

MINUTES OF THE SENATE COMMITTEE ON WAYS AND MEANS.

The meeting was called to order by Chairperson Stephen Morris at 10:30 a.m. on January 22, 2002 in Room 123-S of the Capitol.

All members were present except: All present

Committee staff present:

Ben Barrett, Director, Kansas Legislative Research Department
Alan Conroy, Chief Fiscal Analyst, Kansas Legislative Research Department
Debra Hollon, Kansas Legislative Research Department
Martha Dorsey, Kansas Legislative Research Department
Audrey Nogle, Kansas Legislative Research Department
Julian Efird, Kansas Legislative Research Department
Robert Waller, Kansas Legislative Research Department
Trevor Steinert, Kansas Legislative Research Department
Carolyn Rampey, Kansas Legislative Research Department
Norman Furse, Revisor of Statutes
Michael Corrigan, Assistant Revisor of Statutes
Theresa Kiernan, Assistant Revisor of Statutes
Judy Bromich, Assistant to the Chairman
Mary Shaw, Committee Secretary

Conferees appearing before the committee:

Stephen McElhaney, William M. Mercer, Incorporated
Dr. Kim A. Wilcox, Executive Director, Kansas Board of Regents
Dan Hermes, DCCCA, Incorporated (written testimony)
Kay McFarland, Chief Justice, Supreme Court of Kansas (written testimony)
Duane A. Goossen, Director, Division of the Budget
Charles E. Simmons, Secretary, Department of Corrections

Others attending: See attached list

Bill Introductions

Senator Feleciano moved, with a second by Senator Jordan, to introduce two bills requested by the Department of Social and Rehabilitation Services. The first bill would allow the Department of Social and Rehabilitation Services to use additional tools to manage continually increasing drug costs (1rs1371) and the second bill would authorize the Department of Social and Rehabilitation Services to fix and collect fees from parents or other legally responsible individuals for services the Department provides to their children (1rs 1582). Motion carried on a voice vote.

Chairman Morris mentioned that the Senate Ways and Means Subcommittee Assignments were distributed to the Committee members (Attachment 1).

Chairman Morris welcomed Stephen McElhaney of William Mercer, Incorporated, who presented the Actuarial Audit of the Kansas Public Employees Retirement System (KPERs) Executive Summary (Attachment 2). The purpose of the audit was to perform an independent verification and analysis of the assumptions, procedures and methods used by Milliman USA in preparing the valuation. Mr. McElhaney noted in his testimony that based upon a thorough review of the December 31, 2000, actuarial valuation report, William Mercer, Inc., was pleased to report that they found the work to be reasonable and performed in accordance with generally accepted actuarial principles and practices. A copy of the full report from the William Mercer, Inc., Actuarial Audit of the Kansas Public Employees Retirement System, January 2002 is attached (Attachment 3). Committee questions and discussion followed.

Regarding the three areas of Mortality Assumptions listed on page 3 of the testimony, Senator Barone requested that these areas be quantified so as to know how substantial of a shortfall this is or not.

CONTINUATION SHEET

Chairman Morris noted that the end of January would be the end of the contract period with William Mercer, Inc., and inquired if they would obtain this information or if the KPERS actuary should obtain this information. Mr. McElhaney mentioned that they would need to look into it. Chairman Morris thanked Mr. McElhaney for appearing before the Committee.

Chairman Morris opened the public hearing on:

SB 386 – KPERS funding of unfunded obligations of certain benefits of employees of regents' institutions for prior service

Staff briefed the Committee on the bill.

Chairman Morris welcomed Dr. Kim Wilcox, Executive Director, Kansas Board of Regents, who spoke in favor of **SB 386**. Dr. Wilcox mentioned that **SB 386** deals with the TIAA KPERS transfer and he explained a couple of points in regard to the state universities. Dr. Wilcox mentioned that the proposed bill would move approximately \$5.8 million dollars out of the university budgets along with the commitment against those funds. Dr. Wilcox expressed concern and thought that this is an important consideration regarding the actual timing piece. The second point related to the cluster of changes that they are trying to effect at the Board of Regents among all 36 institutions, primarily the state universities. He mentioned that the Board has proposed, and they are all moving ahead with, an operating grant format for the state universities. He noted that to be true to an operating grant philosophy, any reduction in cost whatever the source, the perspective should be part of that operating grant as well. No written testimony was provided. Committee questions and discussion followed.

The Chairman closed the public hearing on **SB 386**.

Bill Introduction

Chairman Morris welcomed Ben Barrett, Director, Kansas Legislative Research Department, who explained proposed school finance law amendments pertaining to the Contingency Reserve Fund and Local Option Budget determinations (Attachment 4). Committee questions and discussion followed. Senator Adkins moved, with a second by Senator Huelskamp, to introduce a bill concerning school districts; relating to school finances (1rs1684). Motion carried on a voice vote. Senator Feleciano and Senator Schodorf requested to be recorded as voting "No."

Chairman Morris opened the public hearing on:

SB 385 – Supplemental appropriations and adjustments for FY 2002 for state agencies

Staff briefed the Committee on the bill.

Chairman Morris mentioned that written information was received regarding **SB 385** from Kay McFarland, Chief Justice, Supreme Court of Kansas (Attachment 5) and Dan Hermes, DCCCA, Inc. Lobbyist (Attachment 6).

Duane A. Goossen, Director, Division of the Budget, appeared before the Committee to express the Governor's opposition to **SB 385** which reduces the current year State General Fund budget (Attachment 7). Director Goossen further explained that the FY 2002 budget was already adjusted during a very long wrap-up session last Spring. He noted that the Governor believes the approved FY 2002 budget is inadequate, especially in the area of education, and should not be lowered further.

Senator Kerr asked that Director Goossen remind the Committee of some easy measures that were taken two years ago. Director Goossen explained that two years ago, at the beginning of the legislative session, reductions were agreed upon in state agency budgets which was approximately a 1-1/2 percent recision. Senator Kerr requested that agencies that receive a significant amount of money from sources other than the State General Fund be looked at and calculate what portion it would be of the State General Fund.

CONTINUATION SHEET

Charles E. Simmons, Secretary, Department of Corrections, appeared before the Committee in opposition to **SB 385** (Attachment 8) . Secretary Simmons noted that reductions of this magnitude made in this manner would represent a retreat from sound correctional policy and practice in the state. This would continue in FY 2003, since the reductions would be more than twice the level that would occur under the Governor's current resources budget.

Committee questions and discussion followed. Chairman Morris thanked all conferees for appearing before the Committee and stated that the hearing on **SB 385** would be continued the following day, Wednesday, January 23, 2002. The Chairman said that the Committee would try to meet in the Old Supreme Courtroom, Room 313-S, for the next meeting.

The meeting was adjourned at 12:15 p.m. The next meeting is scheduled for January 23, 2002.

**SENATE WAYS AND MEANS COMMITTEE
GUEST LIST**

DATE January 22, 2002

NAME	REPRESENTING
Paul N. Klotz	Assoc. of CMHCs of KS, Inc
Mike Hammond	Assoc. of CMHCs of KS
Glenn Deck	KPERs
Pat Beckham	Milliman USA
Bob Tolan	KS Contractors Association
Diane Gierstad	Wichita Public Schools
Ed De Soignie	Heavy Constructors Assn.
Meaghan Janning	Keys for Networking
Jane Adams	Keys for Networking
Darryl Winston	Keys for Networking
Mark Tallman	KASB
Craig Grant	HNEA
Bill Hougill	Governor's office
Bob Harder	UMC-KS
Sarah Payne	Hein + Weir
Kyle Smith	KBI
John Josseland	KY
Barbara Belcher	Merck
Mito Hattley	Pharmacia
Sally Finey	Ks. Public Health Assn.
Josie Torres	Present
DERL TROFF	PMB

**SENATE WAYS AND MEANS COMMITTEE
GUEST LIST**

DATE January 22, 2002

NAME	REPRESENTING
Shawn W. Hennessey	Greater KC Chamber of Comm.
Marsha Strahm	CMAA of Mo.
Christi Stewart	KS motor carriers assoc.
Shannon Jones	SILCK
Bruce Van Slyke	K4A
Rebecca Good	KS Dept of Agriculture
Stu Westerland	KS Chapter, NASW
John Pinegar	Washburn University
Scott Heidner	Kansas Consulting Engineers
Don Repoe	S.E.A.K.
Jay Arnold	Coalition For Independence
Dody Smith	K.A.P.E.
Tom Conant	KDOR
Kathleen Forde-Prick	KNASW student
Sheila Graham	Community Colleges
Charles Simmons	Dept. of Corrections
Heimse Axt	USA / USD #500
Jan Braske	KSC
Sheli Sweeney	Ks Dept on Aging
Keith Haxton	SEAK
Rosie Ingram	Kansas Dept of Transp
Robert Haley	KDOT

