LEGISLATIVE BUDGET BOARD

Staff Performance Report

JANUARY 2003

SUBMITTED TO THE 78TH TEXAS LEGISLATURE

LEGISLATIVE BUDGET BOARD

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January 21, 2003

Honorable Rick Perry
Governor of Texas

Honorable Members of the Seventy-eighth Legislature Assembled in Regular Session

Ladies and Gentlemen:

This performance report on the operations of state government has been prepared in compliance with the provisions of Section 322 of the Texas Government Code.

The evaluation and audit processes established under these provisions are valuable tools to help the Legislature identify and implement changes that improve agency performance. The results of these evaluations and audits, coupled with ongoing assessments of agency progress towards the achievement of established performance targets contained in the General Appropriations Act, should facilitate the accomplishment of state goals and objectives.

The *Staff Performance Report to the 78th Legislature* includes analyses of the productivity and effectiveness of state agency performance and contains recommendations based on the analyses. Individual staff reports are organized by functional area and should significantly aid members of the Legislature in the decision-making process.

The staff of the Legislative Budget Board appreciates the cooperation and assistance state agencies provided during the preparation of this report.

Respectfully submitted,

John Keel, CPA
Director

cc: Lieutenant Governor David Dewhurst
Speaker of the House Tom Craddick

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INTRODUCTION

The Sixty-third Legislature, 1973, directed the Legislative Budget Board to establish a system of performance audits and evaluations in order to provide a comprehensive and continuing review of state institutions, departments, agencies, and commissions. The Legislature further required that agency functions be analyzed in terms of unit cost, workload efficiency, and program output. To implement these mandates, the Legislative Budget Board has established a system of performance measurement and evaluation for use in the biennial appropriations process. Pursuant to provisions of the General appropriations Act, measures of agency performance and workload are developed by each state agency, the Governor's Office, and the Legislative Budget Board. Using assessments of actual and projected agency performance, as well as other analytic tools, an evaluation has been conducted of selected state agencies which (1) have been in operation for at least one year; and (2) are funded in the most recent General Appropriations Act. These evaluation findings, concerns and recommendations make up this *Staff Performance Report to the 78th Legislature.*

As has been done in the past evaluations, recommendations regarding program performance have been incorporated into funding recommendations where appropriate. Emphasis continues to be placed on the identification and review of certain programs and processes which are critical to efficient and effective government operation. Selection and evaluation of specific programs fulfill the legislative mandate to comprehensively and vigorously assess program performance in order to set appropriate funding levels.

The development of evaluation reports has been greatly aided by continued implementation of and refinements to the state strategic planning process, the Strategic Planning and Budgeting System, and the legislative establishment of key performance targets in the General Appropriations Act. These policy-setting mechanisms more clearly document performance expectations and explicate performance objectives. Further integration and modification of these processes will continue and should provide a powerful information and decision-support system from which state policies can be determined.

The individual agency evaluation reports that follow are organized by state government functional area. Along with a brief summary of the evaluation, the reports include delineation of any significant findings and concerns and a detailed discussion of each program or issue under review. When appropriate, recommendations are presented to correct identified concerns.

Changes in Medicaid Hospital Reimbursement

Inpatient fee-for-service hospital payments account for about 20 percent of Medicaid acute care costs (an estimated $1.6 billion in fiscal year 2002). Federal Disproportionate Share Hospital (DSH) payments to the state totaled approximately $853.4 million for fiscal year 2002. With rising Medicaid caseloads projected for the next biennium, increases in inpatient hospital services will follow. The federal government allows each state to develop its own hospital reimbursement methodology and rates, subject to federal approval. This review examines the current Medicaid reimbursement of inpatient hospital services in Texas.

Significant Findings

- Medicaid savings from selective contracting for Medicaid hospital inpatient services has decreased from $58 million in fiscal year 1995 to $10 million in fiscal year 2001.
- Of the $205.0 million in General Revenue for Medicaid cost savings mandated by the 2002–03 General Appropriations Act, $52.1 million will be achieved by modifying the Medicaid hospital reimbursement and Disproportionate Share Hospital program methodology for fiscal year 2003.
- The Health and Human Services Commission has expanded the use of intergovernmental transfers over the 2002–03 biennium by $256.6 million in local funds to draw down $385.1 million in federal funds to offset cost containment provisions and increase hospital reimbursement.

Significant Concerns

- If the federal formula for Disproportionate Share Hospital state allocations remained the same as it was in fiscal year 2002, Texas would receive an additional $331.2 million for fiscal years 2003 through 2005 ($41.8 million for state-owned hospitals and $289.4 million for non-state-owned hospitals).
- Through the Disproportionate Share Hospital program, Texas could generate an additional $186.2 million in General Revenue Funds by claiming up to 175 percent of each qualifying state-owned public hospital's cost of uncompensated care for the 2004–05 biennium. Disproportionate Share Hospital payments to non-state-owned hospitals would decrease by the same amount.
- Neither the $40.0 million available to The University of Texas Medical Branch at Galveston, nor about $56.1 million projected for the 2004–05 biennium for distribution to tertiary care facilities are leveraged as state match for federal funds.

Recommendations

- **Recommendation 1:** The Legislature should petition Congress to keep the methodology for computing state allocations of federal Disproportionate Share Hospital funds the same as in fiscal year 2002.
- **Recommendation 2:** The Legislature should consider directing the Health and Human Services Commission to increase the Disproportionate Share Hospital payments to state-owned public hospitals to 175 percent of the cost of uncompensated care for state fiscal years 2004 and 2005 to generate $186.2 million in General Revenue Funds for the 2004–05 biennium.

- **Recommendation 3:** The Legislature should consider restructuring the use of Multi-categorical Teaching Hospital Account funds and tertiary care funds to maximize federal funds.

COMMENTS

Medicaid is a joint federal-state partnership for providing medical care to cash assistance recipients (Temporary Assistance for Needy Families), children, pregnant women, the elderly, and disabled persons. Inpatient hospital services are mandated Medicaid benefits (i.e., must be provided to all Medicaid-eligible clients). Services to Medicaid patients include semiprivate accommodations, meals, nursing services, newborn care, and all necessary medical or surgical services. There are 450 general, acute care and rehabilitation hospitals, 8 children's hospitals, 25 non-state-owned psychiatric hospitals and 15 state-owned hospitals participating in the Texas Medicaid program. On average, there are about 500,000 admissions of Medicaid patients to these hospitals every year across the state. Medicaid reimbursement for inpatient services is limited to $200,000 per client, per year (except for children).

MEDICAID ORGANIZATION

The Health and Human Services Commission (HHSC) is the designated state agency responsible for the Medicaid program and the final authority for its oversight. Several agencies, such as the Department of Health (TDH) and the Department of Mental Health and Mental Retardation (TDMHMR), have roles in the daily operations of the Medicaid program. A claims administrator processes claims submitted by hospitals and physicians participating in the Texas Medicaid program.

Federal law requires that a committee be established to advise the state Medicaid director about the program. The Medical Care Advisory Committee (MCAC) consists of consumer representatives, provider members, and three members that are designees of the Texas Department of Human Services, TDH, and TDMHMR. The MCAC considers, observes, studies and makes suggestions and recommendations concerning health and medical assistance issues and policies, the scope and utilization of services, payment methodology, quality of services, program changes and cost containment initiatives.

The MCAC comments on any changes to the hospital Medicaid payments that the Hospital Payment Advisory Committee (HPAC) suggests to HHSC. This committee is composed of hospital industry representatives, consumer representatives, and HHSC staff, and includes a MCAC representative in order to facilitate the exchange of information between both advisory committees. HPAC advises the state Medicaid director in developing and maintaining the inpatient hospital rate-setting methodology. In addition, HPAC comments and advises on necessary changes in hospital payment methodologies for inpatient hospital prospective payments and on adjustments of the Disproportionate Share Hospitals (DSH) program.

PAYMENT METHODOLOGY

GENERAL, ACUTE CARE HOSPITALS

In fiscal year 1987, Texas implemented a prospective payment system for inpatient hospital services provided to clients not served through managed care. A prospective payment system sets payments for hospital inpatient services based on a patient's diagnosis prior to the provision of services. Calculating a hospital payment is basically composed of three elements: the Diagnosis Related Group (DRG), the DRG relative weight, and the standard dollar amount (SDA).

The DRG system is an adaptation of the International Classification of Disease codes used for hospital billing. A hospital must assign a DRG based on the diagnosis of the patient. After assigning a DRG, a relative weight for that particular DRG is identified. DRG relative weights are calculated by dividing the average of all paid claims for a given DRG in a base year by the average of payments for all

DRGs in that same period. HHSC is directed to change the Medicaid claims base data used to calculate DRG relative weights every three years. The last update to DRG relative weights occurred in fiscal year 2000 for fiscal year 2001 reimbursements. DRG relative weights were calculated for fiscal year 2001 by dividing the average of all paid claims for a given DRG in fiscal year 2000 by the average of payments for all DRGs in fiscal year 2000.

The product of the appropriate DRG relative weight and the SDA for the hospital is the method used to calculate the hospital's payment. The SDA approximates the hospital's standardized average cost of treating a Medicaid inpatient admission based on an audited cost report and paid claims data. In addition, the hospital's measure of severity of the patients served and the strain on the resources used by the hospital are considered in the payment methodology (case mix index = sum of DRG relative weights / number of Medicaid cases). An inflation factor is multiplied by the average cost of treating a Medicaid inpatient admission. Figure 1 details the elements required for each of the steps of determining the hospital-specific SDA.

CHILDREN'S HOSPITALS

The Texas Medicaid program uses the Tax Equity and Fiscal Responsibility Act (TEFRA) methodology to reimburse inpatient services provided by children's hospitals. There are eight children's hospitals in Texas. TEFRA methodology uses a retrospective cost-based reimbursement system. A retrospective system allows children's hospitals to bill Medicaid for all the services provided to a particular patient. HHSC reimburses children's hospitals with an interim rate payment for Medicaid inpatient services based on the historical relationship of costs compared to charges. At the end of the reporting cycle, HHSC completes an audit of costs and determines if additional reimbursements or recoupments will occur.

PSYCHIATRIC HOSPITALS

Psychiatric hospitals participating in the LoneSTAR II Selective Contracting program are reimbursed on a per diem basis. The LoneSTAR Select II program allows HHSC to selectively contract with mental health facilities to provide non-emergency inpatient psychiatric services for Medicaid recipients under age 21. Psychiatric hospitals exempt from the LoneSTAR II Selective Contracting program are reimbursed using the TEFRA methodology (similar to children's hospitals).

SMALL HOSPITALS

The Seventy-first Legislature, 1989, included a rider in the 1990–91 General Appropriations Act (GAA) that specifies the Medicaid reimbursement for small hospitals. Beginning in fiscal year 1990, small hospitals with 100 or fewer beds are reimbursed according to DRG payments or the TEFRA reimbursement process, whichever is higher.

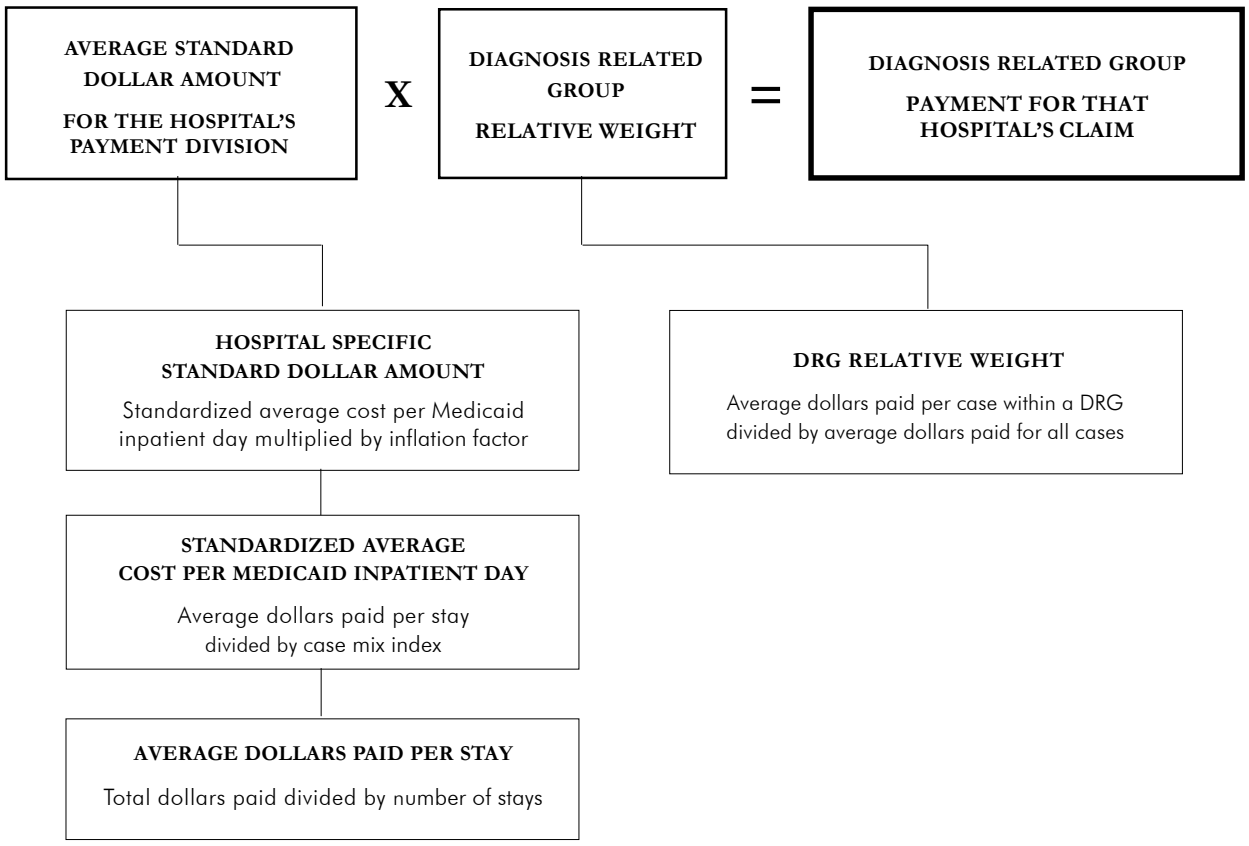
OUTLIER PAYMENTS

Medicaid limits coverage to 30 days of hospital care per spell of illness, excluding clients under the age of 21. Outlier payments are made to hospitals for inpatient services that are exceptionally high cost or exceptionally long lengths of stay for patients less than 21 years of age. According to HHSC, the total for outlier payments in fiscal year 2002 was $32 million in General Revenue Funds (about 2 percent of total hospital inpatient reimbursement). A hospital's claim must meet specific criteria in order to be eligible for a day and/or a cost outlier payment.

SELECTIVE CONTRACTING

Selective contracting may also impact a general, acute-care hospital's payments. Medicaid offers states the option to develop a competitive contracting system for inpatient hospital services provided to Medicaid recipients (except for Medicaid managed-care clients and clients eligible for both Medicaid and Medicare). The Seventy-second Legislature, 1991, mandated a program to competitively bid for Medicaid acute inpatient hospital

FIGURE 1
GENERAL, ACUTE CARE HOSPITAL PAYMENT METHODOLOGY



SOURCE: Legislative Budget Board.

services in response to rising Medicaid expenditures. Texas' Medicaid initiative, LoneSTAR Select I, allows HHSC to selectively contract with hospitals for non-emergency inpatient services for Medicaid recipients. Under LoneSTAR Select I and II programs, providers in urban areas bid a percentage discount from their normal Medicaid reimbursement rates. HHSC then either accepts or negotiates the bids. Selective contracting excludes rural areas of the state because these areas often only have one hospital serving a large geographic area. A participating hospital has its payments reduced by the bid amount.

HHSC has completed three rounds of negotiations for selective contracting since the implementation of this initiative. TDH, as the state agency formerly responsible for Medicaid acute programs, accepted bids from all hospitals that submitted proposals in both the first and second round of the LoneSTAR Select I Contracting Program. In fiscal year 2002, HHSC contracted an independent evaluation of the LoneSTAR Select I Contracting Program. The consultant evaluated the program's third round of negotiations that took place in fiscal year 2000. According to the evaluation report, TDH's reasons for not implementing a highly selective program in

the beginning included the following: fewer participating hospitals could mean disruptions in services; discounts could be offset by higher costs of emergency cases in non-contracted hospitals; and other states met limited success in implementing more highly selective programs.

In fiscal year 2001, $10.0 million was saved through selective contracting. Table 1 shows that savings from selective contracting have decreased every year since implementation, primarily due to smaller discounts negotiated through the years. The evaluation report indicated that percentage discounts obtained by HHSC ranged from no discount to 3 percent. The majority of discounts (63 percent) were less than 2 percent. The following reasons for such low discounts were mentioned in the report:

- In the first and second rounds of selective contracting final bids were made public, allowing hospital providers to learn what discounts their competition negotiated; and
- Hospital providers may not have provided higher discounts because they may have believed other measures would be taken to further reduce reimbursement.

