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GOVERNOR

STATE OF MICHIGAN
OFFICE OF THE STATE BUDGET
LANSING

MARY A. LANNOYE
DIRECTOR

November 21, 2006

The Honorable Shirley Johnson, Chair
Senate Appropriations Committee
Michigan State Senate
State Capitol
Lansing, Michigan 48909

The Honorable Scott Hummel, Chair
House Appropriations Committee
Michigan House of Representatives
State Capitol
Lansing, Michigan 48909

Dear Legislators:

Although bookclosing activities for fiscal year 2006 are not yet complete, it is now apparent that, when final expenditures and revenues have been booked, three (3) agencies will have net general fund overexpenditures for the year: the departments of Corrections, Human Services and State Police. Working with the affected agencies, we are in the process of identifying the affected accounts and estimating the exact amounts of the net overexpenditures. We are also working to determine what resources may be available to address any fiscal year 2006 supplemental needs. Each agency has also been charged with developing a corrective action plan to insure that the situation does not recur in fiscal year 2007.

Detail is attached to this letter describing the situation in each of the affected agencies.

It should be noted that net general fund lapses in other agencies will offset these overexpenditures; we expect that, in the aggregate, statewide general fund overall lapses will be close to the \$25 million assumed last summer during our target-setting discussions.

Sincerely,

Mary A. Lannoye
State Budget Director

Attachments (3)

cc: Senate Fiscal Agency
House Fiscal Agency
Departments of Human Services, State Police and Corrections
Internal State Budget Office Distribution

**Fiscal Year End 2006 Book Closing
Department of Corrections**

Statement of Problem

The Department of Corrections has a number of currently overspent accounts, a number of accounts payable to vendors, and some state departments that have performed services and are not yet paid.

There are insufficient funds within current MDOC accounts to finish the fiscal year with a positive balance. The estimated total department shortfall for FY 2006 is \$13.9 M. This figure includes lapse of the \$4 M prisoner reintegration work project. Should the work project not lapse, the estimated total department shortfall would become \$17.9 M.

Cause of Problem

There are six areas where the department has faced increased costs during the fiscal year. These areas total approximately \$54.6 M in increased costs. The department undertook cost savings measures during the year to alleviate \$30.7 M of the increased costs. Estimated totals are as follows:

ESTIMATED UNFUNDED COSTS

Increased Healthcare Costs	\$19,052,300
Increased Overtime Costs	\$18,000,000
Fuel & Utilities	\$9,100,000
Additional Beds	\$6,100,000
Increased Costs at Prisoner Intake Center / Volume	\$1,893,600
County Jail Services Unit	\$447,000

TOTAL ESTIMATED UNFUNDED COSTS	\$54,592,900
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LESS:

DEPARTMENT WIDE COST SAVINGS MEASURES

Manage vacancies, purchasing restrictions, delayed maintenance projects, etc.	\$30,692,900
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TOTAL ESTIMATED COST SAVINGS MEASURES	\$30,692,900
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LESS: PREVIOUS SUPPLEMENTAL	\$10,000,000
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TOTAL DEFICIT	\$13,900,000
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Healthcare Costs

A number of factors contributed to increased costs in healthcare. The number of hospital inpatient bed days is up 23% from 2005 to 2006 substantially increasing hospital and specialty care costs. Pharmaceutical costs have increased due to a prisoner population that continues to grow older and require more care. Thirty seven percent of the prisoner population receives chronic care treatment (diabetes, cardiovascular, hypertension, etc.)

Overtime Costs

Overtime costs for custody staffing increased substantially during FY 2006 due to a higher number of overtime hours earned. Earned overtime hours have increased due to vacancies in the custody ranks and because of an increased number of prisoners. Employees are also opting for more overtime pay in lieu of earning additional time off (comp time).

Fuel and Utility Costs

Fuel and utility costs increased by \$10.5 M from the previous fiscal year. The department received a supplemental previously during the fiscal year to offset a portion of this increase.

Additional Beds / Prisoner Intake

A spike in trends that drive the prisoner population forced the department to put additional beds on line earlier than anticipated causing increased costs. Felony court dispositions to prison are on pace to increase by 13% for 2006. Parole violator technical returns to prison increased 16%. Prison population is up by more than 3% so far during 2006 – a population size that was not expected until March 2008.