SENATE WAYS AND MEANS COMMITTEE

GUEST LIST

DATE 1/22/02

NAME	REPRESENTING
Nancy Bogina	KDOT
Nicole Atkins	Lt Gov. Office
HELBY SMITH	City of Topeka
Troy Smith	Intcn-Sen. Umbarger
Julie Thomas	DOB
Jacque Doleed	SQE
Bob Vancouver	Bree Valley USD 229
KATH WILB	SACK
Jeanne Abraham-Henry	Self-Advocate Coalition of KS
Bill Watts	KDOT
Dale Huffman	Families Together
Jerry Sloan	Judicial Branch
Jason Wesco	Kansas Legal Services
Gerald Schneider	KDHR
Dennis Taylor	
Carolyn Spindelorf	Ks St Ns Assn
Doug Farmer	KNOA
Conie Thuesen	KDOA
Diane Duffy	SRS
Janet Schalansky	SRS
Dusan Mahony	Gov's Office
Jane Rhys	KCAD

**SENATE WAYS AND MEANS
SUBCOMMITTEE ASSIGNMENTS**

	<u>Subcommittee</u>	<u>Analyst</u>	<u>Final Committee Action</u>
<u>Legislative and Elected Officials</u>			
Legislative Agencies	<u>Salmans</u>	Conroy	February 6
Governor	Downey	Robinson	February 6
Lt. Governor			
Attorney General		Rampey	February 6
Secretary of State		Steinert	February 6
Insurance Commissioner		Krahl	February 6
State Treasurer		West	February 6
Health Care Stabilization Fund Board of Governors		Krahl	February 6
<u>Aging</u>			
Department on Aging	<u>Adkins</u> Jackson Feleciano	Nogle	February 7
<u>SRS—Hospitals</u>			
Larned State Hospital	<u>Morris</u>	Krahl	February 11
Osawatomie State Hospital	Adkins		
Rainbow Mental Health Facility	Jordan		
Parsons State Hospital	Schodorf		
Kansas Neurological Institute	Feleciano		
<u>Department of Administration/KCC</u>			
Department of Administration (Including Public Broadcasting)	<u>Adkins</u> Salmans Downey	Robinson	February 12
Governmental Ethics Commission	<u>Salmans</u>	Steinert	February 12
Human Rights Commission	Barone	Krahl	February 12
Kansas Corporation Commission		Chapman	February 12
Citizens Utility Ratepayer Board			
<u>Department of Education</u>			
	<u>Kerr</u> Jordan Salmans Schodorf Barone	Rampey	February 13

Senate Ways and Means
1-22-02
Attachment 1

	<u>Subcommittee</u>	<u>Analyst</u>	<u>Final Committee Action</u>
<u>Capital Improvements</u>	<u>Morris</u> Jordan Barone	Staff	February 14
<u>Other Education</u>			
School for the Blind	<u>Adkins</u>	Steinert	February 18
School for the Deaf	Schodorf		
Historical Society	Barone	Rampey	February 18
Kansas Arts Commission		Krahl	February 18
State Library			
<u>SRS</u>			
Department of SRS	<u>Morris</u> Adkins Jordan Schodorf Feleciano	Nogle	February 19
<u>Kansas Guardianship Program</u>	<u>Huelskamp</u> Feleciano	Krahl	February 20
<u>KPERS Budget</u>	<u>Kerr</u> Adkins Downey	Efird	February 21
<u>Judicial</u>			
Judicial Council	<u>Morris</u>	Rampey	February 22
Board of Indigents' Defense Services	Schodorf		
Judicial Branch	Barone		
<u>Public Safety</u>			
Topeka Juvenile Correctional Facility	<u>Jordan</u>	Kramer	February 26
Beloit Juvenile Correctional Facility	Huelskamp		
Atchison Juvenile Correctional Facility	Feleciano		
Larned Juvenile Correctional Facility			
Juvenile Justice Authority			
Ombudsman for Corrections	<u>Huelskamp</u>	Dorsey	February 26
Parole Board	Jordan	Waller	February 26
KBI	<u>Jordan</u> Jackson Barone	Waller	February 26

	<u>Subcommittee</u>	<u>Analyst</u>	<u>Final Committee Action</u>
EMS Sentencing Commission	<u>Jackson</u> Downey	Waller	February 26
Fire Marshal Highway Patrol Adjutant General (including Civil Air Patrol)	<u>Morris</u> Downey	Waller	March 5
<u>Health and Environment/Human Resources</u>			
Department of Health and Environment	<u>Adkins</u> Schodorf Downey	Hollon	March 6
Department of Human Resources	<u>Huelskamp</u> Jackson Barone	Steinert	March 6
Veterans Affairs/Soldiers' & Veterans' Home Homestead Property Tax	<u>Jackson</u> Feleciano	Steinert	March 6
<u>Agriculture</u>			
Department of Agriculture Animal Health Dept Kansas State Fair	<u>Morris</u> Huelskamp Downey	Kramer	March 7
Conservation Commission Water Office Wildlife and Parks	<u>Jordan</u> Jackson Downey	Kramer Efird	March 7 March 7
<u>Transportation</u>			
	<u>Adkins</u> Salmans Feleciano	Waller	March 11
<u>Lottery/Racing and Gaming</u>			
Lottery Commission Racing and Gaming Commission	<u>Schodorf</u> Jordan Barone	Efird	March 13
<u>Fee Boards</u>			
Abstracters' Board of Examiners Board of Accountancy Board of Mortuary Arts Board of Pharmacy Board of Barbering	<u>Salmans</u> Huelskamp Jackson Barone	Steinert Steinert Waller Steinert Krahl	March 13 March 13 March 13 March 13 March 13

	<u>Subcommittee</u>	<u>Analyst</u>	<u>Final Committee Action</u>
Board of Cosmetology		Krahl	March 13
Board of Veterinary Medical Examiners		Kramer	March 13
Kansas Dental Board		Krahl	March 13
Board of Nursing		Dorsey	March 13
Board of Examiners in Optometry		Krahl	March 13
Real Estate Commission		Krahl	March 13
Real Estate Appraisal Board		Krahl	March 13
Bank Commissioner		Steinert	March 13
Department of Credit Unions		Steinert	March 13
Securities Commissioner		Steinert	March 13
Board of Technical Professions		Chapman	March 13
Behavioral Sciences Regulatory Board		Steinert	March 13
Board of Hearing Aid Examiners		Steinert	March 13
Board of Healing Arts		Krahl	March 13
<u>KPERS Issues</u>	<u>Kerr</u> Adkins Downey	Efird	March 15
<u>Corrections</u>			
Department of Corrections	<u>Kerr</u>	Dorsey	March 18
Topeka Correctional Facility	Jackson		
Norton Correctional Facility	Feleciano		
El Dorado Correctional Facility			
Winfield Correctional Facility			
Hutchinson Correctional Facility	<u>Jordan</u>	Dorsey	March 18
Larned Correctional Mental Health Facility	Huelskamp		
Lansing Correctional Facility	Barone		
Ellsworth Correctional Facility			
<u>Higher Education</u>			
KU	<u>Morris</u>	West	March 19
KSU	Adkins		
KSU -- Vet. Med	Jordan		
KSU -- Extension	Schodorf		
Wichita State University	Feleciano		
Board of Regents			
KUMC			
Emporia State University			
Fort Hays State University			
Pittsburg State University			
Regents Systemwide			

	<u>Subcommittee</u>	<u>Analyst</u>	<u>Final Committee Action</u>
<u>Commerce/Revenue</u> Department of Revenue	<u>Morris</u> Huelskamp Salmans Feleciano	Efird	March 20
Board of Tax Appeals	<u>Schodorf</u> Feleciano	Krahl	March 20
Department of Commerce and Housing Kansas Inc. Kansas Technology Enterprise Corporation	<u>Kerr</u> Jackson Downey	Hollon	March 20

Actuarial Audit of the Kansas Public Employees Retirement Systems

January 2002

Senate Ways and Means
1-22-02
Attachment 2

I. EXECUTIVE SUMMARY

Purpose and Scope of the Actuarial Audit Review:

William M. Mercer, Inc. was engaged by the Legislative Coordinating Council of the Kansas Legislature (on behalf of the Joint Committee on Pensions, Investments and Benefits of the Kansas Legislature) to conduct an actuarial audit of the December 31, 2000 actuarial valuation of the Kansas Public Employees Retirement System which was prepared by Milliman USA, consulting actuary to the System.

The primary purpose of the audit was to perform an independent verification and analysis of the assumptions, procedures, and methods used by Milliman USA in preparing the valuation. The valuation report reviewed covered the Kansas Public Employees Retirement System (KPERS), the Kansas Police and Firefighter's Retirement System (KP&F) and the Kansas Retirement System for Judges (Judges).