The evaluation report also determined that TDH did not negotiate higher discounts in larger more competitive urban areas. Large urban areas have discounts ranging from 0.7 percent to 1.0 percent. These discounts are near the statewide average of 0.8 percent. Greater competition in large urban areas should derive greater savings under a standard selective contracting program. TDH again received and negotiated acceptable discounts from all hospitals that submitted bids. In fiscal year 2000, 197 of the 236 hospitals eligible to participate in selective contracting were contracted. The remaining 39 chose not to submit bids.

TABLE 1
SELECTIVE CONTRACTING SAVINGS

IN MILLIONS

FISCAL YEAR	EXPENDITURES	SAVINGS	PERCENTAGE SAVINGS
1995	$1,718	$58	3.4%
1996	1,769	51	2.9
1997	1,653	48	2.9
1998	1,520	37	2.4
1999	1,336	30	2.3
2000	1,416	29	2.1
2001	1,409	10	0.7
TOTAL	**$10,821**	**$263**	**2.4%**

SOURCE: Health and Human Services Commission.

OUTPATIENT HOSPITAL REIMBURSEMENT

Outpatient hospital services covered for Medicaid recipients (about four million encounters per year) consist of diagnostic, therapeutic, or rehabilitative services delivered in a licensed hospital setting. Outpatient hospital reimbursement rates for non-managed-care areas are determined retrospectively using a cost-based system. An interim payment rate is used, subject to cost settlement at year-end. A discount factor is applied to each outpatient payment, and then the final rate is determined. New outpatient hospital rates for high-volume Medicaid hospitals were implemented October 1, 2001, increasing the amount of allowable costs paid from 80.3 percent to 84.5 percent of cost. During the Seventy-seventh Legislative Session, 2001, $35 million in General Revenue Funds were appropriated for this change. The remaining hospitals will continue to receive 80.3 percent of allowable costs.

DISPROPORTIONATE SHARE HOSPITAL (DSH)

FEDERAL DSH PROGRAM

Congress created the DSH program in 1980 with the intent of providing special Medicaid payments for hospitals that serve large numbers of Medicaid and

uninsured patients. Later federal revisions to DSH allowed state matching funds to be generated through special, narrowly targeted provider taxes and/or donations. This resulted in states designing expanded DSH programs that dramatically increased the amount of federal funds flowing to them. DSH payments grew nationally from $400 million in fiscal year 1989 to $17.5 billion in 1992. Texas' DSH program, implemented in four phases (Dispro I-IV), grew from $4.8 million to $1.4 billion in fiscal year 1992. This increase was attributed to the additional matching funds provided by large hospital districts, state-owned teaching hospitals, and state-owned psychiatric hospitals.

Starting in 1991, the federal government took notice of states' increasing levels of DSH funding and passed legislation to curtail DSH spending. States were using provider donations as their state match in order to draw down federal funds from Medicaid. States would then reimburse providers some of the federal funds, and the remaining funds would be retained at the state level. Some states were using the funds to provide health-related services, while others were reverting the funds to their treasury for any state purpose. Major provisions in the Medicaid Voluntary Contribution and Provider Specific Tax Amendments of 1991 included a ban on provider donations and a cap on state DSH payments based on 1992 funding levels. In addition, states' DSH payments could not exceed 12 percent of the state's total Medicaid costs.

As a result of the ban on provider donations, states turned to intergovernmental transfers as the revenue source to draw down federal funds under the DSH program. Intergovernmental transfers involve fund exchanges between different levels of government institutions. Public institutions such as state psychiatric hospitals and university hospitals began transferring funds to state Medicaid agencies. In addition, county and city hospitals could also transfer funds to state Medicaid agencies. States would then draw down federal funds and make DSH payments to these public hospitals. In fiscal year 1994, Texas' DSH program consolidated the four phases into the current program, which only utilizes intergovernmental transfers, in order to comply with the federal legislation's ban on provider donations.

In 1993, Congress again targeted the DSH program with the Omnibus Budget Reconciliation Act of 1993 (OBRA). OBRA addressed concerns that some states were making DSH payments to hospitals that were not large Medicaid providers, while other states were making payments to hospitals in excess of their financial losses for providing care to Medicaid and uninsured patients. To ensure that DSH funds assisted safety net providers, OBRA provisions mandated that only hospitals with a Medicaid utilization rate of at least 1 percent could receive DSH payments. In addition, total DSH payments to a hospital could not be more than the unreimbursed costs of Medicaid patients and uninsured patients.

Congress later established new federal DSH fund allotments to states. For Texas, under the Balanced Budget Act of 1997 (BBA) the cap was set at $806 million for federal fiscal year 2000, dropping to $765 million in 2001 and 2002. Beginning in fiscal year 2003, a state's total allotment could grow based on the percentage change in the Consumer Price Index (CPI) for the previous year. The DSH amount could increase only if the state's total DSH reimbursement remained less than 12 percent of its entire Medicaid program. In addition, the BBA of 1997 limited the extent to which states can use DSH for payments to state-operated mental health institutions.

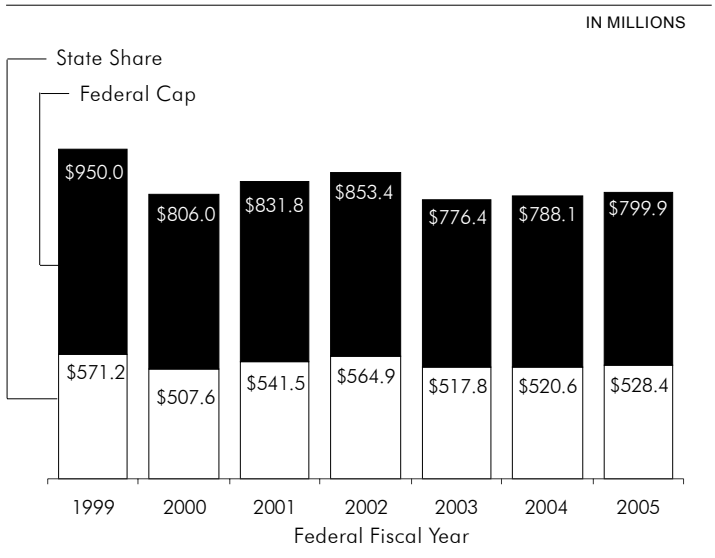
However, the Medicare, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000 (BIPA) provided some DSH fiscal relief to states. The BIPA increased states' total DSH allotments for fiscal year 2001 by freezing allotments at fiscal year 2000 levels and adjusting amounts by the percent change in the CPI for fiscal year 2000. For fiscal year 2002, the allotment would be the fiscal year 2001 allotment increased by the percent change in the CPI for fiscal

year 2001. States' total DSH reimbursements are still subject to the existing 12 percent cap.

BIPA's provisions only temporarily increased DSH caps for states for fiscal years 2001 and 2002. Under current law, states' DSH allocations for fiscal year 2003 are still capped. States' allocations revert to the capped amounts in the BBA adjusted by the percent change in the CPI. In fiscal year 2003, Texas will receive a base amount of $765.0 million adjusted by the percent change in the CPI. Figure 2 shows that Texas' federal allocation will decrease from $853.4 million in fiscal year 2002 to an estimated amount of $776.4 million in fiscal year 2003 (a loss of $77.0 million).

Several attempts were made this year to address the DSH cuts in fiscal year 2003. The Medicaid Safety Net Hospital Continued Preservation Act of 2001 would have eliminated the decreases in current law and permitted each state DSH program to grow with inflation from fiscal year's 2002 funding level. Another attempt to address the loss of DSH funds was made in the House-passed Medicare Prescription Drug Coverage bill. Provisions in this piece of legislation based DSH allocations for fiscal year 2003 on fiscal year 2001 allocations rather than fiscal year 2002 levels, which are lower for many states. Texas' allocations under BBA for fiscal years 2001 and 2002 are the same ($765 million each year) so the proposal would not have prevented the decrease of DSH funds in Texas. A Senate proposal was also discussed that prevented reductions in DSH payments until fiscal year 2005. Congress adjourned before sending any legislation to the President that included provisions affecting DSH state allotments for fiscal year 2003 and later. Recommendation 1 suggests that the Texas Legislature petition Congress to keep the methodology for computing state allocations of federal DSH funds the same as in fiscal year 2002.

FIGURE 2
TEXAS DISPROPORTIONATE SHARE HOSPITAL FUNDING



NOTE: Fiscal years 2004–05 are estimates.
SOURCE: Legislative Budget Board.

TEXAS DSH PROGRAM

DSH payments are funded using the same matching rate as medical services (60.17 percent federal funds, 39.83 percent state funds in federal fiscal year 2002). Both the state and the non-state DSH programs use intergovernmental transfers to supply the non-federal share of Medicaid funding. Appropriations made to state-owned hospitals are counted as match for the DSH program. These include The University of Texas Medical Branch (UTMB), The University of Texas M.D. Anderson Cancer Center, The University of Texas Health Center at Tyler (UT-Tyler), the Texas Center for Infectious Disease (TDH's hospital in San Antonio), and 10 state-owned or funded mental health facilities. It should be noted that two of the 10 facilities (one in Vernon and the other in Wichita Falls) have merged into one entity but are still considered separate hospitals for DSH and Medicare purposes.

A second group of nine large-volume Medicaid public hospitals transfers local funds to draw down the remaining federal

DSH funds. This group, consisting of eight hospital districts and one municipal hospital, includes Bexar, Dallas, Medical Center (Odessa), El Paso, Harris, Lubbock, and Tarrant, as well as Christus Memorial (Corpus Christi) and Brackenridge Hospital (Austin). This a voluntary arrangement, which is negotiated between HHSC and these hospitals. Although the matching funds are put up by these local hospitals, about 150 local hospitals receive a DSH payment through this program. The DSH program has become an important financing supplement for large-volume Medicaid public hospitals.

CONDITIONS OF PARTICIPATION IN DSH

In order to be considered for a DSH payment, hospitals must meet federal and state qualification criteria. Texas state policy defines 11 minimum requirements for a hospital to apply for DSH hospital status. Meeting these 11 conditions alone does not guarantee a DSH payment, but it sets out the conditions of participation. For example, one condition of participation is that hospitals submit a charity care charge policy to the state Medicaid director. Charity care charges are defined as unreimbursed costs to a hospital for providing healthcare services to a person classified by the hospital as financially or medically indigent.

QUALIFYING MEDICAID CRITERIA

There are both federal and state qualifying formulas that will determine whether a hospital will actually receive a DSH payment.

- All hospitals must have at least a 1 percent Medicaid inpatient service rate.
- Hospitals must also have a Medicaid inpatient service rate greater than or equal to an annually calculated percent above the average Medicaid inpatient services rate for all hospitals in the Medicaid program.

MEDICAID INPATIENT SERVICE RATE

=

Number of inpatient days attributable to Medicaid patients

÷

Total number of hospital inpatient days in that period

- Rural hospitals can have a Medicaid service rate greater than the average Medicaid inpatient service rate for all hospitals in the Medicaid program or a low-income patient service rate greater than 25 percent but less than 100 percent.

LOW INCOME PATIENT SERVICE RATE

=

Medicaid and state and local funding

÷

Total Cost

+

Total charity charges − Total state and local revenue

÷

All inpatient revenue (charges)

- Hospitals must have total Medicaid inpatient days at least an annually calculated percent above the average Medicaid inpatient days for all hospitals.
- Hospitals in urban counties with populations of 250,000 persons or less can have a Medicaid service rate of at least 75 percent of an annually calculated percentage above the average Medicaid inpatient days for all hospitals participating in the Medicaid program.

After HHSC has used the above-described criteria, it must complete steps to select which hospitals actually will receive a DSH payment. Table 2 shows the process used for selecting hospitals.

FEDERAL PAYMENT LIMITS

Federal rules set out some payment limitations for DSH hospitals. Specifically, no DSH hospital can

TABLE 2
PROCESS FOR SELECTING
DISPROPORTIONATE SHARE HOSPITALS

STEP / ACTION / RESULT
STEP 1
Medicaid service rates for all applying hospitals listed in descending order.
Hospitals with Medicaid service rates greater than an annually calculated percentage above the average Medicaid service rate for all Medicaid hospitals are selected.
STEP 2
Rural hospitals' Medicaid service rates are listed in descending order.
Hospitals with Medicaid service rates greater than the average Medicaid service rate are selected.
STEP 3
Remaining hospitals have their low-income patient service rates listed in descending order.
Hospitals with a low-income patient service rate greater than 25 percent are selected.
STEP 4
Remaining hospitals have their total number of Medicaid inpatient days listed in descending order.
Hospitals with total Medicaid inpatient days greater than an annually calculated percentage above the average Medicaid inpatient days for all Medicaid hospitals are selected.
STEP 5
The total Medicaid inpatient days of the remaining hospitals are listed in descending order.
Hospitals located in urban counties with population of 250,000 persons or less whose total Medicaid inpatient days are less than 75 percent of an annually calculated percentage above the average Medicaid inpatient days for all Medicaid hospitals are selected.

SOURCE: Texas Administrative Code, Section 355.8065.

receive a DSH payment that exceeds its individual DSH payment limit. The DSH hospital payment limit is calculated by multiplying the sum of a hospital's Medicaid shortfall (the difference between the cost of Medicaid inpatient and outpatient services and the hospital's non-DSH Medicaid payments) and its costs of services to uninsured patients (adjusted for inflation). In Texas, a hospital's Medicaid shortfall is determined each year by its two-year prior cost report. For example, fiscal year 2002's DSH payments are based on fiscal year 2000's cost reports.

In addition, the federal government regulates the payments to mental health hospitals, which the federal government terms Institutions for Mental Disease (IMDs). Federal law sets an additional limit on DSH payments for IMDs. The IMD limit is the lesser of the following: (1) the state's total 1995 DSH amount for IMDs (All Funds) or (2) the product of a state's current total DSH amount and the percentage that IMD DSH funds comprised of total 1995 DSH Funds (All Funds).

PAYMENTS FOR STATE-OWNED HOSPITALS

The Texas Center for Infectious Disease, the state mental health hospitals, and the three state teaching hospitals receive 100 percent of their adjusted hospital-specific limit. If the payments to the state mental hospitals exceed the federal IMD limit mentioned above, payments to these hospitals are adjusted proportionately to bring total IMD payments under the IMD limit. After the state-owned hospitals' payments are calculated, the amount of DSH funding remaining under the federal cap is available for payment to non-state DSH hospitals under the payment method described in the next section.

PAYMENTS FOR NON-STATE HOSPITALS

The remaining DSH funds are paid to non-state hospitals. A hospital's DSH payment is based on its proportion of Medicaid inpatient days and low-income (non-Medicaid) patient days. Both types of days are weighted if the hospital is a children's

hospital (1.25 weight) or if it is in a larger metropolitan area (weights ranging from 1.25 to 3.75).

If funds remain available in the non-state DSH hospital fund after distributing funds with the formula above, there is a second distribution of DSH funds. The remaining funds are distributed proportionally among hospitals that have not reached their hospital-specific limit. The total amount of DSH funding any non-state hospital receives is the sum of the payment under the basic DSH formula and the payment, if any, under this second round distribution of remaining funds. The total of these two cannot exceed the hospital-specific limit.

There are no federal laws governing the use of DSH payments made to hospitals. According to HHSC, hospitals tend to use DSH funds for the following reasons:

- to defray the cost of treating indigent patients;
- to recruit physicians and other healthcare professionals to treat patients;
- to obtain replacement or additional equipment/ technology to treat patients; and
- to renovate existing structures or to build new structures to better treat patients.

INCREASING PAYMENTS TO STATE-OWNED HOSPITALS

BIPA federal legislation extended to all states a special DSH provision that raised the hospital-specific cap for public hospitals to compensate them for Medicaid shortfalls and uncompensated care. For state fiscal years 2004 and 2005, the hospital-specific DSH cap for all state-owned hospitals can be 175 percent of each state hospital's cost of uncompensated care. This provision was previously available only to California hospitals. HHSC would have to modify DSH program rules to implement this higher DSH cap for state hospitals. The modification would save $186.2 million in General Revenue Funds by providing additional federal DSH funds for state hospitals, but it would decrease DSH funds for other public and private hospitals by the same amount. Recommendation 2 specifies that the Legislature should consider directing HHSC to increase DSH payments to state-owned public hospitals to 175 percent of the cost of uncompensated care for the 2004–05 biennium.

ADDITIONAL REIMBURSEMENT TO TEACHING HOSPITALS AND TERTIARY CARE FACILITIES

The Seventy-sixth Legislature, 1999, made unclaimed lottery prize money available for teaching hospitals and tertiary care facilities. The first $40.0 million in each biennium is appropriated to TDH for reimbursement to UTMB through the Multi-categorical Teaching Hospital Account. These funds assist UTMB in providing healthcare services to indigent patients. The remaining balance of unclaimed lottery prize money is available to tertiary care facilities. Tertiary care facilities offer care that requires highly specialized skills, technology, or support not generally available at hospitals. For the 2004–05 biennium, unclaimed lottery funds directed to tertiary care facilities are estimated to total $56.1 million. Neither the $40.0 million to UTMB nor the funds flowing to tertiary care facilities are leveraged as state match for federal funds. The Legislature should consider restructuring the use of these funds to maximize federal funds (Recommendation 3).