County Jail Services Unit

The FY 2006 budget included a reduction to move the County Jail Services Unit to the Department of Labor and Economic Growth; however, the legislation to complete the move was not taken up. This reduction was reversed for FY 2007 and the problem eliminated.

Corrective Action Plan

Recently approved year-end transfers will allow for most vendor payments to proceed. Supplemental appropriations will be needed to insure payments to all vendors and to other state agencies.

Preventive Actions For FY 2007

Healthcare Costs

The department is undertaking a number of cost savings measures in FY 2007 and exploring additional options to reduce healthcare costs. A formulary for prescriptions is being implemented which will significantly

reduce the number of non-generic medications that prisoners receive. Also, mental health pharmaceuticals will be moved into a standard formulary to reduce the use of higher costs drugs. The department has implemented special case management practices for its 300 highest cost medical cases. It is also exploring options for increasing infirmary beds at the department's own hospital in the Jackson prison complex in order to help reduce the number of inpatient hospital bed days in community hospitals.

Overtime Costs

The department is funded for and plans to train 700 new corrections officers to backfill corrections officer vacancies. This will help limit the amount of overtime used to fill vacant positions.

Fuel and Utility Costs

The department is pursuing a number of initiatives to limit increased utility costs. The department continues to upgrade to more efficient lighting fixtures. As capital outlay funding allows, the department is making repairs to steam and condensate lines to reduce heating costs. Energy conservation projects and energy performance contracts continue to be implemented.

Additional Beds / Prisoner Intake

The department will continue to operate incremental beds at existing facilities rather than opening more expensive mothballed prisons.

General Cost Savings Measures

Purchasing Restrictions: The department will continue to monitor and restrict spending to only those goods and services that are necessary to maintain the safety and security of inmates, staff, and the public.

Vacancy Management: The department has managed over 1,000 position vacancies in FY 2006 and will continue to manage vacancies in a safe and secure manner.

Fiscal Year End 2006 Book Closing Department of Human Services

Statement and Cause of the Problem

The Department of Human Services (DHS) has exceeded its fiscal year 2006 budget by \$30.7 million general fund. However, DHS has operated within their gross authorization. There is an unliquidated accounts payable of \$4.6 million to an EBT vendor for Family Independence Program (FIP) benefits that have already been paid to clients. Since year-end transfers for DHS have been approved by the Legislature, FIP is the only line item with a general fund shortfall for the following reasons:

- FIP caseloads were higher than budgeted. The consensus agreement between the Administration and the House and Senate Fiscal Agencies on May 31, 2006, budgeted for an average annual caseload of 78,450 cases but the actual average caseload for FY 2006 was 80,360 cases.
- Revenues from retained child support and public assistance recoupments were lower than budgeted.
- Federal Temporary Assistance for Needy Families (TANF) block grant expenditures were higher than anticipated. The budget assumed expenditures at 97% of the appropriation; actual expenditures were 99%. TANF expenditures over the federal TANF block grant amount pushed the costs to the general fund.

Corrective Action Plan

- DHS implemented a freeze on discretionary administrative expenditures.
- DHS closely monitored expenditures in the field to shift costs to other available funding sources.
- DHS received additional federal Social Services Block Grant funding for Katrina victims. They identified ongoing costs for the Katrina victims and used the funds provided for these efforts to conserve general fund.
- DHS has tightened their internal review process for exceptions to the hiring freeze
- DHS collected higher than budgeted local chargeback revenue in fiscal year 2006. In a supplemental appropriation passed by the Legislature in July, DHS increased the local chargeback funding for the foster care lines.

There is a pending supplemental that appropriates an additional amount in local chargeback revenue to capture the additional revenues.

- An FY 2006 year-end supplemental for \$4.6 million general fund will be needed to address the outstanding EBT vendor payment.

Preventive Actions for FY 2007

DHS is working with the State Budget Office to address any budget shortfalls that carry over to FY 2007. Actions taken include the following:

- Identifying potential shortfalls as early in the fiscal year as possible.
- Accounts that are being reviewed include Family Independence Program, Juvenile Justice, Child Care Fund and Adoption Subsidy.
- Specific plans are being drafted that will identify action steps to keep spending within appropriated amounts. These steps may include tracking and monitoring of expenditures and internal transfers to address specific problems.
- Family Independence Program caseloads are being monitored weekly and monthly to identify trends that could lead to overspending. This will allow preventive actions to be taken early in the fiscal year.
- DHS is monitoring TANF expenditures and is preparing a plan to live within the TANF appropriation for FY 2007.