Statement of Key Findings:

Based upon a thorough review of the December 31, 2000 actuarial valuation report, we are pleased to report that we found the work to be reasonable and performed in accordance with generally accepted actuarial principles and practices. We found that the actuarial methods and assumptions are reasonable and appropriate and that the work was performed by fully qualified actuaries.

Audit Exceptions:

It is important to understand that in selecting and recommending actuarial methods and assumptions, there is a great deal of professional judgment involved. In making the above Statement of Key Findings, we have not attempted to substitute our judgment for that of the consulting actuary to the Fund. However, as a part of our review, we have identified a number of areas where KPERS and its consulting actuary should undertake further investigation or study. These areas are described under the "Comments" within each of the sections that follow this Executive Summary and are summarized below.

Actuarial cost methods: We believe that advantages would be derived by using a single actuarial cost method for all three systems.

Contribution lag period: The proposed “lag” between the valuation date and the start of the fiscal year for which actuarial contribution rates are applied is 30 months. We would prefer that this period be shorter.

Mortality assumptions: We have made a number of comments concerning the mortality tables used in the valuation:

- The mortality tables used for non-disabled KPERS retirees do not appear to provide for sufficient margin for future improvements in mortality. At some point, tables with lower mortality rates may need to be adopted and this will result in increased actuarial liabilities and actuarially determined employer contribution rates.
- The mortality tables used for disabled KP&F retirees are overstating the actual rates of mortality. Adoption of mortality more in line with plan experience would result in increased actuarial liabilities and actuarially determined employer contribution rates.
- The mortality tables used for active members overstate the mortality compared to plan experience. We recommend using tables appropriate for active members, although the effect on valuation results will probably be minimal.

Data review: We found a few inaccuracies with regard to Milliman’s use of KPERS membership data. However, these are relatively minor and do not have a material affect on valuation results.

Test cases review: We believe that the inactive vested liabilities of KP&F and KPERS are slightly overstated, based on an estimation methodology used by Milliman to recognize the liability associated with participants who are inactive vested members in one system, and active members in another system.

Actuarial Audit of the Kansas Public Employees Retirement System

January 2002

Senate Ways and Means
1-22-02
Attachment 3

Actuarial Audit of the Kansas Public Employees Retirement System

January 2002

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I. EXECUTIVE SUMMARY

Purpose and Scope of the Actuarial Audit Review:

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The primary purpose of the audit was to perform an independent verification and analysis of the assumptions, procedures, and methods used by Milliman USA in preparing the valuation. The valuation report reviewed covered the Kansas Public Employees Retirement System (KPERS), the Kansas Police and Firefighter's Retirement System (KP&F) and the Kansas Retirement System for Judges (Judges).

Statement of Key Findings:

Based upon a thorough review of the December 31, 2000 actuarial valuation report, we are pleased to report that we found the work to be reasonable and performed in accordance with generally accepted actuarial principles and practices. We found that the actuarial methods and assumptions are reasonable and appropriate and that the work was performed by fully qualified actuaries.

Audit Exceptions:

It is important to understand that in selecting and recommending actuarial methods and assumptions, there is a great deal of professional judgment involved. In making the above Statement of Key Findings, we have not attempted to substitute our judgment for that of the consulting actuary to the Fund. However, as a part of our review, we have identified a number of areas where KPERS and its consulting actuary should undertake further investigation or study. These areas are described under the "Comments" within each of the sections that follow this Executive Summary and are summarized below.

Actuarial cost methods: We believe that advantages would be derived by using a single actuarial cost method for all three systems.

Contribution lag period: The proposed “lag” between the valuation date and the start of the fiscal year for which actuarial contribution rates are applied is 30 months. We would prefer that this period be shorter.

Mortality assumptions: We have made a number of comments concerning the mortality tables used in the valuation:

- The mortality tables used for non-disabled KPERS retirees do not appear to provide for sufficient margin for future improvements in mortality. At some point, tables with lower mortality rates may need to be adopted and this will result in increased actuarial liabilities and actuarially determined employer contribution rates.
- The mortality tables used for disabled KP&F retirees are overstating the actual rates of mortality. Adoption of mortality more in line with plan experience would result in increased actuarial liabilities and actuarially determined employer contribution rates.
- The mortality tables used for active members overstate the mortality compared to plan experience. We recommend using tables appropriate for active members, although the effect on valuation results will probably be minimal.

Data review: We found a few inaccuracies with regard to Milliman’s use of KPERS membership data. However, these are relatively minor and do not have a material affect on valuation results.

Test cases review: We believe that the inactive vested liabilities of KP&F and KPERS are slightly overstated, based on an estimation methodology used by Milliman to recognize the liability associated with participants who are inactive vested members in one system, and active members in another system.

II. ACTUARIAL COST METHOD

Audit Conclusion:

The actuarial cost method meets applicable professional guidelines and requirements of state law.

Comments:

The actuarial cost method used by each of the three systems is described below:

KPERS:	Projected Unit Credit actuarial cost method
KP&F:	Aggregate actuarial cost method
Judges:	Frozen Entry Age actuarial cost method

The actuarial cost method for KPERS is specified by statute. For KP&F and Judges, the actuarial cost methods are adopted by the KPERS Board upon recommendation from the actuary.

All three of the actuarial cost methods are recognized methods that meet generally accepted actuarial principles and further meet professional standards covering their use for the types of benefits provided under each of these systems. In addition, all of these cost methods are in use at other state retirement systems. Mercer's most recent review of cost methods nationwide showed the following distribution of cost methods for state retirement systems:

Entry Age Normal:	70%
Projected Unit Credit:	13%
Aggregate:	10%
Frozen Entry Age:	7%

Clearly the Entry Age Normal Method is preferred by the majority of state government retirement systems. While the use of the other methods is reasonable, it makes comparisons to funding levels for other states less meaningful. It is not clear why different methods are used for each of the three Kansas systems. However, the use of a single cost method would allow for more comparability in the actuarial valuation results of the three systems.

Statutory limits are applicable with respect to the change in contribution rate from one fiscal year to the next fiscal year. For the State of Kansas, the maximum amount by which the contribution rate may increase from one fiscal year to the next is 0.20% of payroll. For employers other than the State, this maximum is 0.15% of payroll.

The actuarial valuation results are used for the fiscal year that begins in the second calendar year after the year of the valuation. For the June 30, 2000 valuation, the results will be applied for the fiscal year beginning July 1, 2002 and ending June 30, 2003, a "lag" of 24 months. For the December 31, 2000 valuation, it is currently expected that the results will be applied for the fiscal year beginning July 1, 2003 and ending June 30, 2004, a lag of 30 months.

In general it is preferable for the contributions to be based on a valuation as close as reasonably possible to the fiscal year. Most large governments will have some lag between the valuation date and the effective date of contribution rates due to the need to set budgets in advance. However, making contributions at a rate not based on the most current valuation can cause additional volatility in the contribution rates determined at the next valuation, unless valuation results are adjusted for the lag. In addition, the requirements of Government Accounting Standards Board (GASB) Statements 25 and 27 generally require valuation results to be applied with a lag period not exceeding 24 months. It should be noted that most of the preceding commentary on lag periods is academic for KPERS since the statutory limits on contribution rate increases are currently overriding the valuation results.

III. ACTUARIAL ASSET VALUATION METHOD

Audit Conclusion:

The actuarial asset valuation method meets applicable professional guidelines.

Comments:

The actuarial asset valuation method calculates the actuarial value of assets by recognizing one-third of the difference between the expected actuarial value of assets and the market value of assets. The expected value of assets is computed by adjusting the prior year actuarial value of assets by the actual receipts and disbursements of the fund and the assumed rate of return. This method is commonly called a "smoothing method" since it only recognizes a portion of the differences between actual and expected investment experience.

The use of a smoothing method to remove volatility in investment experience is very common for state retirement systems with over 90% of these systems using a method other than actual market value. Using a smoothing method mitigates the effect of short-term changes (market fluctuations) in the fair market value of plan assets. This produces a smoothing effect on the value of plan assets and thereby reduces the volatility of annual funding contribution requirements, thus making it easier to budget contributions and expense.

One disadvantage of the method in use for KPERS is that the actuarial value will not converge completely to market if the actuarial assumption is exactly realized. However, since it is unlikely that expected results will ever exactly equal assumed results over an extended period of time, this result is somewhat theoretical and does not affect our opinion regarding the acceptability of the method.

It is also common for an actuarial asset method to apply a corridor around actual market value in order that the actuarial asset value does not stray too far from actual market. For example, the method might specify a minimum actuarial asset value equal to 80% of market value and a maximum actuarial asset value equal to 120% of market value. Applying such a corridor would have no effect on the current valuation results since the actuarial value of assets at December 31, 2000 was within 1% of the actual market value.

IV. ACTUARIAL ASSUMPTIONS

Audit Conclusion:

The actuarial assumptions are reasonable on both an individual and aggregate basis.

Comments:

The current actuarial assumptions were adopted for the December 31, 2000 actuarial valuation based upon the results of a three-year experience study performed by Milliman USA and presented to KPERS in September 2001.