COST CONTAINMENT STRATEGIES

The Seventy-seventh Legislature, 2001, added a special provision in the 2002–03 General Appropriations Act (GAA) regarding Medicaid cost containment strategies. HHSC's appropriations were to be reduced by $205.0 million in General Revenue Funds due to cost-containment and savings initiatives, proposed by HHSC, to be implemented during the 2002–03 biennium. Two of the 17 initiatives listed in the rider were related to inpatient hospital reimbursement. It was estimated that for the biennium, $24.5 million in General Revenue Funds could be saved through an expansion of selective contracting, and

$6.1 million in General Revenue Funds could be saved by reducing the outlier payment percentage. The rider does not limit HHSC to the approaches listed in the rider to achieve savings during the 2002–03 biennium. HHSC has proposed achieving $52.1 million of the $205.0 million savings in two ways affecting hospital reimbursement: (1) a reduction of the outlier payment percentage (saving $6.1 million in General Revenue Funds) and (2) additional intergovernmental transfers by public hospitals (saving $46.0 million in General Revenue Funds).

OUTLIER PAYMENT PERCENTAGE

At the beginning of fiscal year 2002, HHSC reduced the outlier payment percentage from 75 percent to 70 percent. HHSC will be able to generate savings of $6.1 million for fiscal years 2002–03 by implementing this cost containment initiative.

INTERGOVERNMENTAL TRANSFERS

Initially, the second cost containment initiative proposed by HHSC included a modification to hospital reimbursement methodology. State rules mandate an annual cost of living increase (inflation factor) to be used when calculating hospital Standard Dollar Amounts (SDAs) for base DRG-reimbursed hospital payments. The proposed rules would have removed this inflation factor. HPAC and a workgroup of hospital associations requested that another initiative be developed to preserve federal Medicaid funds. HHSC and these groups developed a three-step initiative to achieve the cost savings in General Revenue Funds while maintaining federal matching funds as follows:

- In fiscal year 2003, select DSH public hospitals will transfer $46.0 million to the Medicaid program to achieve cost savings mandated by the 2002–03 GAA and preserve the federal matching funds ($69.0 million).
- HHSC will then modify the DSH state program for one year. The modification will include the application of a payment conversion factor that provides proportionate increases to the transferring public hospitals and proportionate reductions to urban, non-state, non-public DSH hospitals.
- In order to address the reductions to non-state, non-public DSH hospitals, the fiscal year 2003 inflation factor (cost-of-living index) will not be included in the calculation of all hospital payments. The resulting savings will be used to provide funds to the non-state, non-public hospitals serving a large number of Medicaid patients. HHSC will include an adjustment factor in the SDA calculation for these non-state, non-public hospitals.

HHSC was required to submit Medicaid state plan amendments for approval to the Centers for Medicare and Medicaid Services (CMS) in order to modify the DSH program and to remove the inflation factor. In October 2002, HHSC received approval from CMS for the two Medicaid state plan amendments. HHSC has already published adopted rules in the *Texas Register* to implement the two steps.

HHSC has assumed in the agency's Legislative Appropriations Request for the 2004–05 biennium that hospitals will continue the transfer of funds ($46.0 million biennium total) to the Medicaid program for the next biennium. Without the transfer of funds by the public hospitals for the next fiscal year, HHSC will have to reduce hospital reimbursement rates to maintain savings in the next biennium.

UPPER PAYMENT LIMIT

Federal Medicaid law offers states flexibility regarding payments to healthcare providers. However, Medicaid payments can be no higher than the amount Medicare would pay for the same service (referred to as the upper payment limit for Medicaid). CMS published regulations in fiscal year 2001 raising the upper limit from 100 percent of what Medicare would pay to 150 percent for non-state-owned public hospitals. In fiscal year 2002, federal regulations reduced the upper

payment limit payments for these same hospitals back to 100 percent.

Texas submitted a Medicaid state plan amendment in September 2001 for a supplemental payment using upper payment limit provisions. In April 2002, CMS approved Texas' use of upper payment limits to make supplemental payments to high-volume Medicaid providers. This plan will rely on intergovernmental transfers from large public hospitals (rather than state expenditures) to make supplemental payments for both inpatient and outpatient care to hospitals in Bexar, Dallas, Ector, El Paso, Harris, Lubbock, Nueces, Tarrant, and Travis Counties. According to HHSC, five public hospitals will transfer $93.7 million and draw down an estimated $141.0 million in federal funds for fiscal year 2002.

A similar supplemental payment program for rural, non-state-owned public hospitals was included in the Medicaid state plan in fiscal year 2002. Certain rural non-state-owned public hospitals in counties with populations less than 100,000 would be eligible for supplemental payments. This program would also utilize intergovernmental transfers totaling $9.3 million in local funds to draw down $14.0 million in federal funds for fiscal year 2002.

CONCLUSION

Medicaid hospital inpatient services expenditures account for a large percentage of the Texas Medicaid Program. As a result, any changes to the methodology used to calculate hospital payments have a significant impact on the Medicaid program.

The recommendations proposed in this review address federal legislation affecting Medicaid reimbursement of inpatient hospital services in Texas. A modification to the Texas DSH program can increase payments to state-owned public hospitals and generate General Revenue Funds savings. Texas will face reductions to the DSH funding level for fiscal year 2003 unless Congress addresses current law provisions capping DSH funding levels for states.

COMPARABILITY IN TEXAS' GROUP HEALTH INSURANCE SYSTEMS

This review compares the benefits packages (i.e., the relative participant costs and basic coverage benefits) provided by the following health insurance systems: the Uniform Group Insurance Program (UGIP) administered by the Employees Retirement System (ERS), the University of Texas System Employee Group Insurance Program (UT) and the Texas A&M University System Employee Group Insurance Program (A&M).

COMMENTS

In 1993, under pressure from rapidly rising healthcare costs, all academic institutions of higher education, excepting those institutions within the UT and the A&M systems, opted for inclusion in UGIP. The UT and A&M systems did not opt for inclusion in this umbrella administration for two reasons:

- The two systems had a long history of self-insurance; and
- Both systems had their own health-related institutions to offset the healthcare costs of their employees, and so regarded themselves as positioned to take advantage of the cost savings associated with the newly emerging forms of managed healthcare (primarily health maintenance organizations).

The continuing independence of the UT and A&M group insurance administrations assumes the two systems are able to provide, relative to UGIP, comparable healthcare benefits to their respective employees at costs roughly equivalent to what is appropriated to ERS-UGIP for similar benefits. The statute [VTCA, Insurance Code, Art. 3.50-3, Sec. 4 (a)] authorizing the independence of the UT and A&M group health insurance systems reads as follows:

Sec. 4.

(a) A Texas State College and University Employees Uniform Insurance Benefits Program is hereby created. Each institution shall implement the program for the benefit of its employees.

(b) Each institution shall:

(1) determine basic coverage standards which shall be ***comparable*** to those commonly provided in private industry and those provided employees of other agencies and institutions of higher education of the State of Texas under the Texas Employees Uniform Group Insurance Benefits Act (Article 3.50-2, Vernon's Texas Insurance Code). The institution may design a plan around existing local conditions. [Italics own]

While Texas statute does not define the term "comparable," the Government Code (§ 312.002) does reference the following:

312.002. Meaning of Words

a) Except as provided by Subsection (b), ***words shall be given their ordinary meaning.***

(b) If a word is connected with and used with reference to a particular trade or subject matter or is used as a word of art, the word shall have the meaning given by experts in the particular trade, subject matter, or art. [Italics own, VTCA, Government Code, Title 3, Subtitle B, Chapter 312, Subchapter A]

The Legislature's funding decisions for the UT and A&M group health insurance programs consistently upheld the principle of funding equity among the three systems. In the mid-1990s, the Legislature

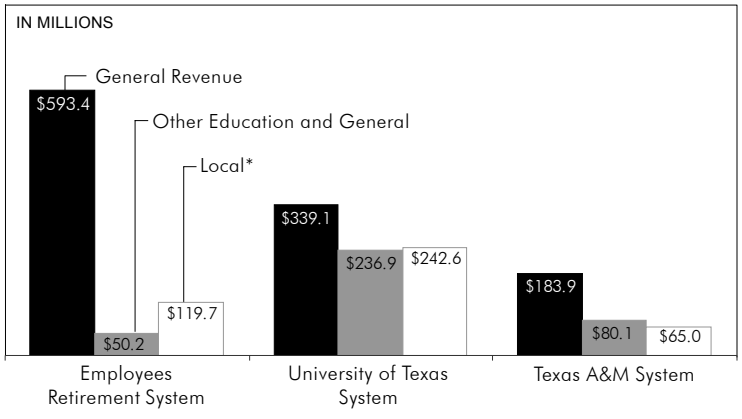
decided to fund health insurance for UT and A&M employees at the same dollar figure as participants in UGIP. That is, UT and A&M appropriations were based on the same cost assumptions used to fund the ERS-UGIP appropriation, without regard to the actual costs of the UT and A&M group insurance systems (Figure 1 below shows the relative funding levels of each system for the Legislative Budget Board's baseline recommendations).

In the mid-1990s through the late 1990s, the appropriation level for these programs funded 50 percent of the total dependent coverage costs for UGIP participants and roughly 80 percent of the dependent coverage costs for the UT and A&M program participants. Due to the availability of health-related institutions to offset insurance costs, and differences in plan design and covered population, the UT and A&M systems' health insurance plans were less expensive to enrolled employees than the UGIP plans.

Beginning with the Seventy-fourth Legislature, 1995, the "80 percent" level became expressed legislative intent in General Appropriations Act rider language.

FIGURE 1
HIGHER EDUCATION GROUP INSURANCE
LBB RECOMMENDED BASELINE APPROPRIATIONS
BY SYSTEM AND METHOD OF FINANCE

2004–05 BIENNIUM



*Amounts are estimated for each system's locally funded (i.e., non-appropriated) group health insurance costs for the 2004–05 biennium.
Source: Legislative Budget Board.

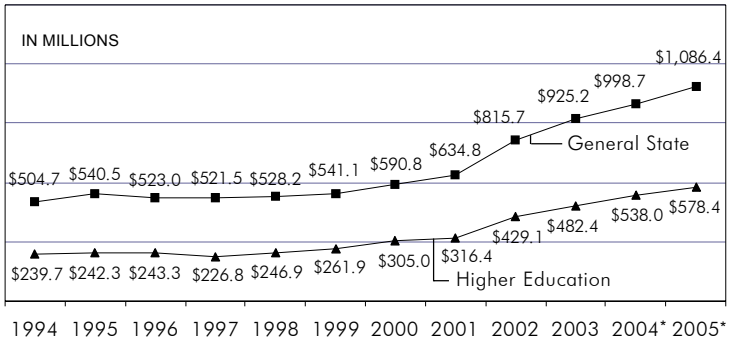
Until recent years, the UT and A&M plan offerings were generally considered to offer a fuller set of benefits than the UGIP benefit package offered by ERS, both in terms of the premium costs and overall benefits offered. Thus, while appropriations for the three programs continued to be based on the principle of funding equity, expectations emerged about actual plan benefits which shifted away from simple "comparability," as expressed in the 80 percent rider language.[1]

However, the relative richness of the UT and A&M plans' respective benefit offerings progressively diminished over the last several years due to the rising costs of medical care (Figure 2 reflects increasing state appropriations due to employee growth and medical cost increases) and the sum-certain appropriation methodology used to fund higher education group insurance contributions. In a sum-certain group insurance appropriation, the state's contribution will not exceed the specific amount appropriated to the institution. If actual costs exceed appropriated amounts, then institutions are obligated to pay the extra cost out of their respective state appropriations or institutional funds. In an estimated group insurance appropriation, on the other hand, the state's contribution is not capped, and the state assumes any additional costs of providing group health insurance.

The state's sum-certain contribution amounts for higher education institutions for each biennium are based on an enrollment census taken in October of each even-numbered year. In recent appropriations bills, the legislature appropriated rate increases in each year of the biennium to

[1]For reasons that will be discussed in this paper, the Seventy-seventh Legislature, 2001, decided to remove all reference to specific dependent coverage percentages in the UT and A&M rider language in the General Appropriations Act.

FIGURE 2
GENERAL AND HIGHER EDUCATION STATE EMPLOYEE HEALTH INSURANCE EXPENDITURES AND APPROPRIATED FUNDS



*Baseline recommendations.
NOTE: Excludes TRS-Care.
SOURCE: Legislative Budget Board.

fund the increasing cost of providing healthcare. Because the sum-certain appropriation will not vary due to higher costs or additional employees, there may have been insufficient funds to allow the UT and A&M systems to comply with legislative intent to provide 80 percent of the dependent coverage costs.

By 2001, it became clear the UT and A&M group insurance programs no longer offered the 80 percent dependent share coverage as intended in rider language. Averaging each system's plan offerings, the range of dependent coverage paid in 2001 by each of the three systems varied significantly, where UGIP paid 50 percent, UT 57 percent and A&M 62 percent, respectively. These amounts represent a weighted averaging of both self-funded and fully funded (e.g., Health Maintenance Organizations, or HMOs) plan offerings for 2001.

Consequently, in the Seventy-seventh Legislative Session, 2001, the "80 percent" rider language was amended to reflect this variation in the dependent share portion funded by the UT and A&M group insurance programs. While all three programs currently cover 100 percent of the premiums for the employee/retiree only, different premium sharing proportions evolved for dependent share coverage. Current legislative intent for UGIP as expressed in Rider 1, page III-46, General Appropriations Act (2002–03 Biennium) for those insured through UGIP reads as follows:

Funds identified above for group insurance are intended to fund:

a. the total cost of the basic life, health and dental coverage for all active and retired employees; and

b. 50 percent of the total cost of health coverage for the spouses and dependent children of all active and retired employees who enroll in coverage categories which include a spouse and/or dependent children.

Current language in Riders 2 and 3, pages III-47 and III-48, 2002–03 General Appropriations Act, for those insured through the UT and A&M systems reads as follows:

> Funds identified above for group insurance are intended to fund the same portion of the costs of basic health coverage for all active and retired employees and their dependents as is provided above for higher education active and retired employees and dependents participating in the Employees Retirement System's Uniform Group Insurance Program. (III-47, Article III, Senate Bill No. 1, Seventy-seventh Legislature, Regular Session, 2001).

There is variability in each system's share of dependent cost coverage borne, and range of benefits offered, because each system is entrusted to manage its respective group insurance program in a manner that is sensitive to the preferences and interests of each system's insured population. As a result, differing plan design philosophies emerged over time, and these differing approaches to providing group health insurance benefits raise the question of similarity and difference within the larger rule of "comparability."

METHODOLOGY

RELATIVE COST TO PARTICIPANT

This paper compares the relative costs of each group insurance system by determining each system's percent of premium cost for dependent coverage paid by the system. Relative premium cost is also indicated by using weighted averages to compare the premiums in each benefit category in each of the systems' self-funded plans.

The "member and family" benefit category is arguably the most valid indicator to use to determine relative dependent coverage. Of the four standardized benefit categories (member only, member and spouse, member and child and member and family), the "member and family" benefit category has the most expensive premiums and thus represents the fullest consideration of dependent coverage cost sharing in a health plan, from the position of healthcare providers.

The analysis takes the weighted averages of the three systems' fully funded and self-funded health plans to generate an overall average institutional share of dependent cost for each system. For example, Appendices I–III show each HMO's enrollment numbers as a ratio of total HMO enrollment. The appendices also show each HMO's total dependent cost for the 'member and family' benefit category and the institutional share for dependent costs. The institutional share dependent cost percentage for each HMO is multiplied by each HMO's ratio of total enrollment to total HMO enrollment. This generates a weighted average percent of dependent cost for each HMO.

The sum of the weighted averages represents the all-HMO percent of premium cost for dependent coverage paid by the institution. Appendices I–III apply this same methodology to each system's self-funded plans, which determines the percent of premium cost for dependent coverage paid by each system's respective self-funded plans. The average HMO share of dependent cost is then multiplied by the ratio of the total number of insured under an HMO. The same is done for the self-funded plans.

The two products are added to produce the combined overall percent of dependent share coverage for each system's HMO and self-funded plans. The combined overall percent of dependent share coverage figures for each system reflect, in comparative terms, differences in overall dependent share cost bearing among the systems.

This data may be supplemented by also comparing the premiums in each benefit category for each of the systems' self-funded plans and fully funded plans to determine the overall range of premium cost among the three systems.

RELATIVE BENEFIT FOR PARTICIPANT

This paper also compares each system's health plan benefits by itemizing common benefits and services and evaluating the relative cost to the insured for each such benefit and service (see in Appendix IV for an example). Criteria common to all health plans should be arrayed in a simple table to allow for efficient comparisons. While there will be differences among the systems in plan terminology and definition of benefits, effort should be made to compare equivalent items.

