications.

The estimate for foster care in FY 2016 is an increase of $6.8 million from all funding sources and a decrease of $3.5 million from the SGF. The increase from all funding sources is attributable to an increase in the anticipated number of children in the foster care system above the spring estimate and an increase in the contracted rates. The spring estimate also included $12.0 million from the SGF for cash flow issues associated with not receiving federal Title IV-E funding. The Department for Children and Families indicated a settlement with the federal Administration for Children and Families on this issue was anticipated to resolve the cash flow issue, resulting in SGF savings.

For the Department of Corrections, expenditures for out-of-home placements for FY 2016 are estimated to be $18.9 million from all funding sources, which is the same as the approved amount.

The FY 2016 estimate for Kansas Department for Aging and Disability Services (KDADS) Non-KanCare is an increase of $2.0 million, including $700,000 from the SGF, above the amount approved by the 2015 Legislature. The revised estimate reflects the transfer of expenditures for State Hospital Assessments from the KanCare to Non-KanCare portion of caseloads beginning January 1, 2016. The estimate also reflects increased costs for nursing facility fee-for-service expenditures.

The FY 2016 estimate for KanCare Medical is $2.8 billion from all funding sources and $988.6 million from the SGF. The new estimate is higher than the approved FY 2016 amount by $40.1 million from all funding sources and $19.4 million from the SGF. For the Kansas Department of Health and Environment (KDHE), the KanCare Medical estimate is $2.1 billion from all funding sources, including $702.5 million from the SGF. The KDADS' KanCare caseload estimate is $708.4 million from all funds, including $284.8 million from the SGF. The KanCare Medical estimate for the Department of Corrections is $2.9 million from all funds, including $1.3 million from the SGF.

The increase for KanCare Medical is attributable to an estimated slight growth in population and capitation rates, continued increases in costs associated with the Affordable Care Act Insurers Fee included in the capitation rates (except for long-term care services and supports which are excluded from the federal requirements), scheduled increases in Medicare buy-in payments (the estimate was made prior to the change at the federal level to modify the increased amount), and costs associated with new drugs for treatment of high cholesterol and cystic fibrosis. The reduction in the KDADS KanCare estimate and increase in the KDHE KanCare estimate continues to reflect refinements made in the allocation to each agency based on additional experience and actual data on the type of medical services needed by consumers in those populations.

The FY 2017 estimate for human services caseload expenditures is $3.0 billion, including $1.1 billion from the SGF. The estimate is an all-funds increase of $82.2 million and a SGF increase of $30.8 million above the FY 2017 approved amount. The base Medicaid matching rate determined by the federal Centers for Medicare and Medicaid Services decreased the required state share by 0.02 percent between FY 2016 and FY 2017. The estimated impact of this adjustment in FY 2017 is $554,415 less from the SGF required for KanCare caseload expenditures.

The FY 2017 estimate for the Temporary Assistance for Needy Families program is an all-funds decrease of $523,068 and a SGF increase of $303,093 for FY 2017. The number of families anticipated to receive services is expected to decrease at a faster rate than projected in the spring. The addition of SGF expenditures is needed to account for an anticipated federal penalty regarding two-parent work participation rates in those receiving services through the program.

The estimate for foster care is an increase of $6.7 million, including $6.2 million from the SGF, for FY 2017. The increase is attributable to an increase in the anticipated number of children in the foster care system above the spring estimate and an increase in the contracted rates.

For the Department of Corrections, expenditures for out-of-home placements for FY 2017 are estimated to be $18.9 million from all funds, which is the same as the approved amount.

The FY 2017 estimate for KDADS Non-KanCare is an increase of $2.1 million, including $800,000 from the SGF, above the amount approved by the 2015 Legislature. The revised estimate reflects a full year of expenditures for State Hospital Assessments in the KDADS Non-KanCare portion of caseloads, which had previously been reflected in KDADS KanCare. The revised estimate also reflects increased costs for nursing facility fees for services.

The FY 2017 estimate for KanCare Medical is $2.8 billion from all funding sources and $1.0 billion from the SGF. The new estimate is higher than the FY 2017 approved amount by $73.9 million from all funding sources and $23.4 million from the SGF. For KDHE, the KanCare Medical estimate is $2.1 billion from all funds, including $735.0 million from the SGF. The KDADS' KanCare caseload estimate is $633.8 million from all funds, including $275.0 million from the SGF. The KanCare Medical estimate for the Department of Corrections is $2.7 million from all funds, including $1.2 million from the SGF.

The increase for KanCare Medical is attributable to an estimated slight growth in population and capitation rates, continued increases in costs associated with the Affordable Care Act Insurers Fee included in the capitation rates (except for long-term care services and supports which are excluded from the federal requirements), scheduled increases in Medicare buy-in payments (the estimate was made prior to the change at the federal level to modify the increase amount), and costs associated with new drugs for treatment of high cholesterol and cystic fibrosis. The reduction in the KDADS KanCare estimate and increase in KDHE KanCare continues to reflect refinements made in the allocation to each agency based on additional experience and actual data on the type of medical services needed by consumers in those populations.

The funding mix for the medical programs is also affected by the implementation of the MCO privilege fee, which increased from 1.0 percent to 3.3 percent. The funds are deposited in the new Medical Assistance Fee Fund to be used for Medicaid funding, which then lessens the SGF needed for caseloads.