It must be recognized in the setting of actuarial assumptions that there is not one answer that reflects the best estimate of future experience. Rather there is a best-estimate range, within which reasonable assumptions lie. We believe all of the actuarial assumptions lie within this range. However, there are a number of areas in the analysis of actuarial assumptions where we have different opinions concerning the interpretation of the underlying experience data or different preferences with regard to the assumption selected. The comments which follow reflect these differing opinions or preferences.

Economic Assumptions:

Interest rate: The assumed actuarial interest rate is 8%, which is the same rate used in previous valuations. As a part of the experience study, Milliman tested this rate by projecting future returns using capital market assumptions set by KPERS' investment consultant combined with KPERS' current asset allocation policy. This projection resulted in a 50% probability that the long-term investment return, after expenses, would lie within 7.2% to 10.3%. The assumed rate of 8% falls within this range.

The methodology used by Milliman to justify the 8% interest rate follows the standards set forth in Actuarial Standard of Practice No. 27.

We also reviewed data concerning the interest rate assumption being used by other large public retirement systems. The *2000 Survey of State and Local Government Employee Retirement Systems*, published by the GFOA Research Center, indicated the average assumed interest rate for all systems was 7.9% and for systems with more than \$10 billion in assets the assumed rate was 8.1%. Therefore, the KPERS assumption of 8% is very near the average.

Salary increases: The current salary increase assumptions are based upon the results of the 1998-2000 experience study. The salary increase assumption is stated as the sum of the following:

- A general wage growth assumption of 4%, based upon an assumed inflation rate of 3.5% and a real wage growth of .5%.
- Increases in each individual's salary due to promotion or longevity, sometimes called the merit scale.

The general wage growth assumption was not changed as a result of the experience study.

For the merit scale, the rates were changed as follows for KPERS and KP&F:

- For KPERS, the rates were developed based upon years of service rather than age. Also separate rates were developed for State, School and Local, whereas previously a single set of rates applied to all three groups.
- For KP&F, rates were developed based upon years of service rather than age.

We agree that the salary assumptions are reasonable and also agree that the change to service-based rates is an improvement over the prior age-based rates.

Inflation assumption: The underlying inflation assumption for the actuarial interest rate and for salary increases is 3.5%. This was unchanged from the previous valuation. We believe that the assumption is reasonable.

Demographic Assumptions:

Death after retirement:

The following assumptions are used for post-retirement mortality:

Non-disabled retirement:

KPERS School:	1994 Group Annuity Mortality Tables for males and females with females set back one year
KPERS Non-school:	1994 Group Annuity Mortality Tables for males and females with males set forward two years and females set forward one year
KP&F:	1994 Group Annuity Mortality Table for males and females
Judges:	1994 Group Annuity Mortality Table for males and females

Disabled retirement:

KPERS School:	1994 Group Annuity Mortality Tables for males and females with males and females set forward twelve years
KPERS Non-school:	Same as KPERS School
KP&F:	Same as KPERS School
Judges:	Same as non-disabled mortality for Judges

Generally, a mortality assumption is conservative if the experience is resulting in more deaths than assumed. An actual to expected ratio of about 110% to 115% is desirable in order to allow for future mortality improvements. For KP&F the results of the 1998-2000 experience study are within this range. However, for KPERS, the actual to expected ratios are below 110%, although in most instances the ratios are over 100%. While this result indicates that the assumptions are a reasonable measure of current retiree mortality, the result also indicates that there is very little margin for future improvements in mortality. Milliman acknowledges in the experience study that this assumption may require adjustment but did not recommend a change since the assumption had just changed at the last experience study. If the next experience study produces similar results, then a change to a new mortality table may be warranted. It should be noted that such a change could cause a significant increase in plan liabilities and actuarially determined employer contributions.

For disabled retirees, it is common to assume a higher rate of mortality since disabled retirees are generally in poorer health than other retirees. For KPERS, the results of the experience study confirm this assumption. However, for KP&F, the actual to expected ratio for disabled retirees was only 71% for the period 1998-2000. This ratio indicates that mortality experience for disabled police and firefighters might not be as different from that for non-disabled retirees as it is for KPERS. This effect is frequently seen in public retirement systems in that the physical threshold for police and firefighter disability is lower than for general public employees. In turn, this results in a lower differential in mortality between disabled and non-disabled retirees. Milliman and KPERS should consider whether the mortality assumption for KP&F disabled retirees should be changed by reducing the number of years in the set forward. This will have the effect of increasing actuarial liabilities and employer contributions.

For Judges, the mortality experience was not measured due to the small size of the population. A standard mortality table has been selected and we agree that this is a reasonable approach.

Preretirement death: The assumption for death of active members is the same as for non-disabled retirees. For KPERS, the actual to expected ratios were only 59% indicating much lower mortality for active employees. This is a result generally observed in public employee retirement systems and many systems recognize this by adopting a separate mortality assumption for active employees. We recommend that KPERS and Milliman consider this after the next experience study, although the overall effect on valuation results will probably be minimal.

For KP&F the actual to expected ratio was 87%. While not as low as the ratio for KPERS, we believe that a separate active mortality table should be considered after the next experience study. Also, for KP&F an assumption is made that 70% of deaths are service related and we agree that this is a reasonable assumption.

For Judges, the mortality experience was not measured due to the small size of the population. A standard mortality table has been selected and we agree that this is a reasonable approach.

Termination rates: For KPERS, the results of the 2000 experience study for termination rates were presented in two ways. One set of results was based upon counts of terminated members and a second set was presented based upon liability weighting. In general, the results by count were very close to the assumed rates but when liability weighting was applied, the actual to expected ratios were generally under 100%. The liability weighted results indicate a need to lower turnover rates. However, Milliman recommended only minor reductions in rates in order to determine whether the lower rates observed will continue. We concur with this approach.

For KP&F, Milliman observed different results for Tier I and Tier II members and recommended splitting the termination assumption such that each group would have an assumption reflecting its own experience. We agree with this recommendation and believe that these assumptions are reasonable.

For Judges, no terminations are assumed and we believe that this is a reasonable assumption which is widely observed in other retirement systems covering judges.

Disability incidence: For KPERS, the 1998-2000 experience study showed actual to expected ratios very close to expected for state, school and local. Milliman also calculated separate actual to expected ratios for males and females. The results by gender indicated some need to develop gender specific disability incidence assumptions. However, Milliman was not comfortable that the results of this one experience study should be used to set different assumptions by gender and therefore recommended that this issue be deferred until the next experience study and that the current assumptions be retained. We agree with this recommendation.

For KP&F, the actual to expected ratio for disability was 63%. Milliman recommended that the assumption be changed to recognize part of this experience and we concur with this recommendation.

For Judges, there is no assumption for disability. This assumption is common for plans covering judges and we agree with this assumption.

Retirement rates: For KPERS, separate retirement rates are assumed for rule of 85 retirement, early retirement and normal retirement. Rates are also determined separately for the school, state, and local groups. Based upon the 1998-2000 experience study, a few modest adjustments were made to several of the retirement rates assumed.

For KP&F, Milliman recommended that a set of separate retirement rates be adopted for early retirement and normal retirement and further separated by Tier I and Tier II. These rates are a refinement from the prior assumptions which assumed that retirements would all occur based upon attainment of certain age and service requirements.

For Judges, an assumption that all judges retire at age 64 was recommended. This is revised from age 65 in the previous valuation.

We believe that all of the retirement rate assumptions are reasonable.

Probability of vested members leaving contributions with system: The 1998-2000 experience study indicated that, in general, fewer member than expected were leaving their contributions with the system upon termination. As a result Milliman recommended somewhat minor modifications to the assumption. We agree that the assumptions as recommended are reasonable.

Marriage assumption: An assumption is made that 70% of members in KPERS and Judges are married and 80% of members in KP&F are married. Also, for all three systems, it is assumed that male spouses are three years older than female spouses. These are somewhat standard assumptions and data is not available to test their validity. We agree that the assumptions are reasonable.

V. REVIEW OF ACTUARIAL REPORT

Audit Conclusion:

The actuarial report meets professional standards and fairly represents the actuarial condition of the system.

Comments:

The communication of actuarial valuation results for pension plans is covered in the Actuarial Standards Board (ASB) Standard of Practice No. 4, *Measuring Pension Obligations*. Generally, sufficient information should be presented such that:

- it would be properly interpreted and applied by the person or persons to whom the communication is directed, and
- another actuary in pension practice could form an opinion about the reasonableness of the conclusion.

Standard of Practice No. 4 also indicates specific requirements for content of actuarial reports including:

- The name of the person or firm retaining the actuary and the purpose of the report,
- An outline of the benefits being valued,
- The effective date of the calculation,
- A summary of participant data,
- A summary of asset information,
- A description of the actuarial methods and assumptions, and
- A statement of the findings, conclusions or recommendations necessary to satisfy the purpose of the communication

The actuarial report prepared by Milliman USA meets or exceeds all of the requirements of Standard of Practice No. 4.