SUMMARY OF FINDINGS

- Appendices I–III show the average portion of the total premium for dependent coverage paid by each of the three systems in plan year 2002 ranged from 50 percent to 84 percent, with A&M providing 84 percent, UT 55 percent and UGIP 50 percent, respectively. In the previous plan year (2001) for the same systems, the portions covered were 62 percent, 57 percent and 50 percent, respectively. As of plan year 2002, both the A&M and UT Systems still contributed a greater proportion of the dependent share premium cost than UGIP. Especially noteworthy is the very high dependent share covered by A&M, which reflects A&M's evolving plan design philosophy to place greater

cost on the enrollee for specific services while lowering actual monthly premiums.

- For HMO offerings in all three systems, there continues to be significant intra-plan variation in the share of dependent coverage paid based on the enrollee's given region of residence in Texas. Appendices I–III show the range of HMO premiums paid varies considerably, with enrollees living in the San Antonio area generally paying the lowest premiums, and enrollees residing in West Texas and Galveston generally paying the highest premiums.
- Ninety percent of state employees insured through UGIP, 64 percent of UT employees and 59 percent of A&M employees were enrolled in a self-funded plan in 2002. In the previous plan year (2001), these percentages were 79 percent, 77 percent and 49 percent, respectively. For all three systems combined, there were 276,962 employees in 2001 and 308,162 employees in 2002 enrolled in a self-funded plan (for an increase of about 11 percent in self-funded plan enrollment). Self-funded plans are generally more costly to the state and enrollee than fully funded HMOs.
- While covering a larger portion of dependent cost and being less expensive for the participant overall than UGIP self-funded plans, Appendix IV shows that the UT and A&M self-funded plans offer their enrollees somewhat lower overall benefits. This is especially the case for deductibles and out-of-pocket maximums. The three systems offer roughly comparable prescription drug benefits. The UGIP and A&M plans offer yearly vision exams, while UT's vision coverage is optional. All three systems offer separate dental plans.
- Overall, there exists a connection between what is paid for by the system and enrollee on the one hand, and the level of benefits and services provided on the other hand. In relation to the UT and A&M systems, the UGIP system offers greater overall benefits and services to its enrollees, but does so by paying more and requiring higher premiums from its enrollees.
- The evolution of differing plan design philosophies may offer legislators an opportunity to evaluate differing approaches to the cost-sensitive issue of health benefits coverage for state employees.

APPENDIX I
UNIFORM GROUP INSURANCE PROGRAM
"MEMBER AND FAMILY" BENEFIT CATEGORY COMPARISON

FISCAL YEAR 2002

TOTAL ENROLLED	267,558	100%*	TOTAL HMO	27,225	10.2%	TOTAL SELF-FUNDED	240,333	89.8%

HMO	PROPORTION OF HMO INSURED	ENROLLED EMPLOYEES (MF)	MONTHLY PREMIUM MF	MONTHLY PREMIUM MO	TOTAL DEPENDENT COST	EMPLOYEE MONTHLY PREMIUM	DEPENDENT COST INSTITUTION'S SHARE	DEPENDENT COST WEIGHTED AVERAGE PERCENTAGE
FULLY-FUNDED								
AmCare – El Paso	0.024	128	$606.82	$209.28	$397.54	$198.77	50.0%	1.21%
AmCare – Houston	0.096	507	606.17	209.06	397.11	198.55	50.0	4.78
Community First – San Antonio	0.064	341	566.73	195.55	371.18	185.59	50.0	3.22
FirstCare – Abilene	0.078	414	723.39	249.20	474.19	237.09	50.0	3.90
FirstCare – Lubbock	0.096	508	731.65	252.03	479.62	239.81	50.0	4.79
Mercy Health – Laredo	0.013	70	634.38	218.72	415.66	207.83	50.0	0.66
PacifiCare – Austin	0.131	694	681.80	234.96	446.84	223.42	50.0	6.54
PacifiCare – San Antonio	0.120	637	580.27	200.19	380.08	190.04	50.0	6.01
Scott and White – Central	0.348	1,843	730.83	251.75	479.08	239.54	50.0	17.38
Texas Health Choice	0.000	1	641.04	221.00	420.04	210.02	50.0	0.01
Texas University Health Plan	0.030	160	677.31	233.42	443.89	221.94	50.0	1.51
TOTAL, FULLY-FUNDED	**1.000**	**5,303**						**50.00%**
SELF-FUNDED								
HealthSelect**		30,225	$799.27	$275.18	$524.09	$262.03	50.0%	
ALL–PLAN AVERAGE DEPENDENT COVERAGE SHARE							**50.0%**	

Using the "Member and Family" benefit category as an evaluative standard, the combined weighted averages for both ERS' self-funded and fully-funded plans confirm ERS pays 50 percent of the dependent coverage share of its employees' premiums.

*Includes SKIP and retired enrollment.
**Weighted average metered per enrollment in two self-funded UGIP healthcare plans (with a 61.7 percent and 38.3 percent split).
NOTE: MF = member and family; MO = member only.
SOURCE: Employees Retirement System.

APPENDIX II
UNIVERSITY OF TEXAS SYSTEM
"MEMBER AND FAMILY" BENEFIT CATEGORY COMPARISON

FISCAL YEAR 2002

TOTAL ENROLLED	78,161	100%*	TOTAL HMO	27,801	35.6%	TOTAL SELF-FUNDED	50,360	64.4%

HMO	PROPORTION OF HMO INSURED	ENROLLED EMPLOYEES (MF)	MONTHLY PREMIUM MF	MONTHLY PREMIUM MO	TOTAL DEPENDENT COST	EMPLOYEE MONTHLY PREMIUM	DEPENDENT COST: INSTITUTION'S SHARE	DEPENDENT COST: WEIGHTED AVERAGE PERCENTAGE
FULLY-FUNDED								
Humana HMO – Austin	0.228	1,234	$638.69	$235.45	$403.24	$179.56	55.5%	12.66%
Humana HMO – Galveston	0.138	744	751.32	276.85	474.47	211.53	55.4	7.63
Humana HMO – Houston	0.314	1,699	636.86	234.77	402.09	179.04	55.5	17.43
Humana HMO – San Antonio	0.102	550	610.05	224.91	385.14	171.44	55.5	5.65
Humana HMO – Corpus Christi	0.001	6	614.00	226.46	387.80	172.63	55.5	0.06
HMO Blue – Dallas	0.166	899	674.86	248.74	426.12	189.83	55.5	9.22
HMO Blue – El Paso	0.031	165	674.86	248.74	426.12	189.83	55.5	1.69
HMO Blue – Permian	0.001	6	674.86	248.74	426.12	189.83	55.5	0.06
TUHP HMO	0.019	103	546.60	201.59	345.01	153.42	55.5	1.06
TOTAL, FULLY-FUNDED	**1.000**	**5,406**						**55.46%**
SELF-FUNDED								
UT Select (In-network)		5,611	$769.80		$486.15	$216.78	55.40%	
ALL–PLAN AVERAGE DEPENDENT COVERAGE SHARE							**55.43%**	

Using the "Member and Family" benefit category as an evaluative standard, the combined weighted averages for both UTS' self-funded and fully-funded plans indicate UTS pays about 55 percent of the dependent coverage share of its employees' premiums.

*Includes retired, survivor, and COBRA participants.
NOTE: MF = member and family; MO = member only.
SOURCE: University of Texas System.

APPENDIX III
TEXAS A&M UNIVERSITY SYSTEM
"MEMBER AND FAMILY" BENEFIT CATEGORY COMPARISON

FISCAL YEAR 2002

TOTAL ENROLLED	29,585	100%*	TOTAL HMO	12,116	41.0%	TOTAL SELF-FUNDED	17,469	59.0%

HMO	PROPORTION OF HMO INSURED	ENROLLED EMPLOYEES (MF)	MONTHLY PREMIUM MF	MONTHLY PREMIUM MO	TOTAL DEPENDENT COST	EMPLOYEE MONTHLY PREMIUM	DEPENDENT COST INSTITUTION'S SHARE	DEPENDENT COST WEIGHTED AVERAGE PERCENTAGE
FULLY-FUNDED								
AETNA	0.007	24	$598.50	$257.77	$340.73	$80.00	76.5%	0.57%
CIGNA	0.151	485	595.23	260.18	335.05	76.73	77.1	11.67
FirstCare – West Texas	0.038	121	623.02	257.45	365.57	104.52	71.4	2.70
HMO Blue – Corpus Christi	0.023	74	607.94	280.23	327.71	89.44	72.7	1.68
HMO Blue – Dallas	0.005	17	658.78	264.62	394.16	140.28	64.4	0.34
HMO Blue – El Paso	0.002	5	745.59	290.27	455.32	227.09	50.1	0.08
HMO Blue – Houston	0.005	15	669.94	266.45	403.49	151.44	62.5	0.29
Humana – Corpus Christi	0.028	90	594.84	264.64	330.20	76.34	76.9	2.16
Humana – San Antonio	0.001	2	588.62	258.22	330.40	70.12	78.8	0.05
Mercy	0.008	25	645.00	253.82	391.18	126.50	67.7	0.53
PacifiCare	0.021	66	623.08	264.64	358.44	104.58	70.8	1.46
Scott & White	0.712	2,280	573.61	263.28	310.33	55.11	82.2	58.52
TOTAL, FULLY-FUNDED	**1.000**	**3,204**						**80.05%**
SELF-FUNDED								
A&M Care 250/500**	21%/79%	2,438	$531.05	$263.11	$267.94	$34.85	86.99%	
ALL–PLAN AVERAGE DEPENDENT COVERAGE SHARE							**84.15%**	

Using the "Member and Family" benefit category as an evaluative standard, the combined weighted averages for both TAMUS' self-funded and fully-funded plans indicate TAMUS pays about 84 percent of the dependent coverage share of its employees' premiums.

*Includes retired, survivor, and COBRA participants.
**Weighted average metered per enrollment in two self-funded TAMUS healthcare plans (with a 21.16 percent and 78.84 percent split).
NOTE: MF = member and family; MO = member only.
SOURCE: Texas A&M University System.

APPENDIX IV
COMPARISON OF BASIC SELF-FUNDED HEALTH PLAN PROVISIONS

FISCAL YEAR 2002

PROVISION	UT SELECT, IN-AREA	A&M CARE 250, IN-AREA	ERS-UGIP HEALTHSELECT, IN-AREA
ANNUAL DEDUCTIBLE	$250 per person per plan year $750 per family/plan year	$250 per person per plan year $750 per family	$0
OUT OF POCKET MAXIMUM	$1,750 maximum per person per plan year $5,250 maximum per family (includes deductible)	$1,400 maximum per person per plan year $4,200 maximum per family (includes deductible)	$500 per person per plan year
IN-HOSPITAL CARE	15 percent after plan deductible	20 percent after plan deductible	10 percent of allowable charges
EMERGENCY ROOM	$50 copayment	20 percent after plan deductible	$50 copayment if not admitted 10 percent of allowable charges if admitted
SURGERY	15 percent after plan deductible	20 percent after plan deductible	10 percent of charges
OUTPATIENT SURGERY	15 percent of after plan deductible	20 percent after plan deductible	10 percent of allowable charges
OFFICE VISITS	$10 per visit $25 per visit to a specialist	$15 per visit (same for each visit to a specialist)	$15 per visit
PRESCRIPTION DRUGS	*30-day supply:* $10 for generic drugs $25 for preferred drugs $40 for non-preferred drugs Must purchase from a network retail pharmacy *Mail order (90-day supply):* $20 for generic drugs $40 for preferred drugs $60 for non-preferred drugs	*30-day supply:* $5 for generic drugs $15 for brand-name formulary drugs $30 brand-name non-formulary drugs Must purchase from a network retail pharmacy *Mail order (90-day supply):* $10 for generic drugs $30 for brand-name formulary drugs $60 for brand-name non-formulary drugs	*30-day supply:* $5 for generic drugs $20 for preferred brand-name drugs $35 for non-preferred brand-name drugs Must purchase from a network retail pharmacy *Mail order (90-day supply):* $10 for generic drugs $40 for preferred brand-name drugs $70 for non-preferred brand-name drugs
VISION	None. Coverage optional. Plan covers illness-related eye exams.	$15 exam, one per plan year through network provider	$15 for eye exam, one per plan year per participant
DENTAL	None. Coverage optional. Covers accidental injury to healthy, normal teeth; subject to deductible and coinsurance.	None. Coverage optional. Covers accidental injury to healthy, normal teeth; subject to deductible and coinsurance.	None. Coverage optional. Covers accidental injury to healthy, normal teeth; subject to deductible and coinsurance.
THIRD PARTY ADMINISTRATOR FOR MEDICAL BENEFITS	Blue Cross/Blue Shield	Blue Cross/Blue Shield	Blue Cross/Blue Shield
PHARMACY BENEFITS MANAGER	Merck-Medco	Eckerd Health Services	Merck-Medco

SOURCES: Employees Retirement System; University of Texas System; Texas A&M University System.

Coordinating State Expenditures on Emissions Reductions

In July, 2002, the U.S. Environmental Protection Agency (EPA) issued a notice to Texas that the Dallas-Fort Worth and Houston-Galveston Statewide Implementation Plans (SIPs) were in jeopardy of being disapproved. The EPA asserts that disapproval is likely if funding cannot be restored to the Texas Emissions Reduction Plan (TERP) created by Senate Bill 5, Seventy-seventh Legislature, 2001. A disapproved SIP could result in the EPA imposing sanctions against Texas, which could ultimately have a negative impact on the amount of federal funding the state receives and could hinder economic development, especially in the Houston-Galveston and Dallas-Fort Worth areas.

The Commission on Environmental Quality (TCEQ) has estimated that it will be necessary to provide $188.7 million per year in revenues to the TERP fund in fiscal years 2004 and 2005, which represents an increase of $168.1 million per year over the current level of revenues. Arriving at a mechanism to provide this level of funding will no doubt prove challenging. This report attempts to assess whether funds currently being spent on reducing emissions by the state are being directed toward projects which are the most cost-effective at reducing emissions and conducive to qualifying for the most credit possible for the SIPs.

Significant Concerns

- Texas could face EPA-imposed sanctions if the Houston-Galveston and Dallas-Fort Worth SIPs are disapproved by the EPA.
- Since the largest source of funding for the TERP was found to be unconstitutional, funding for the TERP is significantly less than needed to achieve the emission reductions the TERP is required to achieve in the SIP.
- Significant expenditures on emissions reductions are made by Metropolitan Planning Organizations using federal Congestion Mitigation and Air Quality (CMAQ) funds received by the Department of Transportation. However, not all CMAQ expenditures are resulting in quantifiable emissions reductions in the SIPs. In addition, there are no cost-effectiveness criteria required for CMAQ project selection.
- The Department of Transportation and the Commission on Environmental Quality currently have no performance measures that capture the number of tons of emissions reductions being achieved through CMAQ- and TERP-funded projects or that provide the amount being spent per ton reduction in nitrous oxide.
- A significant amount of state agency expenditures on programs aimed at reducing air emissions and energy consumption are not resulting in credits recognized by the SIPs.
- There is no formal process for coordinating major emissions reductions programs, such as the TERP and the CMAQ programs, administered by state agencies and local governments.

Recommendations

- **Recommendation 1:** The Texas Emissions Reduction Plan Advisory Board should examine all state agency spending directed toward improved air quality to determine whether such expenditures are achieving

quantifiable reductions in the release of ozone-forming pollutants that can be used in the Statewide Implementation Plans, especially in the Dallas-Fort Worth and Houston-Galveston areas.

- **Recommendation 2:** The Commission on Environmental Quality, in conjunction with the Department of Transportation, should play a role in setting criteria for evaluating Congestion Mitigation and Air Quality projects which are selected for funding by local Metropolitan Planning Organizations.
- **Recommendation 3:** Cost-effectiveness criteria, similar to those contained in the Texas Emissions Reduction Plan (TERP), or some other performance-based criteria, should be applied to both TERP and non-TERP expenditures made using state and state-controlled federal funds (such as Congestion Mitigation and Air Quality funds) for improving air quality, promoting alternative fuels, or reducing energy consumption.
- **Recommendation 4:** Performance measures for the Department of Transportation and the Commission on Environmental Quality should be included in the 2004–05 General Appropriations Act capturing the following: the number of tons of nitrous oxide reduced through Congestion Mitigation and Air Quality projects and Texas Emissions Reduction Plan projects, and the average cost of achieving a one ton reduction of nitrous oxide through such programs.
- **Recommendation 5:** The Department of Transportation should consider allocating more non-Congestion Mitigation and Air Quality Funds to air-quality-related transportation projects in nonattainment areas, because the use of Federal Funds for highway projects in those areas could be restricted, if sanctions are imposed on Texas by the U.S. Environmental Protection Agency.
- **Recommendation 6:** Representatives of the Department of Transportation and metropolitan planning organizations should be included as ex-officio members of the Texas Emissions Reduction Plan Advisory Board.