University of Kansas Capital Improvements Central District Development

A representative from the University of Kansas reported on the capital improvements for the Central District Development Project at the University of Kansas. The estimated cost of the total project would be in the range of $325 million to $350 million. The staff noted Malott and Haworth Halls were designed and built in another era, and they cannot house modern science educational and research activities. There is an increased demand for science and lab classes with the increase in the number of pharmacy and engineering students. The Central District Development Project includes:

- Integrated science building;
- Residence hall;
- Apartment-style student housing building;
- New student union facility;

- New parking garage; and

- New central utility plant.

The representative responded to concerns that tuition would be increased to pay for the project. Out-of-state and international student enrollment and efficiency savings would pay for the project, and tuition fees would rise only at the normal rate. Staff noted total efficiency savings were estimated at $7.5 million dollars. Staff reported the old student union would be demolished, Malott Hall would be re-purposed for another use, and the science building would be converted into classrooms.

KPERS Valuation Update

Staff from the Kansas Public Employees Retirement System (KPERS) presented an overview of the 2014 actuarial valuation, which is a snapshot of the financial condition of the Retirement System as of December 31, 2014. The actuarial valuation was estimated to be $15.662 billion. Actuarial assets are calculated by "smoothing" investment gains and losses over a five-year period. An estimated $660 million in deferred gains could be realized in the outlying years. Due in large part to investment gains over the past three years, the funding status has improved for all membership groups (KPERS state, school, and local groups; Kansas Police and Firemen's Retirement System; and Judges' Retirement System). The unfunded actuarial liability for the entire system decreased in 2014 by $298 million, leaving $9.468 billion remaining to be funded. The funded ratio increased from 59.5 percent in 2013 to 62.3 percent in 2014. Legislative reforms enacted in 2012, including increased employer and employee contributions, will continue to improve funding. Assuming all actuarial assumptions are met in the future, KPERS will be fully funded at the end of the amortization period in calendar year 2031. The valuation does not include the proceeds of the recently issued pension obligation bonds, which will be included in the 2015 actuarial valuation report.

Efficiency Study

The 2015 Legislature appropriated $3.0 million, in House Sub. for SB 112 (L. 2015, Ch. 104), to enter into a contract with a professional consulting service to assist in the review of state government. The Legislature stated such review and evaluation shall include examining state agency core functions, procedures, and efficiencies which may result in the consolidation of state agencies and functions, resulting in an overall reduction in expenditures and reporting to the Senate Ways and Means Committee and House Appropriations Committee on or before January 1, 2016, on its findings.

On August 3, 2015, the Committee discussed the timeframe for the efficiency study and determined there would be 10 days for communication of interest, 5 days for questions, 5 days for responses, 15 days for proposal presentations, and a final approval date of October 1, 2015. KLRD staff provided an overview of the request for proposal (RFP) process and provided the draft RFP for the efficiency study to the Committee. The Committee determined the RFP would be posted on the KLRD website and the closing date for the RFP would be September 11, 2015.

The Committee reviewed the RFP and amended the RFP to have the legislative liaison report to the Legislative Coordinating Council; set the deadline for completion of the study as January 1, 2016; exclude city and county governments from the scope statement; include school districts within the scope of the study; and make other technical corrections.

On September 17, 2015, the Committee heard public overviews from three consultants who bid on the RFP to perform the efficiency study: Boston Consulting Group, McGladrey, and Deloitte Consulting.

The Committee entered into executive session for the purpose of discussing confidential and trade secret data regarding the proposals from the three consultants. The Committee held separate executive sessions for each consultant at which only the Committee members and the members of the consulting firms were present.

On September 18, 2015, the Committee heard the public overview from Alvarez and Marsal Public Sector Services. The Committee then entered into executive session for the purpose of discussing confidential and trade secret data of Alvarez and Marsal.

After the executive session, staff from KLRD and the Office of Revisor of Statutes briefed the Committee on further details of the RFP. The First Assistant Revisor stated the cost proposal components of the consultant proposals are confidential and sealed until the the proposals are reviewed. The cost proposals will be open to the public after a consultant is selected. The Chairperson indicated he would release the confidential price proposals to the Committee after the merits of the various proposals were discussed.

The Assistant Director for Fiscal Affairs briefed the Committee on the selection process, stating it is a two-phase process. The first phase is review of the technical proposals from the consultants. The second phase is review of the cost proposals. The bidders would be evaluated based on their experience, statement of finances and integrity, organizational staffing, and methodology of their analysis.

The Committee discussed the proposals, complimenting all four consultants on the quality of their submissions. The Chairperson requested Committee members rank the bids based on the technical proposal.

The Committee selected Alvarez and Marsal Public Sector Services to begin negotiations with over its proposal. The Committee stated this selection was made based on effective communications skills of the consultant, willingness to confer with groups who may be impacted by the study, and demonstrated knowledge base on specific state programs.

On November 9, 2015, Alvarez and Marsal provided a status update to the Committee. The consultant indicated the company would submit a preliminary report to the Legislature on December 16, 2015. The areas of focus are the Department of Transportation, Medicaid and social services, the Department of Education, the procurement process, the Office of Information and Technology Services, the Department of Corrections, the Department of Commerce, state employee group health insurance, and the State's revenue and tax collections processes. The consultant indicated the data collection process was almost complete.

Conclusions and Recommendations

Following its review, the Committee recommends Alvarez and Marsal be retained for purposes of the efficiency study.