VI. DATA REVIEW

Audit Conclusion:

The membership data used by Milliman USA December 31, 2000, actuarial valuation is consistent with the data provided by KPERS.

Comments:

Mercer requested and received the data file that KPERS provided to Milliman for the December 31, 2000 valuation as well as Milliman's actual valuation database.

We compared the data from three sources:

- the data provided by KPERS,
- the data in the Milliman valuation data file, and
- the data presented in the report.

The only differences we found are described below:

There were a number of records on the KPERS data file missing one or more data fields. These fields included date of birth, sex of the participant, and prior year salary. When data fields such as these are blank, the actuary must make an assumption of the value to use in the data field before including these participants in the valuation. We have determined that Milliman's selection of assumed data for valuation purposes is reasonable.

There were 1,131 active participants for whom the KPERS data had very limited information, most often showing only prior year salary, prior year contribution amount, and service as of the census date. The salary used in the valuation for these participants is 96% of the salary amount reported by KPERS, due to the methodology employed by Milliman in annualizing salaries for new entrants. With such limited information provided for these participants, it is difficult to know what the appropriate salary amount should be. However, an adjustment to reflect less than the reported salary is likely not intended. Since this represents only a slight understatement of the salary for less than 1% of the KPERS active population, this adjustment does not have a material impact on overall system liabilities.

The data supplied by Milliman showed that all beneficiaries currently receiving benefit payments (i.e. after the participant has died) were male. It appears this resulted from data being reported differently for this valuation than in the past; Milliman is aware of the issue and indicated they will modify their procedures accordingly. Since the valuation assumes that females will live longer than males, reflecting some beneficiaries as female will increase liabilities for beneficiaries by roughly 8-12%. Because only beneficiaries are affected, and not actives or retirees, the liability difference is less than 1% of the overall total and is not significant compared to the total liability of the systems.

We were able to match the participant counts shown on pages 13-15 (KPERS) and page 17 (Judges) of the Milliman actuarial report. For KP&F, there were two deferred disability participants who, according to Milliman, were valued with a liability but were not counted, and two other deferred disability participants who were not valued because of inconsistencies within the data provided by KPERS. These differences are not material to the valuation results.

We conclude that the data used for the actuarial valuation was accurate and reasonable.

VII. REVIEW OF ACTUARIAL COMPUTATIONS

Audit Conclusion:

Our review of the actuarial computations included the following:

- Review of the calculations presented in the actuarial report for consistency and accuracy. We found no material issues in our review.
- Reproduction of valuation results from the December 31, 2000 valuation. Our results are within reasonable tolerances of the valuation results performed by Milliman.
- Checking of test cases to determine whether plan provisions and actuarial assumptions were programmed properly. We recommend a minor revision to the way inactive vested benefits are valued for KPERS and KP&F. The current procedure results in a slight overstatement of liabilities.

Comments:

Review of the calculations presented in the actuarial report for consistency and accuracy

For this review, we mathematically checked a number of report exhibits for consistency within the exhibit and for consistency with other exhibits. Amortization amounts were checked, as were calculations of actuarial asset value. Some results presented in the December 31, 2000 valuation also provide comparisons to the results from the prior valuation as of June 30, 2000. We compared the prior valuation results shown in the December 31, 2000 report to those amounts shown in the June 30, 2000 report. All June 30, 2000 values were the same in each report except for the normal cost for the Judges plan, which was restated in April 2001.

The projected annual salaries of active members shown for the TIAA membership group (page 15 of the report) is actually a salary figure for all Board of Regents employees, and not just the active members eligible for benefits. The TIAA contribution rate shown in the report is 2.20% of total Board of Regents payroll (excluding group insurance). We believe that this distinction should be made more clear in the valuation report.

Table 11 in the report shows the KP&F employer additional contribution rates reflecting any unfunded past service liability or excess benefit liability for each employer. It is unclear why the total number of employees in this exhibit is larger than the total number of active employees shown elsewhere in the report for the KP&F system (6,332 versus 6,258). In any case, we do not believe this issue has a material effect on the employer additional contribution rates derived in this exhibit.

Reproduction of valuation results from the December 31, 2000 valuation

We have independently calculated the results of the December 31, 2000 valuation using the actuarial methods and assumptions described in the Milliman report. The actuarial valuation systems of each of the major actuarial firms contain certain inherent differences in the methodologies they use in performing the liability calculations. A typical standard is based upon a 5% corridor, i.e., results are considered to reasonably match when they are within $\pm 5\%$ in total. It is not unusual for particular ancillary benefits to be somewhat outside the 5% range.

As shown below, our results are within 5% of the results obtained by Milliman. We therefore conclude that the valuation results are reasonable and we have no reason to question their accuracy.

KPERS Present Value of Future Benefits	Milliman USA	Mercer	Ratio
Active employees			
Retirement	\$ 7,641,618,025	\$ 7,690,393,837	100.6%
Pre-retirement death	141,531,979	131,807,371	93.1%
Withdrawal	623,835,475	584,096,194	93.6%
Disability	286,112,670	280,441,570	98.0%
Total Active	8,693,098,149	8,681,863,079	99.9%
Inactive Vested	262,427,255	261,144,528	99.5%
Inactive Non-vested	45,638,269	45,639,466	100.0%
Deferred Disabled	175,894,829	170,176,661	96.7%
Retirees	3,885,819,520	3,913,263,275	100.7%
Beneficiaries *	146,527,915	147,790,244	100.9%
TOTAL excluding reserves	\$ 13,209,405,937	\$ 13,219,877,253	100.1%

KP&F Present Value of Future Benefits	Milliman USA	Mercer	Ratio
Active employees			
Retirement	\$ 833,679,742	\$ 815,885,096	97.9%
Pre-retirement death	21,978,440	21,775,676	99.1%
Withdrawal	30,853,336	29,610,547	96.0%
Disability	128,096,986	129,401,231	101.0%
Total Active	1,014,608,504	996,672,550	98.2%
Inactive Vested **	25,047,125	24,020,014	95.9%
Inactive Non-vested	7,138,740	7,138,609	100.0%
Retirees (incl. Disabled)	538,792,947	550,214,392	102.1%
Beneficiaries *	52,424,252	54,627,879	104.2%
TOTAL excluding reserves	\$ 1,642,555,880	\$ 1,632,673,444	99.4%

Judges Present Value of Future Benefits	Milliman USA	Mercer	Ratio
Active employees			
Retirement	\$ 80,558,146	\$ 80,195,251	99.5%
Pre-retirement death & withdrawal	2,632,832	2,673,631	101.5%
Total Active	83,190,978	82,868,882	99.6%
Inactive Vested	1,586,818	1,522,331	95.9%
Inactive Non-vested	104,992	104,993	100.0%
Retirees (incl. Disabled)	27,402,197	27,537,369	100.5%
Beneficiaries *	6,941,232	7,169,599	103.3%
TOTAL excluding reserves	\$ 119,226,217	\$ 119,203,174	100.0%

* Results shown are from the Milliman report as of December 31, 2000. The actual beneficiary liability would need to be recalculated to reflect actual beneficiary sex (see comment in Section VI).

** Amount shown in Milliman column differs from amount shown in December 31, 2000 report. The amount above has been recalculated to reflect a change in anticipated retirement date for some KP&F Tier 2 inactive vested participants, and was provided to us by Milliman. The change in data procedures was discovered by Milliman during the process of assisting in the matching valuation.

Checking test cases to determine whether plan provisions and assumptions were programmed properly

We requested from KPERS copies of actual benefit calculations that occurred shortly following the date of the actuarial valuation. We then requested test cases from Milliman for these same members. We would normally expect to see the benefit in the test case for the first year nearly identical to the actual benefit calculation. In general, we found the test case calculations to be consistent with the actual benefit calculations in our comparison.

We requested from Milliman test cases of inactive plan members with a wide range of benefit types, and test cases of active plan members selected from among various age and service combinations. Test cases were received from all groups (i.e., KPERS, KP&F and Judges). It is important to realize that test cases are carefully selected to check all of the plan provisions rather than being selected randomly. For the test cases of active plan members, our review included checking closely the projected benefits for each member (known as "benefit arrays") as well as a review of the actuarial present values computed from such benefit arrays.

In the course of reviewing inactive vested sample lives in the KP&F system, Milliman described their methodology for estimating benefits and liabilities related to inactive vested KP&F members who are active members in another part of the system, such as KPERS. This estimation is necessary because the KP&F benefit will be based on final average salary earned while employed in KPERS. We believe the methodology employed results in an overstatement of the inactive vested liabilities because the salary projection extends beyond the age at which the participant is assumed to retire under KP&F. It is difficult to determine an amount by which the KP&F inactive vested liabilities are overstated, but it is almost certainly less than \$2 million. The same methodology would also affect the inactive vested liabilities of KPERS, but the impact is likely smaller since KPERS retirement ages are generally later than those of KP&F. While we would recommend a refinement of the methodology such that the salary projection stops at the assumed retirement age, the overstatement is not material to the results of the overall valuation. (Note that Mercer's results for the inactive vested liabilities of KP&F and KPERS use the same methodology as that described to us by Milliman.)