COMMENTS

FEDERAL CLEAN AIR ACT

The Federal Clean Air Act (CAA), first enacted in 1963, substantially overhauled in 1970, and amended again in 1977 and 1990, requires Texas to meet certain air quality standards by limiting the amount of certain pollutants in the air. Those standards are administered by the U.S. Environmental Protection Agency (EPA). Under the CAA, the Commission on Environmental Quality (TCEQ) develops a SIP to address air quality. The SIP includes a set of rules to be implemented in "nonattainment" areas, or those areas exceeding EPA standards for particular air pollutants. The standards are known as the National Ambient Air Quality Standards and apply to six common air pollutants: ozone, particulate matter, nitrogen dioxide, carbon monoxide, sulfur dioxide, and lead.

Nonattainment areas are classified based on the extent to which they exceed air quality standards. They may be classified as

- marginal
- moderate
- serious
- severe
- extreme

Texas currently has four nonattainment areas for ozone (one moderate, two serious, one severe) and three that are very close to being classified as nonattainment areas. Strategies are being implemented in these areas, as well as statewide, to improve air quality and to ensure that these areas will achieve or

maintain attainment status. These strategies prescribe requirements that generally become stricter and more numerous as an area moves from one classification level to another.

Consequences of Non-compliance with the Clean Air Act

If the EPA administrator determines that a state has failed to submit an acceptable SIP achieving and maintaining air quality standards or has failed to implement the requirements of an approved SIP, the EPA notifies the state of that finding. If the deficiency is not corrected within 18 months, the EPA is authorized to impose two types of sanctions under the CAA:

- mandating a minimum 2-to-1 emissions offset ratio for new and modified major emissions sources; and
- withholding of certain federal highway dollars.

Under EPA rules, the administrator first imposes the minimum offset requirement. If the deficiency is not corrected within six months, both sanctions are imposed.

Additional consequences may also be imposed on states that do not meet CAA requirements. These include imposition of a federal implementation plan, direct federal enforcement of SIP provisions, and the withholding of transportation and other dollars due to a transportation conformity lapse (or lack of demonstration that an area's transportation plans conform to the local SIP.) Additionally, for an area classified as having severe or extreme ozone nonattainment, EPA regulations require that states impose a fee of $5,000 per ton of emissions per day on major stationary sources if the area does not achieve national ambient air quality standards by the prescribed attainment date.

The Texas SIP

The CAA requires any state with one or more areas that fail to meet federal air quality standards to develop statewide implementation plans mapping out how the state will bring these areas into compliance with the act and avoid the type of sanctions discussed above. A SIP collects the regulations a state will use to clean up polluted areas. The EPA must approve each SIP; if the SIP is not acceptable, the EPA can assume responsibility for enforcing the CAA in that state under a federal implementation plan.

Currently, there are four areas in Texas that do not meet the one-hour ozone standard and have therefore been designated as nonattainment areas by the EPA. One of them, El Paso, falls under special federal rules and is not required to revise its SIP because TCEQ has demonstrated that much of the emissions responsible for poor air quality in that area are produced in Mexico. Of the other three, the portions of the SIP relating to Beaumont-Port Arthur and Houston-Galveston have been approved by the EPA. Dallas-Fort Worth's portion is still pending EPA approval.

Control strategies contained in the SIPs aim to reduce air pollution, and in most areas strategies focus on reducing nitrous oxides (NOx), the precursor to ground-level ozone. Each control strategy aims to achieve a targeted reduction in the number of tons of pollutants being emitted by identifiable "point" sources, such as industrial facilities, and by less identifiable "nonpoint" sources, such as vehicles, construction equipment, lawn equipment, etc.

The TCEQ estimates the number of tons of each pollutant, such as NOx or particulate matter, that each nonattainment area must eliminate through these control strategies, and the SIP includes a listing of each strategy and the expected number of tons in daily emissions. Control strategies in the SIPs for Houston-Galveston and Dallas-Fort Worth currently do not achieve all of the reductions necessary for these areas to reach attainment status. The difference

between the reduction in tons achieved by the SIP and the amount necessary for the area to reach attainment is known as the area's emissions "gap." The Houston-Galveston SIP was submitted with a gap of 16 tons of NOx per day (tpd).

The Texas Emissions Reduction Plan

The TCEQ adopted SIPs for Houston-Galveston and Dallas-Fort Worth that originally included two items: the early purchase of Tier II and Tier III Equipment (Tier II/Tier III) and the construction shift rules that were expected to achieve substantial NOx emissions in both the Dallas-Fort Worth and Houston-Galveston areas. The Tier II/Tier III rule required operators of certain diesel equipment to replace equipment at an accelerated pace and was estimated to achieve a reduction in NOx of 26 tpd in both the Houston-Galveston and Dallas-Fort Worth areas combined.

The construction shift rule prohibited construction during the ozone season (roughly April through October) between the hours of 6:00 AM and 10:00 AM in Dallas-Fort Worth and between 6:00 AM and 12:00 noon in the Houston-Galveston area, since it has been shown that emissions in the early morning hours are responsible for a significant portion of ground-level ozone created throughout the day. The construction shift rule was expected to achieve a reduction in NOx of 9.2 tpd in both the Houston-Galveston and Dallas-Fort Worth areas combined.

The TCEQ received considerable opposition to the implementation of the Tier II/Tier III and construction shift rules because many citizens perceived these control strategies as being too onerous on industry, businesses, and ultimately to private citizens themselves. Even some state agencies expected the rules to increase certain costs. For instance, the Department of Transportation (TxDOT) estimated in 2000 that the construction shift rules could increase construction and maintenance costs starting in 2005 by as much as 12 percent in the Houston-Galveston nonattainment area and by as much as 16 percent in the Dallas-Fort Worth nonattainment area. TxDOT bases these estimates on a January 2001 study by the Texas Transportation Institute.

As a result of opposition and the perception that these two rules would increase the cost of doing business in the Dallas-Fort Worth and Houston-Galveston areas, Senate Bill 5, Seventy-seventh Legislature, 2001, required TCEQ to revise existing SIPs for Dallas-Fort Worth and Houston-Galveston and delete the requirements of the Tier II/Tier III and construction shift rules. In place of these measures, and to fill a portion of the "gap" mentioned above for the Houston-Galveston SIP, Senate Bill 5 created the TERP as an incentive-based program to achieve NOx reductions.

TERP programs include a diesel engine reduction incentive program, a motor vehicle purchase or lease incentive program, an energy efficiency grant program, a new technology research and development program, and statewide building and energy performance standards. However, the diesel engine reduction incentive program is the only TERP program with a quantified NOx emissions reductions target contained in the SIP. TERP provisions in Health and Safety Code, Section 386.106, require that projects achieve emissions reductions of at least one ton of NOx per year for every $13,000 in assistance provided, or $4.7 million per ton of NOx reduced per day.

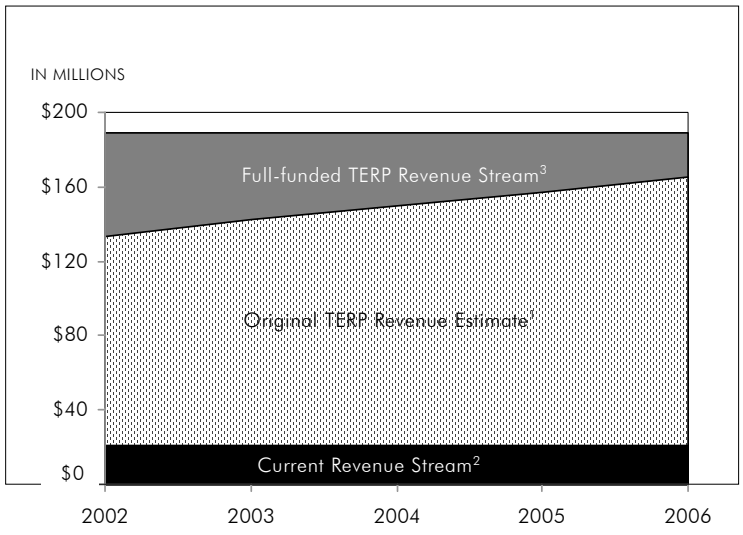
Senate Bill 5 provided for TERP programs to be funded through a series of fees and taxes. The various fees and taxes created in TERP were originally estimated to generate approximately $133.3 million starting in fiscal year 2002, rising to an estimated $165.3 million by fiscal year 2006. However, because a $225 out-of-state vehicle inspection fee created by Senate Bill 5, Seventy-seventh Legislature, 2001, was ruled to be unconstitutional, the majority of funding for the program has failed to materialize (only $20.6 million in revenues were collected in 2002) with similar amounts expected in future years (Figure 1). Because of this

revenue shortfall, the EPA has warned Texas that "unless Senate Bill 5 funding is restored or other equivalent pollution reduction measures are enacted, the Dallas-Fort Worth area SIP will not be approved, and the Houston-Galveston SIP's approval will be jeopardized."

The revenue shortfall in fiscal years 2002 and 2003 means that fewer emissions reductions are likely to be realized in those years. Whereas total NOx emissions reductions of 51 tpd to 55 tpd were envisioned through the TERP program, as of October 2002, only 1.3 tpd has actually been achieved. Consequently, funding in fiscal years 2004 through 2008 will have to be substantially higher than current levels, and perhaps at substantially higher levels than Senate Bill 5 was originally expected to produce. The TCEQ has determined that $188.7 million per year between fiscal years 2004 and 2008 would be needed to achieve the full NOx emissions reductions currently targeted by the TERP program. This represents an increase of $168.1 million per year over the current revenue stream, and approximately $30 to $40 million more per year than estimated upon passage of Senate Bill 5.

One possible solution to the TERP funding shortfall could be for the Seventy-eighth Legislature, 2003, to create and implement new fees and/or taxes, or to expand or to increase existing TERP fees and surcharges, to generate revenues needed to restore the TERP in its entirety. As an alternative, Recommendation 1 would provide that existing expenditures on air quality programs at other state agencies could be examined by the TERP Advisory Board. Subsequently, future TERP expenditures could be directed towards activities to produce the greatest quantifiable reductions in emissions possible, thereby reducing the amount of revenue that would have to be raised for TERP programs. In addition, the TCEQ, in conjunction with other state agencies and local governments that expend funds to reduce air pollution, could attempt to include any related reductions in the SIP to ensure that the state is receiving the maximum credit possible.

FIGURE 1
TEXAS EMISSIONS REDUCTIONS PLAN FUND REVENUES



SOURCES: [1]Legislative Budget Board; [2]Comptroller of Public Accounts; [3]Commission on Environmental Quality.

CONGESTION MITIGATION AND AIR QUALITY IMPROVEMENT PROGRAM

The Federal Highway Administration (FHWA) administers the CMAQ as a funding source for transportation projects that will contribute to attainment of national air quality standards in nonattainment areas. Since 1992, Texas has received over $1 billion in CMAQ funds from FHWA. All of the funds are designated for projects in the state's four nonattainment areas, with each area receiving an allocation of the funding based on population and a weighting factor determined by how severe the area's air pollution problems are. Table 1

provides a breakdown of CMAQ apportionments by metropolitan planning organization (MPO) from 1998–2002.

All CMAQ projects require a 20 percent match, which is usually paid for by the local government entities, but TxDOT can also pay for the match requirement if the project is part of the state highway system. There are various types of projects that are eligible for CMAQ funding, including, but not limited to the following:

- intersection and traffic flow improvements;
- hike and bike trails;
- programs for improved public transit;
- vanpool programs;
- alternatively fueled vehicle programs; and
- the construction of high-occupancy vehicle lanes.

In addition, all CMAQ projects must conform to an area's transportation improvement plan, and CMAQ funds may not be used to create or expand single-occupancy vehicle capacity. In all cases, CMAQ projects must demonstrate some benefit to a region's air quality. Although the FHWA requires an annual report from each state quantifying emission reductions from CMAQ projects, the FHWA does not require projects to receive credit in a SIP.

METROPOLITAN PLANNING ORGANIZATIONS AND CMAQ

TxDOT is the recipient of CMAQ funds in Texas. TxDOT delegates project selection to each area's metropolitan planning organization (MPO). TxDOT does not impose any additional criteria on MPOs in their selection process. As long as a project meets CMAQ guidelines, it is up to each local community to decide what type of projects it will fund and the order in which projects will be implemented.

The TCEQ works with TxDOT and MPOs to calculate emissions reductions resulting from CMAQ projects. Although TCEQ is the agency responsible for ensuring that regions in Texas attain air quality standards, TCEQ has no input into selection criteria by MPOs regarding CMAQ funding priorities. Although some CMAQ projects appear to have a substantial benefit to air quality and have been selected by leaders in the local MPO areas as local priorities, some other projects appear to fail to gain any credit toward the SIP.

The lack of coordination between TCEQ and air quality agencies on CMAQ project selection and the SIP appears to be a common problem across the United States. In fact, a study prepared for the EPA in April 2002 finds that air quality agencies across the country had limited involvement in project selection, and the study calls for more involvement in project evaluation. The study also recommends that "to qualify for CMAQ funds, a project should be required to demonstrate that a specified minimum air quality benefit threshold is met or exceeded, based on established criteria and supporting data; such a threshold should be determined

TABLE 1
ANNUAL CONGESTION MITIGATION AND AIR QUALITY IMPROVEMENT PROGRAM APPORTIONMENT BY METROPOLITAN PLANNING ORGANIZATION

IN MILLIONS

	FISCAL YEAR APPORTIONMENT					
DISTRICT	1998	1999	2000	2001	2002	TOTAL
Beaumont	$2.6	$3.3	$4.7	$5.1	$4.8	$20.5
Dallas	20.9	27.4	30.6	33.4	31.1	143.3
El Paso	6.4	8.2	9.0	9.9	9.2	42.6
Fort Worth	10.3	12.9	14.5	15.8	14.7	68.1
Houston	35.4	45.7	50.1	54.6	50.8	236.7
TOTAL	**$75.5**	**$97.5**	**$109.0**	**$118.7**	**$110.5**	**$511.2**

SOURCE: Department of Transportation.

with the concurrence of the appropriate state and/or local air quality agency."

In Texas, extensive efforts are made to quantify NOx reductions from CMAQ projects, and MPOs generally target a portion of CMAQ funds directly to projects in the SIP. Similar to the TERP program's On-Road Diesel Purchase or Lease Incentive program, the Houston-Galveston Area Council's (H-GAC) Clean Vehicle program provides incentive payments for the purchase of vehicles and the retrofitting of existing on-road engines. The H-GAC reports that some of its projects are actually using a combination of funding from both CMAQ and TERP funds, with TERP funds being used as the required matching funds.

The H-GAC also uses cost-effective criteria similar to those contained in the TERP for Clean Vehicles funding eligibility. Projects must achieve a reduction of at least one ton of NOx per year for every $15,000 in CMAQ assistance, or a minimum of $5.5 million per ton of NOx reduced per day. The H-GAC is responsible for achieving a total of 23 tpd in NOx reductions required in the SIP, 7 tpd of which the MPO is attempting to achieve by 2007 through the Clean Vehicle program.

The H-GAC reports that only about $7.5 million out of a total allocation of more than $30 million per year is spent on Clean Vehicle projects. Remaining funds are spent on various other projects, most of which achieve some emissions reductions. However, these projects are not necessarily selected based on the amount of NOx they reduce, and many of these projects only achieve negligible emissions reductions. It therefore appears that greater reductions could be achieved and applied toward credit in the SIP if more of H-GAC's annual funding were designated for SIP projects selected based on cost-effectiveness criteria.

The North Texas Council of Governments (NTCOG) also has a Clean Vehicles program and uses cost-effectiveness criteria in selecting projects for funding. However, similar to the H-GAC, the NTCOG spends substantial funds on projects for which emissions reductions are negligible or remain unquantifiable.

Maximizing SIP Credit for Transportation-related Expenditures

Considering the loss of TERP funding in Texas and the threat of sanctions by the EPA if funding is not replaced, TxDOT and TCEQ should work together to establish guidelines for project selection, maximizing the amount of emissions reductions received from the more than $100 million per year in Federal Funds Texas MPOs are already spending on air quality projects (Recommendation 2). This could reduce the amount of funding that is needed for the TERP. Recommendation 3 suggests that a cost-effectiveness standard, such as the one used for the TERP program ($13,000 tpd) and the one used by the H-GAC ($15,000 tpd) could be applied to additional CMAQ-funded projects. As an alternative, some other type of performance-based criteria could be developed to ensure that projects funded by CMAQ are attaining a reasonable level of emissions reductions that can be used in the SIP. One option would be to include performance measures in the 2004–05 General Appropriations Act for TxDOT and TCEQ establishing targets for the number of tons of NOx to be reduced through CMAQ and TERP funds, respectively, and for the average cost of reducing NOx emissions by one ton (Recommendation 4).