**Fiscal Year End 2006 Book Closing
Department of State Police (MSP)**

Statement of the Problem

There are insufficient funds within remaining Department of State Police accounts to enable the department to close the fiscal year 2006 with a positive balance. As of 25 November 2006, the Department of State Police estimates a fiscal year end 2006 general fund overexpenditure totaling \$3,060,300.

To date there is one vendor payment outstanding related to a recent flooding disaster in Oscoda County totaling \$30,000. In addition, MSP has not paid several state departments for services performed during the fiscal year. Specifically, State Police has insufficient spending authorization to pay the Department of Information Technology (DIT) for \$2.5 million in information technology (IT) charges and has not paid the Department of Management and Budget (DMB) for \$1.9 million in fleet services. DIT and DMB have recorded deficits in their internal service funds to reflect these unpaid bills.

Cause of the Problem

The overexpenditures in MSP are attributable to a variety of factors, including the failure to realize administrative cost reductions included in the original enacted budget, unfunded state employee economic costs, restricted revenue shortfalls, and inter-agency charges in excess of the amounts included in the enacted budget. These problems were partially offset by available savings from banked leave, retirement savings in excess of those assumed in the budget, and supplemental appropriations.

STATE POLICE PROBLEM IDENTIFICATION

Enacted Administrative Reductions ¹	(\$11,000,000)
Unfunded 1.5 % Employee Economics	(\$2,500,000)
FY 2006 Trooper Banked Leave Time Savings	\$2,600,000
Restricted Revenue Shortfalls ²	(\$3,000,000)
Retirement Savings	\$3,200,000
FY 2006 Supplemental (P.A. 345 of 2006)	\$1,900,000
Excess Information Technology Charges	(\$1,000,000)
Excess Fleet Charges	<u>(\$1,900,000)</u>
TOTAL PROBLEMS	(\$11,700,000)

Of the enacted savings built into the FY06 State Police budget, the agency has been able to realize approximately \$2.9 million in savings in the following areas:

Sale of fixed wing airplanes	\$400,000
General Fund Vacancy Savings	\$1,000,000
DROP Savings	<u>\$1,500,000</u>
TOTAL REDUCTIONS	\$2,900,000

Corrective Action to Address and/or Minimize the Problem

Several measures have been implemented to reduce the scope of the MSP budget shortfall including shifting general fund expenditures to available restricted revenues where appropriate (\$1.1 million), and cancellation of outstanding encumbrances (\$500,000). In addition, the MSP budgetary shortfall does not reflect the unpaid bills to DIT and DMB for inter-agency services.

¹ The original enacted budget for MSP included ~ \$11.0 million in administrative reductions and program efficiencies. Specifically, consolidation of the Fire Investigation unit into the Criminal Investigations unit (\$2.2 million); DROP savings (\$1.5 million); department wide elimination of vacant positions (\$3.1 million); information technology contractual savings (\$1.7 million); sale of two fixed wing aircraft (\$400,000); training administrative reductions (\$250,000); and various other administrative savings identified and enacted by the Legislature (\$1.8 million).

² During FY 2006 the State Police has experienced revenues coming in at less than anticipated levels for a number of state restricted revenue sources including Traffic Law Enforcement Safety Fund; Highway Safety Fund; Sex Offender Registration Fee Fund; Laboratory/Forensic Science Reimbursement Fee Fund; and Training Academy charges.

Preventive Actions for FY 2007

The following measures have been taken to ensure a balanced budget by close of fiscal year 2007.

Internal Strategic Review

- Director Munoz has convened a budget restructuring committee within the agency, tasked with evaluating the fiscal year 2007 budget to identify cost reduction options and revenue enhancement options. The committee is seeking specific input from the departments of Management and Budget, Information Technology, Corrections, and the cost allocation-consulting group Maximus for suggestions and options to control costs.

General Cost Savings Measures

- MSP has established new standards for use of procurement cards (e.g., reduced spending authorizations, reduced the number of procurement card holders, etc.).
- MSP is re-evaluating the rate structure for the training academy to ensure sufficient revenue to support operating costs.
- MSP conducted a department-wide inventory of laptops and PCs; turned in obsolete equipment, salvaging approximately 400 computers, which will result in IT cost reductions.