We conclude that our review of the test cases supports our overall opinion concerning the reasonableness of the valuation results.

January 22, 2002

To: Senate Committee on Ways and Means

PROPOSED SCHOOL FINANCE LAW AMENDMENTS PERTAINING TO THE CONTINGENCY RESERVE FUND AND LOCAL OPTION BUDGET DETERMINATIONS

Contingency Reserve Fund

Current Law. KSA 2001 Supp. 72-6426 establishes the contingency reserve fund in each school district. This fund consists of money deposited in it or transferred to it according to law. The law authorizes transfers from only the school district general fund to the contingency reserve fund.

A district may transfer money from its general fund to the contingency reserve fund, subject to the limit that the amount in this fund may not exceed 4.0 percent of the amount of the general fund budget of the district in the current school year. However, if the amount in the fund exceeds the statutory cap due to a decrease in enrollment, the district may maintain the "excess" amount in the fund until the amount is depleted by expenditures from the fund.

Money may be spent from this fund for financial contingencies not anticipated at the time the general fund budget was adopted.

Proposed Amendments. The following changes would be made:

- The limitation that expenditures from the contingency reserve fund be only for financial contingencies not anticipated at the time the general fund budget was adopted would be removed. This would leave the spending decision entirely to the discretion of the school board. *This change would be permanent; that is, it would not apply only to the 2001-02 school year.*
- For the 2001-02 school year only, school district boards, on their own action (without petitioning the State Board of Tax Appeals), could issue no-fund warrants in order to provide revenue to offset the reduction in Base State Aid Per Pupil (BSAPP), subject to the following restrictions:
 - A tax levy would be imposed in the fall of 2002 to redeem, in full, the warrants.

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- The amount of warrants issued may not exceed the amount of the difference between the amount available in the district's contingency reserve fund and the amount lost to the school district's general fund budget due to any FY 2002 reduction in Base State Aid Per Pupil (BSAPP) below the statutory rate of \$3,870. Amounts in the contingency reserve fund must be expended for this purpose before no-fund warrants can be issued.
- The sum of amount of warrants issued, together with current balances in a district's contingency reserve fund, may not exceed the amount that would authorized by the 4.0 percent contingency reserve fund cap.
- The money produced upon issuance of no-fund warrants is credited to the school district general fund and is treated as a reimbursement for purposes of the school finance law.

Local Option Budget (LOB)

Current Law. Subject to various limitations, a school district may adopt a local option budget equal to 25.0 percent of its state financial aid, more commonly referred to as the district's general fund budget.

A school district's state financial aid is the product of BSAPP and the district's weighted enrollment.

Following is an example of what would happen to a school district using a 25.0 percent LOB in the 2001-02 school year if BSAPP were reduced from the current statutory rate of \$3,870 to \$3,831.

2001-02 SCHOOL YEAR

A. General Fund Budget				
<u>District Weighted Enrollment</u>	times	<u>BSAPP</u>	equals	<u>Budget</u>
2,584		\$3,870		\$10,000,080
LOB				
<u>LOB Percent Used</u>	times	<u>General Fund Budget</u>	equals	<u>LOB Amount</u>
25.0		\$10,000,080		\$2,500,020

B. General Fund Budget				
<u>District Weighted Enrollment</u>	times	<u>BSAPP</u>	equals	<u>Budget</u>
2,584		\$3,831		\$9,899,304
LOB				
<u>LOB Percent Used</u>	times	<u>General Fund Budget</u>	equals	<u>LOB Amount</u>
25.0		\$9,899,304		\$2,474,826

The \$39 BSAPP decrease in FY 2002 causes a reduction in the district's general fund budget of \$100,776. This, in turn, translates into a reduction in the district's LOB of \$25,194.

Proposed Amendment. The LOB law would be amended to authorize a school district to maintain its LOB for the current school year in an amount produced by applying a legally authorized LOB percentage based upon the statutory BSAPP rate in effect at the time of budget adoption. This would remove the prospect of a mandatory reduction in the LOB amount adopted by a school district due to application of a BSAPP decrease in a current school year. In other words, the district in this illustration would not lose the \$25,194 in LOB authority. *This change would be permanent; that is, it would not be limited to the 2001-02 school year.*



Supreme Court of Kansas

KAY MCFARLAND
Chief Justice

Kansas Judicial Center
Topeka, Kansas 66612-1507

(785) 296-5322

January 22, 2002

Senator Stephen Morris
Chair, Senate Ways and Means Committee
Room 120-S, Statehouse
Topeka, Kansas 66612

Dear Senator Morris:

I am writing in regard to Section 2 of SB 385, which provides current year supplemental funding for the Judicial Branch. I am pleased that, in your budget proposal, you and Senator Kerr have responded to the Judicial Branch's budget needs, and I appreciate your efforts. Many other members of the Senate Ways and Means Committee have been extremely supportive, and I appreciate their efforts as well.

The \$500,000 supplemental appropriation included in SB 385 represents that portion of the \$1.9 to \$2 million maintenance budget underfunding that remains after taking the following steps:

- imposing an across-the-board 60 to 90 day hiring freeze on all vacant positions;
- reducing funding for temporary hours by 25%;
- eliminating district magistrate judge travel from outlying districts into districts that do not have district magistrate judges;
- eliminating travel for Court of Appeals hearings, so that all hearings are held in Topeka; and
- imposing a local savings reduction on each district, which forced additional savings by either further reducing temporary hours or holding positions open beyond 60 to 90 days.

The steps noted above have been necessary, but they have been counterproductive to our need for accurate, thorough, and timely work in a judicial system already struggling with years of caseload growth and hiring freezes in eight of the past ten years. While I would expect our employees to bear with us during difficult budget times, the unfortunate fact is that the current budget cannot be viewed as an anomaly, as we have been chronically underfunded for years. Our employees have borne the brunt of the underfunding for years by struggling to do more and more work while many of the positions around them go unfilled due to lack of funding.

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Senator Stephen Morris
January 22, 2002
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Without the \$500,000 current year supplemental appropriation, the Judicial Branch will be forced to impose a minimum of three furlough days in the current year. It is difficult to imagine that, for lack of \$500,000, an entire branch of government could be shut down. However, a budget that is approximately 97% salaries and wages leaves few options; either there is funding to meet the payroll, or there is not.

If a three or more day furlough were necessary, the Judicial Branch had hoped to deal with the situation by giving approximately 60 days notice to our employees and by staggering the days so that employees would not have more than one day without pay per month. We are left with the difficult choice of taking some action now, which ultimately may be determined to have been unnecessary, or waiting to see if the supplemental appropriation will be enacted into law. If it is not and furlough days are not taken until May, Judicial Branch employees will see at least one day without pay in each of the last three pay periods remaining in the year after the Legislature adjourns.

I realize that SB 385 primarily addresses FY 2002 issues, but I would be remiss if I did not note that the Governor's original budget proposal for FY 2003 underfunds the Judicial Branch by \$3.6 million, which would result in an even more precarious fiscal situation than in the present fiscal year. I will have no choice but to pursue this funding from the 2002 Legislature at every opportunity.

Again, I appreciate your efforts to fund the Judicial Branch and to understand the budget issues we face. Please do not hesitate to contact me or my staff if any additional information would be helpful to you.

Sincerely,



Kay McFarland
Chief Justice

KMcF:mr

cc: Senate Ways and Means Committee Members

PUBLIC SOLUTIONS

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LEGISLATIVE TESTIMONY

TO: Chairman Steve Morris and Members of the Senate Committee on Ways and Means

FROM: Dan Hermes, DCCCA, Inc. Lobbyist

DATE: January 22, 2002

SUBJECT: Family Preservation Services (SB 385)

Mr. Chairman and Members of the Committee, my name is Dan Hermes and I represent DCCCA, Inc. based in Lawrence. DCCCA is the current contract provider for family preservation services for the Department of Social and Rehabilitation Services (SRS) for four of the five regions in the state. St. Francis is the current provider for the remaining region.

Although the bill you are considering today is primarily rescinding current budget authority for the majority of state agencies, it does contain supplemental appropriations for "entitlement" programs for SRS. Included in these appropriations are \$9.7 million for foster care contracts and \$1.8 million for adoption contracts. These are the amounts necessary for the state to meet the contractual obligation to provide services for the current estimate for the number of people requiring services.