TxDOT's Use of Non-CMAQ Funds to Achieve Air Quality Improvements

According to the FHWA, Congress did not intend CMAQ funding to be the only source of funds to reduce congestion and air quality. Other funds under the Surface Transportation Program, for instance, may be used for this purpose as well. TxDOT reports that it does spend non-CMAQ funds on improving air quality, and the agency reports that emissions reductions credits are claimed for projects where funds are used other than CMAQ, but TxDOT does not track the amount of SIP credit such expenditures achieve.

Because EPA sanctions for Texas noncompliance could result in the restriction of federal funding for transportation projects in nonattainment areas, Recommendation 5 suggests that it might be reasonable for TxDOT to allocate more of its non-CMAQ Federal Funds toward air quality projects that do achieve SIP credit in the Houston-Galveston and Dallas-Fort Worth areas and to track the amount of credit being achieved through such expenditures. As a preventative step to achieve emissions reductions, this also could reduce the amount of funding needed to be raised for the TERP and decrease the chances of EPA-imposed sanctions on Texas.

Other State Agency Expenditures on Emissions Reductions

The majority of state funding to reduce air pollutants occurs at the TCEQ and at TxDOT. In addition to $100.0 million or more being spent on CMAQ by TxDOT each year, and in addition to expenditures on TERP programs, TCEQ also makes significant expenditures on improving air quality. Although the TCEQ has not been able to determine the total cost spent on SIP-related activities, according to the agency's Legislative Appropriations Request for 2004-05, the TCEQ spent $79.7 million out of the Clean Air Account No. 151, all on air-related activities. That amount is expected to increase in 2003, 2004 and 2005, as the Low-Income Vehicle Repair Assistance Program expands. Once TCEQ determines how much is being spent on SIP-related activities, those expenditures also should be analyzed to ensure the agency is maximizing the amount of SIP credit being attained.

The State Energy Conservation Office (SECO), housed within the Office of the Comptroller of Public Accounts, spends approximately $11.8 million annually to promote energy conservation in the State. Since there is a direct correlation between energy use and emissions from power-producing facilities, SECO's success at reducing energy use can also translate to emissions reductions. Although there currently is no focus by the agency on nonattainment or near nonattainment areas specifically, the SECO could consider focusing attention to areas at risk for noncompliance with the CAA. Projects that reduce the demand for energy produced in the Houston-Galveston or Dallas-Fort Worth airsheds, for example, could be designated as priorities for funding by the agency.

In addition, the TCEQ reports that none of SECO's projects currently are receiving SIP credit. SECO should work with the TCEQ to ensure that SECO-funded projects receive SIP credit when possible. SIP eligibility could be an additional criterion or priority focus that SECO could add when considering projects for funding.

As mentioned above, the only TERP program receiving SIP credit is the diesel engine reduction incentive program at the TCEQ. Remaining TERP programs which currently are not receiving SIP credit include the motor vehicle purchase or lease incentive program operated by the Comptroller of Public Accounts, the energy efficiency grant program operated by the Public Utility Commission, a new technology research and development program operated by the Council on Environmental Technology, and the statewide building and energy performance standards, operated by the Energy Systems Laboratory at the Texas Engineering Experiment Station. The TCEQ reports that these programs will be re-evaluated during mid-course review of the SIP (beginning in 2003 or 2004). The TCEQ should move as quickly as possible to determine how effective these programs will be at producing quantifiable emissions reductions that can be included in the SIP. Funding could then be shifted to the programs or types of projects proven to achieve the greatest emissions reductions per dollar spent.

The Railroad Commission has an established alternative fuels program for which the main focus is promoting the use of liquid propane gas in the state. The Railroad Commission spent $3.3 million on promoting the use of liquid propane gas in fiscal year

2002. The agency's focus, however, is on increasing the market for alternative fuels and not on promoting alternative fuels for emissions reductions. The agency could work with the TCEQ to determine if a shift in focus for the agency to promoting fuels that reduce emissions in nonattainment areas could result in some quantifiable emissions credits in the SIP.

Interagency Coordination on Emissions Reductions

Senate Bill 5 created the TERP Advisory Board as a 15-member body representing several industries and consumer groups. There are also seven members that serve as ex-officio members of the TERP Advisory Board, including the Chair of the Senate Natural Resource Committee and the House Natural Resource Commission, plus representatives of five state agencies: TCEQ, TCET, the General Land Office, the Railroad Commission, and the Comptroller of Public Accounts. The Board reviews the TERP program and makes recommendations to the TCEQ on potential changes to revenue sources or financial incentives or any legislative, regulatory, or budgetary changes needed.

Considering the amount of CMAQ expenditures made by TxDOT each year through the MPOs, and considering that the goals of TERP and CMAQ are quite similar—providing funding to reduce emissions—the Legislature should consider adding representatives of TxDOT, the H-GAC and the NTCOG to the TERP Advisory Board as ex-officio members (Recommendation 6). The scope of the board's purview also could be expanded to include the review of all state spending on air quality improvement programs. This would help to ensure more coordination and promote more effective progress towards cleaning the air in Texas and avoiding sanctions by the EPA.

Disaster Assistance Payments: Recent Experience

This review focuses on Texas' experience with funding sources and disaster assistance payments for natural disasters in Texas with an emphasis on funding mechanisms. Matching requirements for some recent disaster relief efforts have exceeded the governor's contingency fund resources and required transfers or expenditures from other state agency appropriations.

Significant Findings and Concerns

- The governor's contingency fund fully covered the state share of expenditures with the exception of portions of Hurricane Bret (fiscal year 1999), the Fort Worth tornado (fiscal year 2000), and the Northeast Texas ice storms (fiscal year 2001). The state share of expenditures in excess of contingency funding was covered by lapsing General Revenue Funds appropriated in the Nursing Home strategy from the Department of Human Services (DHS) in the amount of $409,806.
- During fiscal year 2001, the state share of expenditures for Tropical Storm Allison was covered by appropriations made to the Department of Human Services. Earned Federal Funds totaling $43.0 million was expended, including $2.6 million from the Texas Integrated Eligibility System (TIERS). General Revenue Funds expended for Tropical Storm Allison totaled $3.9 million (June 2001).
- In fiscal year 2002, the state share of expenditures for the Central Texas floods is being covered by funds appropriated to the Nursing Home Strategy. $3.9 million is being allocated for cash flow purposes (or until other authorized funding is secured) for the 2002–03 biennium state share of expenditures.
- Limitations placed on full-time-equivalent positions for state employment levels do not apply to a state agency or institution in instances of employment of temporary or contract workers directly associated with events declared disasters by the governor (Article IX, Sec. 6.14 (g), 2002–03 General Appropriations Act).
- The Comptroller of Public Accounts may allow a state agency or institution of higher education to reimburse or pay a travel expense incurred by an employee if the expense is incurred while the employee is completing official state business that the agency deems critical to the agency's or institution's constitutional or statutory duties (Article IX, Sec. 5.09(e)(2)(c), 2002–03 General Appropriations Act).

Recommendations

- **Recommendation 1:** In the General Appropriations Act, the Legislature should clarify funding availability from state agencies in the event of a federally declared natural disaster.
- **Recommendation 2:** If the disaster occurs in the first year of the biennium, or after the Legislature has met, the Legislature should clarify the appropriation mechanism that will allow expenditures to be made without calling a special legislative session or other extraordinary session.
- **Recommendation 3:** The Legislature should include a rider in the General Appropriations Act that would allow for transfers between agencies in the event that a disaster is declared.

To implement this recommendation, the Seventy-eighth Legislature, 2003, should consider adopting the following language for the 2004–05 biennium:

Disaster Related Transfer Authority.

a) In the event of a disaster proclamation by the Governor under the Texas Disaster Act of 1975, Chapter 418, Government Code, transfers of appropriations made in this Act, if necessary to respond to the disaster and if made according to the terms of this section, are permitted.

b) Health and Human Services Agencies: For a health and human services agency listed in Chapter 531, Government Code, that directly responds to the disaster, the Commissioner of Health and Human Services is authorized to transfer funds from another health and human services agency listed in Chapter 531, Government Code to the responding agency, and may transfer funds between the strategies of each agency for the purpose of funding the disaster response subject to the prior notification of the Legislative Budget Board and Governor as provided by Subsection (e).

c) Other Agencies: An agency other than a health and human services agency listed in Chapter 531, Government Code that directly responds to a disaster may transfer appropriations within the agency, without regard to any limits on transfer of appropriations between strategies, subject to the prior notification of the Legislative Budget Board and Governor as provided by Subsection (e).

d) Transfers Between Agencies: In the event that a transfer involving at least one agency not listed in Chapter 531, Government Code is necessary in order to respond to a disaster, the agencies involved in the transfer shall request approval from the Legislative Budget Board and the Governor for the emergency transfer of funds, pursuant to Article XVI, Section 69, Texas Constitution. Any request under this subsection should include the same information required in the recommended plan of transfer below, and a copy shall be provided to the Comptroller.

e) Notification of Recommended Plan of Transfer.

(1) Recommended Plan of Transfer: A recommended plan of transfer submitted by an agency to the Governor and Legislative Budget Board under this section must include the following information:

(a) a copy of the appropriate disaster proclamation made under Chapter 418, Government Code;

(b) the amounts to be transferred (listed by method of finance);

(c) the agency or agencies affected;

(d) the programs affected by the transfer; and

(e) any other information requested by the Legislative Budget Board.

(2) Notification and Approval: An agency must notify the Legislative Budget Board, the Comptroller, the Governor, and any other agency involved in the transfer at least 14 days prior to the date of recommended transfers. If neither the Legislative Budget Board nor the Governor issue a written disapproval within 14 days of receipt of the agency recommended plan of transfer, the Comptroller shall transfer the funds as recommended.

COMMENTS

Federal disaster aid to victims is provided through the Individual and Family Grant Program (IFGP),

administered by the Federal Emergency Management Agency (FEMA) and DHS. FEMA is an independent agency of the federal government, reporting to the president. The agency's mission is to reduce loss of life and property and protect this nation's critical infrastructure from all types of hazards through a comprehensive, risk-based, emergency management program of mitigation, preparedness, response and recovery. In the event of a natural disaster in Texas, FEMA works with state officials to provide assistance to individuals or families who are victims. Upon declaration of a major disaster, applicants may register for assistance with FEMA.

The 2002–03 General Appropriations Act includes $7 million in the Disaster Fund strategy of the Governor's Office. The most costly disasters, or multiple disasters in a single biennium, may require state matching funds greater than amounts appropriated to the Governor's Office.

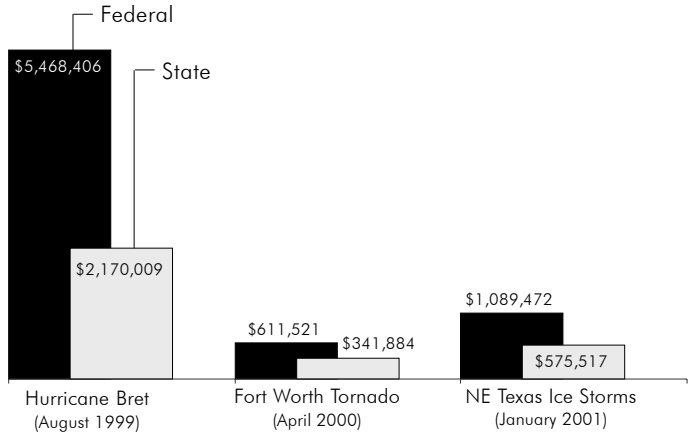
Figure 1 shows a breakdown of state and federal expenditures for portions of Hurricane Bret, the Fort Worth tornado and the Northeast Texas ice storms. The state share of expenditures in excess of contingency funding was covered by lapsing General Revenue Funds from DHS. The state share of expenditures totaled approximately $3.1 million for all three disasters, and federal expenditures were approximately $7.2 million.

Tropical Storm Allison has been the largest declared disaster in Texas. The state and federal government have provided over $265.0 million to the victims of this disaster since its occurrence in June of 2001 (See Figure 2). Fiscal year 2001 expenditures reported by the DHS for Tropical Storm Allison show that Earned Federal Funds totaling $43.0 million were expended, including $2.6 million from the Texas Integrated Eligibility System (TIERS). General Revenue Funds expended for Tropical Storm Allison totaled $3.9 million. Funding from the Nursing Home strategy ($18,312,727) is being used for cash flow purposes (or until other authorized funding is secured) for the fiscal year 2002–03 state share of expenditures.

Estimated costs for the Central Texas floods of 2002 total $15.9 million. Since the event was declared a disaster by the President, DHS will be reimbursed for 75 percent of the cost. Figure 3 illustrates the state and federal expenditures for this disaster. Applications for assistance are still being processed by the agency and may increase the total expenditures.

Reports show that there have been 45 disaster declarations since 1974 in Texas. Since this time, the state and federal government have granted 84,644 grants to victims. Overall, the average amount per grant is estimated to be $2,520.88 and the total grant amount provided to victims of natural disasters from 1974 to present is $379,454,820. The total method of finance

FIGURE 1
DISASTER ASSISTANCE

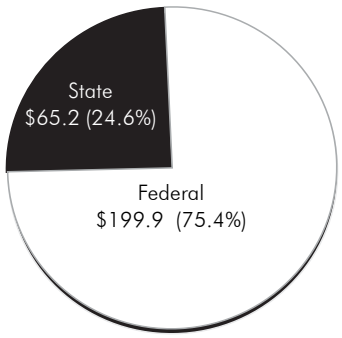


SOURCE: Department of Human Services.

FIGURE 2
TROPICAL STORM ALLISON EXPENDITURES
JUNE 2001

IN MILLIONS

TOTAL = $265.1 MILLION

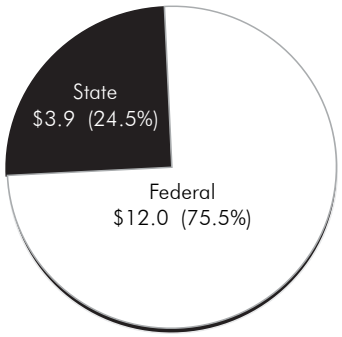


SOURCE: Department of Human Services.

FIGURE 3
CENTRAL TEXAS FLOODS EXPENDITURES
JULY 2002

IN MILLIONS

TOTAL = $15.9 MILLION



SOURCE: Department of Human Services.

is $390,222,560 ($293,834,586 for federal and $120,564,262 for Texas).

The following table (see Table 1) provides funding information on the history of disaster declarations in Texas for the past 10 years. The two largest disasters reported are Tropical Storm Allison (2001) and the Central Texas floods (2002). The numbers provided for these disasters are only estimates since applications are still being received for both disasters and the dollar amount for the grants is expected to grow.

Within 24 hours of a disaster declaration by the governor, temporary staff are contracted by DHS and FEMA coordinators and immediately deployed to the disaster site to assist with preparation of services for victims. During the Allison floods of 2001 and the Central Texas floods of 2002, both federal and state agencies hired temporary staff to assist with processing applications and providing assistance to affected individuals. The state and federal government employed 1081 temporary staff for the Allison floods and 555 individuals for the Central Texas floods. The number of staff hired will depend on the number of disaster applications needing to be processed.

OVERVIEW OF THE STATE PROGRAM

In Texas, coordinating the emergency services' response to natural and man-made disasters is the responsibility of the Governor's Division of Emergency Management (DEM), which is directed by the Department of Public Safety (DPS). DEM's 74-member staff does its job with the help of the State Emergency Management Council (made up of 30 state agencies), the American Red Cross and the Salvation Army.

Chapter 418. Emergency Management, Subchapter A. General Provisions and Subchapter B. Power and Duties of Governor provide broad powers to the Governor for use of resources during a declared disaster.

IN SECTION 418.017, USE OF PUBLIC AND PRIVATE RESOURCES

a) The governor may use all available resources of state government and of political subdivi-

TABLE 1
DISASTER DECLARATIONS IN TEXAS
CALENDAR YEARS 1992–2002

IN MILLIONS

DECLARATION DATE	DISASTER RECOVERY NUMBER	NAME	TOTAL GRANTS	METHOD OF FINANCE		
				FEDERAL	STATE	TOTAL
March 1992	937	Harris County floods	$2.6	$2.1	$0.7	$2.8
July 1992	949	Fritch tornado	0.6	0.5	0.2	0.6
December 1992	970	Harris County tornado	1.0	0.8	0.3	1.1
April 1994	1026	North Texas tornadoes	0.8	0.7	0.2	0.9
October 1994	1041	Southeast Texas floods	35.5	27.9	8.9	36.7
June 1995	1056	San Angelo tornado	1.4	1.1	0.4	1.5
July 1997	1179	Hill Country floods	1.6	1.2	0.4	1.7
August 1998	1239	Del Rio flood	5.7	4.8	1.6	6.4
September 1998	1245	Houston and Galveston flood	2.4	1.9	0.6	2.5
October 1998	1257	Central Texas floods	42.3	33.4	10.8	44.2
May 1999	1274	Northeast Texas tornado	0.4	0.3	0.1	0.4
August 1999	1287	Hurricane Bret	6.9	5.5	2.2	7.6
April 2000	1323	Ft. Worth tornado	0.8	0.6	0.3	1.0
January 2001	1356	N.E. Texas ice storms	1.4	1.1	0.6	1.7
June 2001	1379	Tropical storm Allison	260.5	199.9	65.2	265.1
July 2002	1425	Centex 02 floods	15.5	12.1	3.9	16.0
TOTAL GRANTS AND METHOD OF FINANCE			**$379.5**	**$293.8**	**$96.4**	**$390.2**

NOTE: Method of finance is 75 percent federal and 25 percent state.
SOURCES: Department of Human Services; Federal Emergency Management Agency automated system.

sions that are reasonably necessary to cope with a disaster.

b) The governor may temporarily reassign resources, personnel, or functions of state executive departments and agencies or their units for the purpose of performing or facilitating emergency services.

c) The governor may commandeer or use any private property if the governor finds it necessary to cope with a disaster, subject to the compensation requirements of this chapter.