Family preservation services are used by the state to keep children out of the foster care system and, eventually, adoption services. The current amount budgeted for family preservation will not allow all of the eligible clients to be served. In fact, people have been denied services since October of last year. Based on an estimate from DCCCA, Inc. an additional \$1.5 million would be necessary to once again be able to provide services to all eligible clients beginning in mid-March.

As you are aware from your experience with the SRS budget, it costs \$3,800 for a family to receive family preservation services for one year, while foster care costs \$26,000 for one child for a year. While I recognize the fiscal problems facing the state, reductions in family preservation services will only increase the need for foster care and cost the state more money in the current year.

I thank the committee for its time and attention and would stand for any questions.

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DIVISION OF THE BUDGET
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Bill Graves
Governor

Duane A. Goossen
Director

MEMORANDUM

TO: Senate Ways and Means Committee
FROM: Duane A. Goossen, Director of the Budget
DATE: January 22, 2002
SUBJECT: SB 385

Mr. Chairman, Members of the Committee:

Thank you for the opportunity to testify on SB 385. I appear to express the Governor's opposition to this bill which reduces the current year State General Fund budget. The FY 2002 budget was already adjusted during a very long wrap-up session last Spring. The Governor believes the approved FY 2002 budget is inadequate, especially in the area of education, and should not be lowered further.

In addition, applying stiff across the board cuts late in the fiscal year leaves many agencies in an unnecessarily difficult situation.

Last week you were provided a one page synopsis of the Governor's recommended FY 2002 revised budget. A copy of that is attached. For comparison, a similarly formatted synopsis of this bill is also attached.

The key differences are the substantial and immediate cuts that SB 385 imposes.

Public education is cut \$25 million from the Governor's proposal with the presumption that the education budget would stay at that lowered level in FY 2003. Given what we know about obligations and revenue in future years, there is little hope that education would gain in FY 2004 and FY 2005.

Higher education immediately loses \$8.4 million from its present budget and stays at that level in FY 2003. This amount is \$24 million below the Governor's recommendation for that

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same period. Plus, savings of roughly \$6 million connected with KPERS-TIAA that would have eventually accrued to the universities are taken for the State General Fund.

State hospitals would sustain a cut of \$632,000 in the remainder of this fiscal year. The rest of the SRS system would be cut approximately \$12 million. However, much of the SRS budget consists of caseloads that cannot be cut. To cut \$12 million, the reductions would need to be applied to non-caseload programs—HCBS-DD, HCBS-PD, alcohol and drug programs, family preservation, child care, etc.

Likewise at Aging, most of the budget is devoted to nursing home caseloads. The agency's managers will have no choice but to apply the \$2.9 million current year cut to in-home care and meal programs. The short-term alternative would be to pend claims into FY 2003 which would then require \$5.8 million of cuts to in-home care and meal programs in the coming budget year.

The Corrections budget is perhaps the most difficult. In what is left of this fiscal year, the Corrections system would be cut over \$4 million at a time when \$1.5 million must be added to cover the food and medical contract costs of a rising inmate population. In FY 2003, if the Corrections system is forced to stay at that level, the system would be \$13.7 million below the Governor's recommendation. Corrections would be forced to close facilities and shut down inmate programs.

You have a better alternative available. The Governor's proposal keeps FY 2002 intact, and funds the necessary caseload costs. The Governor's proposal provides hope that public education, higher education, and social services can be sustained in the next fiscal year.

The Governor is not proposing anything lavish for FY 2003. Your sub-committees will discover that most agency budgets still contain cuts and require many hard decisions, but agencies are allowed time to plan and adjust. Most importantly, the most vital services are maintained now and in FY 2003.

Governor's Recommendation
 FY 2002 State General Fund Planning Report
(Dollars in Millions)

Revenue:

Beginning Balance	\$ 365.7
Consensus Revenue Estimate	4,336.0
Other Revenue	0.4
Total Available	\$ 4,702.1

Expenditures:

Approved Budget	\$ 4,508.9
Shifted Expenditures	4.6
KDOT Veto Adjustment	(26.5)
SRS Caseloads	34.5
School Finance Shortfall	9.4
Corrections Medical and Food Contracts	1.5
Other Adjustments	(4.7)
Total	\$ 4,527.7

Ending Balance \$ 174.4

Balance as Percent of Expenditures 3.9%

SB 385

FY 2002 State General Fund Planning Report (Dollars in Millions)

Revenue:

Beginning Balance	\$ 365.7
Consensus Revenue Estimate	4,336.0
Total Available	<u>\$ 4,701.7</u>

Expenditures:

Approved Budget	\$ 4,508.9
Shifted Expenditures	4.6
SRS Caseloads	34.5
LOB Supplemental	20.3
Judiciary Supplemental	0.5
Other Adjustments	
School Base State Aid Reduction	(22.6)
Special Education Savings	(13.7)
TIAA KPERS Liability	(5.8)
General Government Agencies	(2.3)
SRS	(11.7)
Hospitals	(0.6)
Aging	(2.9)
Other Human Resources Agencies	(0.2)
Education (with Schools for Blind & Deaf)	(0.7)
Regents	(8.4)
Arts Commission	(0.03)
Historical Society	(0.1)
State Library	(0.1)
Corrections Systemwide	(4.1)
JJA Systemwide	(1.3)

Highway Patrol	(0.5)
KBI	(0.3)
Other Public Safety Agencies	(0.1)
Agriculture	(0.2)
KDHE	(0.6)
Wildlife & Parks	(0.09)
Other Ag & Natural Resources Agencies	(0.2)
KDOT	(26.0)

Total	<u>\$ 4,466.3</u>
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Ending Balance	\$ 235.4
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Balance as Percent of Expenditures	5.3%
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Testimony on SB 385
before the Senate Ways and Means Committee

by

Charles E. Simmons, Secretary of Corrections

January 22, 2002

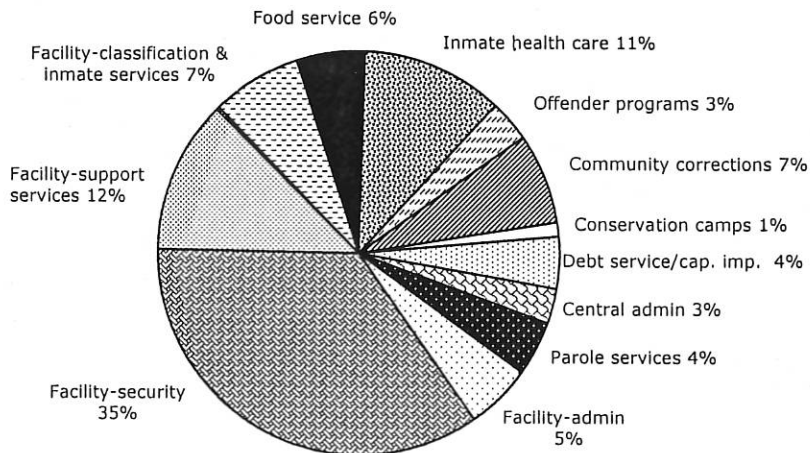
Senate Ways and Means
1-22-02
Attachment 8

The FY 2002 KDOC Budget — As Recommended by the Governor

- The total budget recommended by the Governor for KDOC in FY 2002 is \$244.6 million.
- The Governor's recommendation for FY 2002 includes a \$1.5 million supplemental from the State General Fund for food service and inmate medical care resulting from an increase in the inmate population above the level projected in September 2000 by the Kansas Sentencing Commission. The actual June 30, 2001 inmate population was 8,540, while the projected population was 8,026. Correspondingly, the ADP for FY 2002 will be higher than anticipated at the time the budget was approved last session.
- The KDOC budget is financed primarily by the State General Fund, including—
 - 90.7% of the operating budget
 - 85.7% of the total budget.

FY 2002 State General Fund Expenditures, by Category of Expenditure

Expenditure Category	Expenditures	% of SGF	Expenditure Category	Expenditures	% of SGF
Facility security	\$73,706,811	35.2%	Parole services	9,192,221	4.4%
Facility-support services	25,244,318	12.0%	Debt service & cap. improve.	8,206,736	3.9%
Inmate health care	23,828,635	11.4%	Offender programs	6,496,711	3.1%
Community corrections	15,309,220	7.3%	Central administration	5,938,650	2.8%
Facility-class. & inmate services	15,106,189	7.2%	Conservation camps	2,685,866	1.3%
Food service	12,078,098	5.8%	Facility-transportation	670,672	0.3%
Facility administration	10,981,366	5.2%	Day reporting centers	121,800	0.1%
\$ 209,567,293				100.0%	



Current Year Budget Cuts—Constraints and Considerations

- Approximately three-fourths of the recommended FY 2002 SGF budget is in expenditure categories which we consider to be unavailable for reduction for one of the following reasons:
 1. *The budgeted expenditures have direct safety and security implications for correctional staff and/or the public—*
 - Correctional facility security expenditures, primarily for uniformed staff.
 - Parole services, primarily for parole staff.
 - Inmate classification and unit team supervision.
 2. *The budgeted expenditures provide necessary services to the inmate population or are required to operate facility physical plants—*
 - Facility support services, including utilities, maintenance, laundry, and supplies for the inmate population, such as clothing.
 - Inmate medical care.
 - Inmate food service.
 3. *The budgeted expenditures are a fixed commitment—*
 - Debt service and capital improvements. *Note: Nearly all of this amount is for debt service; the budget also includes matching funds for the ECF expansion project, however.*
 - Local jail costs. The amount budgeted for this purpose was \$1,950,000; the FY 2002 expenditure is now estimated (as of December 31, 2001) at \$2.7 million.
- The target reduction amount of two percent under SB 385 is estimated to be \$5.5 million total, including a rescission of approximately \$4 million from funds previously appropriated, plus \$1.5 million that it is assumed would not be provided as a supplemental for food service and medical care needed for the increased inmate population.
- If implemented over a five-month period, the \$5.5 million target reduction would require an average of \$1.1 million per month in expenditure reductions. This magnitude of reduction could not be achieved without eliminating whole programs or operating units.
 - Because these types of options involve contract cancellations or layoffs which have notice requirements, additional time is needed to implement them.
 - Therefore, it is assumed that most of the savings to be realized would have to be achieved during the last three months of the fiscal year.

Current Year Budget Cuts—Constraints and Considerations (cont)

- If required to implement current year cuts, the department would start by using the approach outlined in the reduction scenario submitted as part of the FY 2003 budget and would advance the implementation of those reductions to April 1, 2002.
- These reductions, however, would not be sufficient to meet the target amount. The table below provides estimated savings of those reduction options, plus elimination of all state-funded offender programs for the duration of FY 2002 (which also includes termination of programs funded with inmate benefit and correctional industries funds, and the use of these funds to supplant state general funds). All savings estimates are based on an April 1st effective date.

Expenditure Reduction Options	Estimated FY 2002 Savings
Close facility units at Stockton, Osawatomie, and Toronto	\$ 600,000
Close both conservation camps in Labette County ¹	670,000
Eliminate funding for adult residential centers in Johnson and Sedgwick counties ¹	500,000
Eliminate community service work crew supervisor positions	46,000
Community corrections rescissions ¹	250,000
Terminate all state-funded offender program contracts ²	2,500,000
Total Estimated FY 2002 Savings	\$4,566,000

¹ Grant funds for community corrections and the male conservation camp have already been distributed to the programs. Any FY 2002 lapses against these accounts will not produce savings in the current year unless the programs return the funds to the state.

² Does not include termination of therapeutic community programs which are partially federally funded.

- Reductions achieved through implementation of all of the facility closure options at the state and local level, plus the elimination of state-funded offender programs in FY 2002, still would fall short of the target by approximately \$1.0 million.
- We have not yet determined where the balance of the cuts might be taken. Security and safety considerations make it unwise to reduce FTE or to require vacancies to be held open in uniformed staff, parole officer or unit team positions. Contracted services for basic inmate needs such as medical care and food service must still be provided. Further, we have already taken significant cuts in other operational areas, the base for which has not since been restored. Examples include:
 - 50% cut in SGF funding for capital outlay in FY 2001.
 - reduction, beginning in FY 2001, in the funding available for systemwide rehabilitation and repair projects. The FY 2003 recommendation is 20% less than the FY 2000 amount. The FY 2000 appropriation was \$4.3 million, reduced to \$3.8 million in FY 2002, and proposed at \$3.5 million in FY 2003.

Current Year Budget Cuts—Constraints and Considerations (cont)

- a 12% reduction in state expenditures for offender programs over the past two fiscal years.
- In August 2001, I directed the KDOC System Management Team to take certain actions in containing and managing FY 2002 expenditures. (*A copy of this memo is attached.*) This action was taken because of indications that some facilities may have difficulty in staying within authorized funding levels in FY 2002.

The FY 2003 Budget

- In preparing its FY 2003 allocated resources budget as submitted to the Division of the Budget, the department included several reductions that became part of the Governor's recommendations. These include:
 - A one-year delay in full staffing of J Cellhouse at Topeka Correctional Facility. This cellhouse previously housed the Reception and Diagnostic Unit, and is being remodeled for use as a medium security dormitory for female inmates.
 - Eliminated facility-based substance abuse treatment programs (except therapeutic communities.)
 - Eliminated funding for condition violator grants for community corrections programs.
- If the intent is to appropriate funds in FY 2003 in an amount equal to that authorized for FY 2002 under the provisions of SB 385, the budget for the Department of Corrections would compare as follows to the Governor's recommendations:

<u>Budget Proposal—KDOC</u>	<u>FY 2003 SGF Budget</u>
Governor's Budget Report	\$212.2 million
Governor's Restoration and Enhancement Package	\$217.8 million
Maintenance of the SB 385 Budget Level in FY 2003	\$204.1 million
Difference between Governor's Budget Report and SB 385	\$ 8.1 million
Difference between Governor's Enhancement Package & SB 385	\$ 13.7 million

- For the Department of Corrections, SB 385 does not dilute the effect of budget cuts by spreading them over two fiscal years. Many of the reduction measures required in FY 2002 would need to be perpetuated in 2003, and the degree of cuts required in FY 2003 would be significantly greater than those included in the Governor's Budget Report.
- - *The Governor's Budget Report already reflects closure of the Osawatomie, Stockton, and Toronto units, as well as the conservation camps. Therefore, the \$8.1 million difference between the GBR and the SB 385 budget would have to come from other parts of the department's budget. For the reasons discussed earlier, this would be highly problematic.*

Summary

In summary, I respectfully request that the committee not take the budget reduction approach employed in SB 385 for the Department of Corrections. Reductions of this magnitude made in this manner would represent a retreat from sound correctional policy and practice in the state—and it is a retreat that would continue in FY 2003, since the reductions would be more than twice the level that would occur under the Governor's current resources budget.

For more than a decade, Kansas policymakers and corrections professionals have worked together to re-shape the state correctional system from one seen by the courts as seriously deficient to one that not only meets constitutional standards and is fully accredited, but also provides effective correctional services. Although there is still much that we would like to do and improvements yet to be made, we in the department feel that the state has made tremendous gains in building a sound and effective correctional system. Some of those gains would be placed in jeopardy if reductions are made in the manner required by SB 385.

In the past several years, the department's budget has received reductions in offender programs, capital outlay, and rehabilitation and repair projects. We are willing to do our share in making it through these difficult fiscal times. However, the impact of SB 385 will produce unacceptable results for this department.




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Bill Graves
Governor

Charles E. Simmons
Secretary

MEMORANDUM

TO: System Management Team
FROM: Charles E. Simmons 
DATE: August 27, 2001
SUBJECT: FY 2002 Budget

I am directing the following actions with respect to management of the FY 2002 budget:

1. For positions which become vacant after September 1, 2001, a period of 90 days shall pass prior to filling the vacancy. This policy shall not apply to the following:
 - corrections officers (CO I through CS III);
 - parole officers (PO I through Parole Director);
 - positions funded from sources other than state general fund;
 - corrections counselors (CCI through Unit Manager);
 - personnel working with inmate records;
 - information technology staff.

For other positions, the appointing authority may petition the applicable Deputy Secretary for an exception to this policy, showing special circumstances why a position should not be held open. The Deputy Secretary shall decide each such request on a case by case basis.

2. Community service work where the facility will incur costs for supervision or transportation will not routinely be provided. Immediate and short-term assistance following a natural disaster (such as the Hoisington tornado) will be provided. However, the requesting agency will be informed that if assistance is desired on a long-term basis the entity will need to provide supervision and transportation. Any short term projects of any kind where a commitment has

already been made will be honored. The community details where the supervisor is funded in the FY 2002 budget will continue to operate. Community details where the requesting entity provides the transportation and supervision are not affected by this memorandum.

3. Lansing will end the hiring and recruiting bonus program effective close of business August 31, 2001.
4. Travel, both in state and out of state, shall be carefully reviewed prior to approval. Only necessary travel, travel paid by sources other than SGF, or travel where the benefits to the agency clearly outweigh the costs, shall be approved. Examples of types of travel which will be approved are security audits, classification meetings, and SORT training.
5. Wardens shall review energy conservation and utilities usage measures in order to ensure that cost efficiency is maximized.
6. All areas of discretionary spending shall be carefully reviewed prior to the expenditure being authorized. Expenditures should not be authorized if the requested item is not essential to agency operations.
7. Only essential physical plant renovation or relocation projects shall be initiated beyond those already approved and included in the Capital Improvements Plan, unless the project will result in a clear and measurable increase in efficiency or financial savings and has the prior approval of the Deputy Secretary.

We will continue to monitor the FY 2002 budget. Additional measures will be taken as necessary in order to ensure that we operate within appropriated funding. Any questions should be directed to Dennis Williams or the appropriate Deputy Secretary.