IN SECTION 418.022, AID FOR INDIVIDUALS

a) The governor may designate in the state emergency management plan the Department of Human Services or another state agency to carry out the functions of providing financial aid to individuals or families qualified for disaster relief. The designated agency may employ temporary personnel for those functions to be paid from funds appropriated to the agency, from federal funds, or from the disaster contingency fund.

PROCESS

The governor, by executive order or proclamation, may declare a state of disaster for areas of the state affected by a disaster event or the imminent threat of such an event. The Stafford Act requires that the governor of the affected state submit requests for major disaster assistance to the president. The governor's request must be based on a finding that the disaster is of such severity and magnitude that effective response is beyond the capabilities of the state and the affected local governments. To make this determination, the governor relies on the DPS, DEM, and DHS staff who are responsible for conducting a Preliminary Damage Assessment to estimate costs and damages associated with the disaster. A state disaster proclamation activates the disaster recovery and rehabilitation aspects of the emergency management plan and authorizes the deployment of resources needed to cope with the disaster situation. The presidential declaration activates a variety of federally funded disaster recovery programs. FEMA disaster aid is only available during presidentially declared disasters.

IFGP administered by these two agencies assist victims of natural disasters in obtaining federal grant money.

- The funding flow begins when DHS submits a request for estimated expenses (grants and administrative costs) to the governor. Upon receiving the governor's request, the DPS and DEM request an allocation from FEMA. FEMA allocates, or makes available through SMARTLINK (computer application), funds from the Disaster Relief Fund for the state to meet the expected needs of the IFGP.
- Grants of up to $14,800 (adjusted annually for inflation) are provided directly to eligible disaster victims for serious disaster-related needs and necessary expenses. Eligible IFGP clients are disaster victims who live in a declared disaster area, have no insurance or are underinsured, do not qualify for loan assistance from the Small Business Administration, and have serious needs and necessary expenses resulting from the disaster. Funding for grants is 75 percent federal and 25 percent state with the state share coming from the Governor's Disaster Contingency Fund. Federal funds pay for 100 percent of the program administration costs and up to 5 percent of the federal share of total grants *(Statutory Reference: Relief Act of 1974, P.L.93-288, Sec. 408; Chapter 22, Human Resources Code).*
- IFGP-eligible categories include real and personal property, medical, dental, funeral, and transportation (vehicle and other transportation, such as public transportation costs). Ineligible costs include improvements or additions to real or personal property, recreational property, cosmetic repair, business expenses, and debts incurred before the disaster.
- Water and ice services are also provided to individuals and families who are victims of natural disasters. When it becomes evident that more quantities are going to be necessary, the agency will make a purchase of water and ice. If the president declares the disaster, FEMA will reimburse DHS up to 75 percent of the cost.

CONCLUSION

The recommendations proposed in this report emphasize the need to review statutes that authorize powers and duties during a declared natural disaster. To better plan for disaster assistance expenditures, it is recommended that the Legislature consider establishing authority in the General Appropriations Act to allow for transfers between agencies in the event of a natural disaster. Statutory changes in state laws relative to disaster assistance payments may facilitate the involvement of state agencies in the event that a disaster is declared.

Early Childhood Intervention Funding Issues

Since the 1996–97 biennium, funding for the Early Childhood Intervention program at the Interagency Council on Early Childhood Intervention has more than doubled. The Interagency Council on Early Childhood Intervention projects the enrollment growth in comprehensive services to be 9 percent in fiscal year 2004 and 8 percent in fiscal year 2005. The agency received an additional $11.2 million in fiscal year 2001 above appropriated levels to address budget shortfalls. It is requesting an additional $48.8 million in General Revenue Funds for the 2004–05 biennium. To be eligible for federal Individuals with Disabilities Education Act (IDEA), Part C funds, there are certain services that the federal government considers entitlements. This review, however, examines options available to the state for controlling costs.

Significant Concerns

- Federal Individuals with Disabilities Education Act funds for infants and toddlers may be merged with federal IDEA funds for preschool and school-age children to promote a seamless system of services and support for children from birth to 21 years of age. Of the 50 states, Texas is the only state that has a designated lead agency for Part C that is not under a state health, state education, or other state agency.
- Although the U.S. Department of Education treats the program as an entitlement, federal funds have not increased commensurately with caseload growth and service costs, dropping from 50 percent of the agency budget in the 1996–97 biennium to 31 percent for the 2002–03 biennium.
- The federal government allows states to decide the extent of developmental delay a child must have to be eligible for early intervention services. Some other states use more selective criteria than Texas.
- About 90 percent of services are being provided in the home. The state is bearing the cost, therefore, of related travel for medical, professional and paraprofessional staff. Medicaid reimbursement for therapies provided to children does not cover these costs. Any remaining provider costs are covered by the agency with other state and federal funds.
- States are allowed to establish cost sharing for families who are able to pay, yet there are no income limits or cost-sharing provisions for receiving early childhood intervention services in Texas.
- Local providers currently bill Medicaid, but not to the extent predicted by the agency. Medicaid eligibility among children receiving early childhood intervention services dropped from 71 percent in 1993 to 48 percent in fiscal year 2000. A new service covered by Medicaid, Developmental Rehabilitation Services, has not generated the amounts projected for the 2002–03 biennium. Certification deficiencies for staff providing early interventions services has been cited as a barrier.
- Early intervention programs provide service coordination and transition planning services. The activities that are covered by these categories are numerous. The range of costs among providers varies a great deal, and the services are significant cost drivers.

- The federal government will not allow early intervention services providers to bill private insurance without parental consent.

RECOMMENDATIONS

- **Recommendation 1:** To promote a seamless system of services for children from birth to 21 years of age and maximize federal funding streams, the Legislature should consider amending state statute to move the administration of the Individuals with Disabilities Education Act, Infants and Toddlers program to the Texas Education Agency.
- **Recommendation 2:** The Office of State and Federal Relations should promote increases in federal funding for the Individuals with Disabilities Education Act, Infants and Toddlers Grant and relief from federal mandates related to natural environments, cost-sharing, third-party insurance and application for Medicaid benefits.
- **Recommendation 3:** The Interagency Council on Early Childhood Intervention should consider more selective criteria for measuring developmental delay in children to address agency budget shortfalls.
- **Recommendation 4:** The Interagency Council on Early Childhood Intervention and the Health and Human Services Commission should consider establishing a Medicaid reimbursement rate for in-home therapies for children from birth to three years of age. If the rate is implemented, the council should provide the state share of Medicaid reimbursement for in-home therapies and early intervention services. Providers should accept Medicaid reimbursement as full payment for in-home therapies.
- **Recommendation 5:** The Interagency Council on Early Childhood Intervention should examine less expensive alternatives to delivering all services in the home.
- **Recommendation 6:** The Legislature should consider changing state statute to allow for a system of payments related to early childhood intervention services. Families with income above 100 percent of the federal poverty level would be required to share in the cost of services or be responsible for payment.
- **Recommendation 7:** In order to maximize reimbursement for Developmental Rehabilitation Services, the Interagency Council on Early Childhood Intervention should maintain policy and procedures that ensure that all personnel providing services are certified in the agency's competency demonstration system.

COMMENTS

The Sixty-seventh Texas Legislature created the Interagency Council on Early Childhood Intervention (ECI) in 1981 to provide early intervention services. In 1986, Congress passed the Education of the Handicapped Act, allowing all states to apply for funding to plan and implement early childhood intervention programs. In 1987, the governor designated ECI as the lead agency in Texas to administer the infant and toddlers program. The agency currently supports 65 local programs that provide comprehensive services such as service coordination, vision services, speech-language therapy, physical therapy and occupational therapy. ECI provides services directly or offers access to them. ECI also maintains a comprehensive "child find" system that identifies eligible infants and toddlers in need of services. In fiscal year 2002, a total of 53,102 children received eligibility determination services and 37,932 children received comprehensive services.

FUNDING FOR EARLY CHILDHOOD INTERVENTION

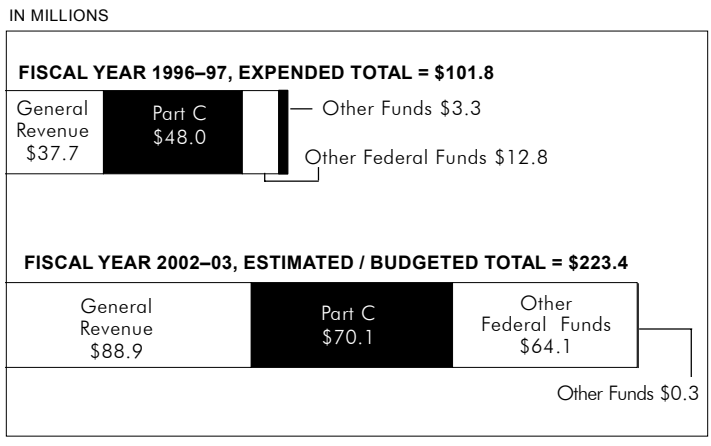
In 2001, the Seventy-seventh Legislature appropriated $204 million in Article II (All Funds) for the 2002–03 biennium ($31.3 million in General Revenue Funds and $16.5 million in Foundation School Funds transferred through an interagency contract from the Texas Education Agency [TEA] and designated for eligibility determination services). ECI was also appropriated a total of $1 million in Tobacco Settlement Receipts for the 2000–01 and 2002–03 biennia. In fiscal years 1999 and 2001, the agency received additional funding, in accordance with a rider provision in the General Appropriations Act (GAA), allowing ECI to certify the need for additional funding to the Commissioner of Health and Human Services by February 1 of each year of the biennium. The additional funds were requested to fund expenditures associated with caseload growth.

The federal government provides Individuals with Disabilities Education Act (IDEA) funding to states through three grant programs. Part B, School-age Grants, and Part B, Section 619 Preschool Grants, are awarded to state education agencies to meet the excess costs of providing special education and related services to children with disabilities. Similar formula distributions exist for both Part B programs. A state is allocated a base amount (previous year amount for School-age Grants and fiscal year 1997 amount for Preschool Grants). Of the funds exceeding the base amounts, 85 percent are allocated according to the number of children in the general population; 15 percent of the remaining funds are based on the number of children living in poverty.

ECI receives federal funds for the third component of IDEA, Part C, which relates to early childhood intervention programs for infants and toddlers with disabilities. As shown in Figure 1, federal funding from Part C funds accounts for 31 percent of ECI's appropriation in the current biennium, compared to 47 percent in the 1996-97 biennium. The federal funds are awarded based on a state's share of children ages zero to two years in the general population (according to the most recent satisfactory data determined by the Secretary of Education). The grants are awarded yearly and obligated for a 15-month period from July 1 through September 30, and they carry a one-year carryover provision. The federal regulations regarding Part C of IDEA, as amended in 1997, indicate that the purpose of Part C is to provide financial assistance to states for the following reasons:

- to maintain and implement a statewide, comprehensive, coordinated, multidisciplinary, interagency system of early childhood intervention services for infants and toddles with disabilities and their families;
- to facilitate the coordination of payment for early childhood intervention services from federal, state, local and private sources

FIGURE 1
INTERAGENCY COUNCIL ON EARLY CHILDHOOD INTERVENTION STATE AND FEDERAL FUNDS



SOURCES: Legislative Budget Board; Interagency Council on Early Childhood Intervention.

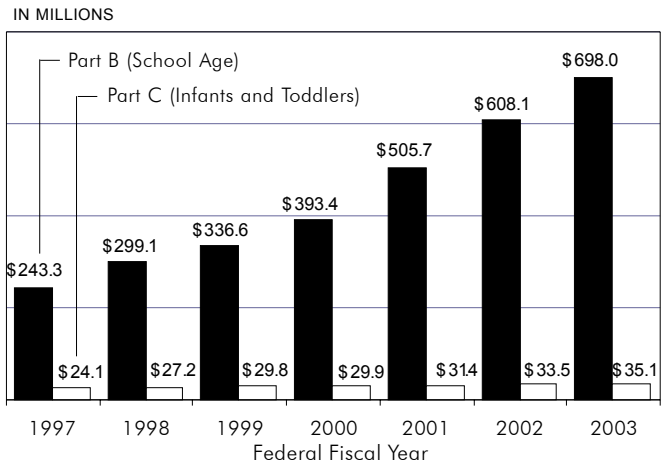
(including public and private insurance coverage);

- to enhance the states' capacity to provide quality early childhood intervention services and expand and improve existing early childhood intervention service; and
- to enhance the capacity of state and local agencies and service providers to identify, evaluate, and meet the needs of historically underrepresented populations, particularly minority, low-income, inner-city, and rural populations.

In federal fiscal year 1991, the federal appropriation under Part C of IDEA was $117 million. The number of children served nationally during this period was 194,363. By 2001, federal appropriations had increased to $383.6 million, and 230,853 children received services that year under Part C.

Figure 2 shows there has been no significant increase in IDEA, Part C funding to Texas over the last several years. In contrast, IDEA, Part B funds have increased by over 150 percent between fiscal years 1997 and 2002. IDEA, Part C funds may only be used for early childhood intervention services that an eligible child needs, but is not currently entitled to, through any other federal, state, local or private source.

FIGURE 2
FEDERAL FUNDING TO TEXAS FOR PART B AND PART C OF THE INDIVIDUALS WITH DISABILITIES EDUCATION ACT (IDEA)



NOTE: President's budget estimate for fiscal year 2003.
SOURCE: U.S. Department of Education.

ADMINISTRATION OF THE STATE'S EARLY CHILDHOOD INTERVENTION PROGRAMS

ECI is the state agency that administers the Part C Grant for Infants and Toddlers. The agency has been a freestanding agency since 1993. Administration of Part C varies among the states. Table 1 shows that out of the 50 states, the District of Columbia, and Puerto Rico, 23 ECI programs are administered by health or health and social/human services entities and 12 programs are administered by education agencies. Nine entities are categorized as social/human service/economic security.

Most states have positioned ECI programs within other state entities. In Texas, proponents of a freestanding agency believe that this arrangement allows for easier access to the state and local programs and better coordination of local programs. The emphasis on family-centered services, and a minimal degree of difficulty in resolving problems, are reasons given in support of a freestanding agency.

On the other hand, designating a single state agency to administer all the parts of IDEA may enhance the administration of a seamless system of services and foster better cooperation and coordination among the entities responsible for providing services under IDEA. TEA already provides Foundation School Funds for eligibility determination services for infants and toddlers. Other opportunities exist to use federal funds designated for one age group for services to another age group. There are many policy and fiscal implications that would need to be considered

TABLE 1
ADMINISTRATION OF
PART C EARLY CHILDHOOD INTERVENTION SERVICES
BY STATE AGENCIES AND OTHER ENTITIES

TYPE OF ADMINISTERING ENTITY	NUMBER OF AGENCIES BY TYPE
Health	14
Education	12
Social/Human Services /Economic Security	9
Health and Social/Human Services	9
Mental Health/Mental Retardation	2
Rehabilitation/Developmental Services	2
Children and Family Services	1
Early Childhood Intervention	1
Other	2
TOTAL	**52**

SOURCE: National Early Childhood Technical Assistance.

regarding administration by a single agency, but in the long term, greater benefit could be derived from a comprehensive structure that provides a system of services for all Texas children in need, regardless of age. Recommendation 1 would amend state statute to move the administration of the IDEA, Part C program to TEA to provide for a seamless system of services for children from birth to 21 years of age and to maximize federal funding streams.

COST DRIVERS FOR THE ECI PROGRAM

TREATMENT AS AN ENTITLEMENT

The federal Office of Special Education Programs indicates that Part C of IDEA is an entitlement program. According to the National Council of State Legislatures, IDEA is not a traditional entitlement in the same sense as Medicaid and the School Lunch Program are. Federal entitlements require the federal government to provide appropriations sufficient to serve all eligible persons. IDEA funding levels are not sufficient to serve all eligible toddlers and infants, yet ECI programs are not allowed to implement a waiting list. There is a state maintenance of effort provision under Part C, requiring states to commit at least the previous year's state spending level. But unlike a traditional matching program, increased state expenditures do not draw additional federal funds. Recommendation 2 specifies that the Office of State and Federal Relations should promote increases in federal funding for the IDEA, Infants and Toddlers Grant and relief from federal mandates related to natural environments, cost-sharing, third party insurance and application for Medicaid benefits.

According to federal statute and regulations, however, eligible children and their families are entitled to access to early childhood intervention services. Evaluation and assessment services, as well as service coordination, must be provided at public expense. Direct services, such as physical therapy and nutrition services, must be available to all eligible children in the state but are not required to be provided at state expense.

To some degree, Part C also allows states to define the population of eligible children and their families that will be served. Although the IDEA statute for Part C specifies the developmental areas that are to be included in states' definitions of developmental delay, states must identify appropriate diagnostic instruments, procedures, and levels of functioning or other criteria that will be used to determine eligibility. Table 2 provides examples of the criteria used in a few states. In Texas the criteria is based on the number of months of delay, which is the difference between the child's chronological age and the child's tested developmental age. A more restrictive criteria can limit eligibility for services. For example, a two year old with a three-month delay in one area would be eligible for services in Texas, but not in New York or Massachusetts. Recommendation 3 would direct the

TABLE 2
PART C ELIGIBILITY CRITERIA

STATE / LEVEL OF DEVELOPMENT
TEXAS
Ages 2 months or less documented atypical behaviors
Ages 3–12 months – 2-month delay in one area
Ages 13–24 months – 3-month delay in one area
Ages 25–36 months – 4-month delay in one area
NEW YORK
12-month delay in one area, or 33 percent delay in one area or 25 percent delay in two areas, or
2 standard deviations in one area or 1.5 standard deviation in two areas, or informed clinical opinion by interdisciplinary team
MASSACHUSETTS
Age 6 months – 1.5-month delay
Age 12 months – 3-month delay
Age 18 months – 4-month delay
Age 24 months – 6-month delay
Age 30 months – 6-month delay

SOURCE: National Early Childhood Technical Assistance.

ECI to consider more selective criteria for measuring developmental delay in children to address agency budget shortfalls.

SERVICE COORDINATION AND TRANSITION SERVICES

Under Part C of IDEA, service coordination must be provided to each child and the child's family. The service coordinator is expected to carry out activities that assist and enable children eligible for services provided under Part C and their families to receive the rights, procedural safeguards, and services that are authorized under a state's early childhood intervention program. Specific service coordination activities include coordinating the performance of evaluations and assessments; facilitating and participating in the Individualized Family Service Plan (IFSP) process; assisting families in identifying available service providers; and coordinating with medical and health providers.

Transition services must be provided to toddlers who will be leaving the ECI program when they have reached their third birthday. Local providers must start the transition planning when a toddler turns two years old. Transition planning includes activities that assist families in learning what services are available for toddlers with developmental delays, such as coordinating the transition planning for toddlers who qualify for Part B services provided by the local school district or services available in the community. Transition planning may include activities such as setting up meetings between parents and local school district Part B staff.

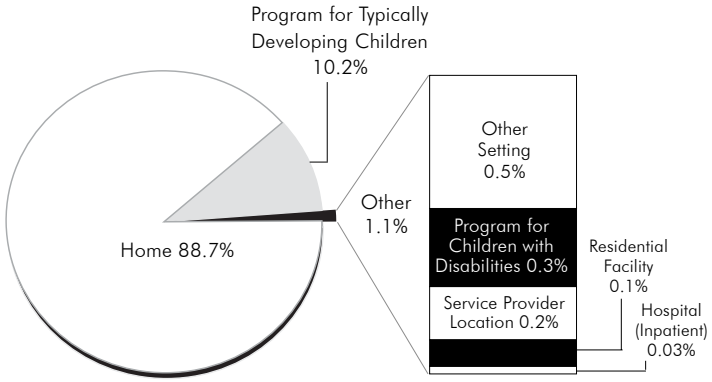
According to recent rate analysis of the ECI program, in fiscal year 2001 service coordination statewide averaged approximately $47 per month per child, and one-time transition services cost about $865 per child. Because of the numerous activities that can be included under service coordination and transition planning, these two types of services may become significant cost drivers for local ECI programs.

NATURAL HOME ENVIRONMENT

With the reauthorization of IDEA in 1997, Congress included provisions to ensure that early childhood intervention services, to the maximum extent appropriate, are provided in natural environments, including the home and community settings in which children without disabilities participate. IDEA mandates that a justification of the extent, if any, to which the services will not be provided in a natural environment must be included in an infant or toddler's IFSP.

Federal regulations define natural environments as settings that are natural or normal for the child's age peers who have no disabilities. According to ECI, prior to 1992, half of the early childhood intervention services provided to infants and toddlers were provided in center-based settings in which only children with disabilities were present. As shown in Figure 3, in December 2000 over 88 percent of children were served in their homes and only 10.2 percent were served in programs designed for typically developing children.

FIGURE 3
EARLY CHILDHOOD INTERVENTION SERVICES SETTINGS
DECEMBER 1, 2000 SURVEY



NOTE: Other Settings include equestrian facility, gymnasium, library, public school, and public park.
SOURCE: U.S. Department of Education, Office of Special Education and Rehabilitative Services.

REIMBURSEMENT RATES

A consultant was contracted by HHSC and ECI to sample a number of ECI programs to determine fee-for-service rates for early childhood intervention services. Table 3 compares Medicaid and ECI reimbursement rates for select early childhood intervention services. According to ECI, local providers are reimbursed for professional service fees and travel. The impact of providing medical services in the home is evident from a comparison of ECI rates with Medicaid rates. Based on 2001 expenditure data, ECI's estimated cost per hour for speech, physical, or occupational therapy was between $107 and $126—

TABLE 3
EARLY CHILDHOOD INTERVENTION SERVICES

PROGRAM / SERVICES	MEDICAID REIMBURSEMENT RATE	EARLY CHILDHOOD INTERVENTION RATE (ALL FUNDS)
TEXAS HEALTH STEPS, EARLY PERIODIC SCREENING, DIAGNOSIS, AND TREATMENT/ COMPREHENSIVE CARE PROGRAM (EPSDT/CCP)		
Occupational Therapy	$40.60	$126.20/hour
Physical Therapy	$40.60	$106.90/hour
Speech Language Therapy	$40.60	$112.66/hour
Dietary/Nutrition Services	$30.45	$54.02/hour
DEVELOPMENTAL REHABILITATION SERVICES		
Special Instruction	$73.57	$119.69/hour

SOURCES: Legislative Budget Board; Interagency Council on Early Childhood Intervention.

approximately triple the Medicaid rates for the same therapies ($41 per hour). Recommendation 4 directs ECI and HHSC to consider establishing a Medicaid reimbursement rate for in-home therapies for children age birth to three years old. If implemented, ECI should provide the state share of Medicaid reimbursement for in-home therapies, and early intervention services providers should accept Medicaid reimbursement as full payment for in-home therapies.

A review of ECI's estimated costs for other early childhood intervention services indicates the range of costs among providers for certain services varies significantly. Providers bill the ECI program for one-time transition service cost starting at $605 and as high as $1,541 per child. Another ECI service cost that varies significantly is social work services, ranging from $53 to $952 per hour. In addition, nutrition services varied from $17 to $491 per hour across the sampled programs. Recommendation 5 requires ECI to examine less expensive alternatives to delivering all services in the home.

IDEA, PART B, SECTION 619 PRESCHOOL GRANTS

States have the discretion to use Preschool Grants Program federal funds under IDEA for two-year-old toddlers who will turn three years old during the school year. Because federal law requires that free, appropriate public education be available for children served with Preschool Grant funds, the local school district could be held responsible for providing special education and related services to toddlers turning three during the school year.

The Seventy-seventh Legislature, 2001, allocated Foundation School Funds to provide eligibility determinations for ECI clients ($5.1 million in fiscal year 2002 and $11.4 million in fiscal year 2003). As mentioned earlier, Texas has experienced considerable caseload growth in its ECI program. Not only are the demands for comprehensive services increasing, referrals are also increasing; therefore, the need for eligibility determination services has increased. The Seventy-seventh Legislature, 2001, revised the agency's structure to include a separate strategy for eligibility determination because of concerns about increasing expenditures related to this activity. Rider 6, in the agency's bill pattern for the 2002–03 biennium, provides Foundation School Fund monies that are restricted to funding eligibility determination services.

Texas received a total of $23.7 million in fiscal year 2002 for special education students in preschool programs. Although states must distribute most funds to local educational agencies, 25 percent of the amount they received for fiscal year 1997 (adjusted by the rate of inflation) may be retained for state-level activities. TEA may use these funds for activities such as direct services for children eligible for services, administration, and supplementing other funds used to develop and implement a statewide coordinated services system. The amount for these activities may not exceed 1 percent of the amount received by the state under this program ($0.2 million in fiscal year 2002).

The memorandum of understanding between ECI and TEA outlines the responsibilities for transitioning children from ECI to local school districts. Currently, ECI notifies the local school district when a child will turn three years old and will be exiting the Part C program. Part C services continue to be provided by ECI until the child turns three. After the age of three, children who are eligible to receive special education and related services transition to the responsibility of school districts. Not all children exiting ECI services qualify for special education and related services provided by Part B funds. In fiscal year 2001, 2,453 children exiting the ECI program upon turning three did not have assessments completed for Part B, preschool services. According to ECI, parents declined to have their children referred to a school system.

According to ECI, 52 percent of children enrolled in services were two year olds during a December 1, 2000 count. ECI could avert early childhood intervention services costs by transitioning two-year-old

children who will turn three during the school year and qualify for Part B services to school districts. In addition, school districts enrolled as providers in the Medicaid program (SHARS) can receive federal reimbursement for eligible children.

The federal government offers this choice to assist states and local school districts in creating a smooth transition process from Part C to Part B Preschool Grants. The child may enter the local school district's program at the beginning of the school year rather than waiting until the third birthday, which could occur later in the year. Local school districts could alleviate some problems associated with children turning three during the school year and entering the school system throughout the year. This allows better planning options for the local school district regarding personnel, space, and transportation needs.

IDEA, PART B STATE GRANTS FOR SCHOOL AGE

TEA, as the lead agency for Part B of IDEA, is responsible for the distribution of funds to school districts. Similar federal provisions exist directing the distribution between state activities and school districts of Part B funds for school-age children. Allowable uses for funds retained by the state are parallel with the Preschool funds as well. Since fiscal year 1996, TEA has transferred IDEA, Part B funds to ECI for identifying, locating, and evaluating infants and toddlers with disabilities. TEA has distributed the funds with the understanding that the transfer is limited to 1 percent under federal law.

Texas' estimated allocation for IDEA, Part B in fiscal year 2002 is $608.1 million, which limits TEA's state-level funds to ECI to approximately $6.08 million. TEA reported in its fiscal year 2000 annual state plan to the U.S. Department of Education that no funds were allocated to coordinate a service system to improve results for children. The annual state plan states 15 percent of the total Part B funds would be used for direct and support services, including technical assistance and training. For fiscal year 2000, TEA reported the Part B funds distributed to ECI as direct services. TEA refined their reporting for the 2002 annual state plan by reporting that 0.85 percent of Part B funds will be used for coordinating a service system to improve results for children. If TEA reports Part B state-level funds used by ECI as direct services, this strategy may not be considered under the 1 percent limit.

FAMILY COST PARTICIPATION

IDEA requires that the lead agency of Part C have funding policies that specify what services will be provided at no cost to parents and, if any, will be subject to a system of payments. No fees may be charged to parents for the following services: identifying children with developmental delays; evaluation and assessment; service coordination; development, review, and evaluation of IFSPs; and complaint resolution. However, states are not obligated to fund other services listed in Table 4 to families able to pay.

TABLE 4
DIRECT EARLY CHILDHOOD INTERVENTION SERVICES

SERVICE	SERVICE
Assistive Technology	Physical Therapy
Audiology	Psychological Services
Family Training, Counseling, Home Visits	Respite
	Social Work Services
Health Services	Special Instruction
Medical Services	Speech-Language Therapy
Nursing	Transportation
Nutrition	Vision Services
Occupational Therapy	Other Services

NOTE: Other Services include hippotherapy (therapy that uses horses), interpretation, music therapy, and play therapy.
SOURCE: U.S. Department of Education, Office of Special Education and Rehabilitative Services.

The level of participation of a family in the sharing of costs for early childhood intervention services may be based on its income level. There are 18 states that have implemented cost-sharing arrangements based on sliding scales. For example, one state's Part C program will pay for up to two hours of service per week at no cost to the family. Families may have a copayment if the child requires more than two hours per week of service. In addition, a number of states facing budget constraints are holding discussions with advocates and parents to implement copayments or sliding-fee scales for direct services.

Most health and human services programs in Texas limit assistance to low-income families. In October 2001, an opinion was issued by the Office of the Attorney General clarifying that ECI can gather income information from families. There are several programs that offer services critical to children in Texas that require a fee or copayment based on a family's income. For example, the Commission for the Blind's Children's Vocational Discovery and Development Program requires parents with resources to pay some fees for direct services. The Children's Health Insurance Program (CHIP) requires families with incomes between 150 percent and 200 percent of the federal poverty level (FPL) to pay a monthly premium ($15 for 151-185 percent of the FPL and $18 for 186-200 percent of the FPL). Copayments for office visits, emergency room visits, and prescription services are also collected based on the income level of CHIP families. Recommendation 6 suggests that the Legislature consider changing state statute to allow for a system of payments related to early childhood intervention services. Families with income above 100 percent of the federal poverty level would be required to share in the cost of services or be responsible for payment.

Health Coverage for ECI Clients

According to the U.S. Department of Education, preliminary data obtained from the National Early Intervention Longitudinal Study indicate that approximately 95 percent of children participating in Part C are covered by some form of insurance; and 57 percent have some form of private insurance. According to ECI's most recent once-a-year survey of local providers, of the children served in fiscal year 2000, 48 percent of children enrolled in ECI were eligible for Medicaid compared to 71 percent in fiscal year 1993. ECI children covered by private insurance have increased from 29 percent in fiscal year 1993 to 42 percent in fiscal year 2000.

Medicaid

Nationally, approximately two-thirds of school districts are receiving Medicaid reimbursement for certain special education services. In 1999–2000, the estimated total amount of Medicaid funds school districts received to cover certain special education services was $648 million. The President's Commission on Excellence in Special Education has been asked by the U.S. Senate Committee on Health, Education, Labor and Pensions and the U.S. House of Representatives Committee on Education and the Workforce to provide further analysis on the use of Medicaid to support IDEA-related services.

Although families in other health and human services programs are required to apply for Medicaid, ECI does not require all families to do so. ECI cannot make Medicaid enrollment a prerequisite to receive ECI services. The U.S. Department of Education has indicated that a state cannot deny children services in the event that the family does not enroll in Medicaid. Currently, state rules require local providers to determine client eligibility for all third-party reimbursement, including Medicaid. Illinois' Part C program requires that local providers complete a screening tool with families to determine if the child may be eligible for Medicaid.

ECI providers must participate in four Medicaid programs: Texas Health Steps - Comprehensive Care Program (THSteps-CCP), ECI Targeted Case Man-

agement (TCM), Developmental Rehabilitation Services (DRS), and Medicaid Administrative Claiming (MAC). ECI providers are currently billing Medicaid for DRS, but not to the extent predicted by the agency. ECI has provided local providers with resources to bill Medicaid. ECI, only recently, published rules to strengthen its authority to penalize local providers that are found to bill state General Revenue or IDEA, Part C funds for services reimbursable by Medicaid.

According to the agency, Medicaid does not cover toddlers with developmental delays or mental retardation. The agency also determined that the Centers for Medicare and Medicaid Services (CMS) do not approve services that are provided by personnel who are not ECI-certified specialists. Recommendation 7 requires ECI to maximize reimbursement for Developmental Rehabilitation Services by maintaining policy and procedures that ensure that all personnel providing services are certified in the agency's competency demonstration system.

To begin receiving federal reimbursement for DRS, which constitutes 45 percent of the IFSP services provided, ECI submitted a Medicaid State Plan Amendment in October 2000. The amendment, which was approved by CMS in May 2001, allowed ECI to bill Medicaid retroactively for DRS services from October 2000. This initiative addresses recommendations of the Sunset Advisory Commission (SAC) and HHSC's report to the Legislature to expand the types of services and personnel reimbursed by Medicaid. ECI projected in the state plan amendment an estimated annual fiscal impact for this initiative of $4.7 million in Federal Funds. However, in its Legislative Appropriations Request, ECI projects $2.5 million for each fiscal year in DRS federal revenue for the upcoming 2004–05 biennium. Local providers are not required to project revenue from Medicaid for DRS, although they are required to submit a monthly report on DRS services.

Children's Health Insurance Program (CHIP)

The CHIP program may cover services previously paid for by ECI. ECI providers must also participate in billing CHIP for eligible infants and toddlers. Prior to billing CHIP, local providers must negotiate contracts with CHIP providers. Not all local ECI programs have secured all the necessary contracts with CHIP providers in their service area. To date, 51 of the 63 local programs have secured contracts with all the participating health plans in their designated service area. ECI is working with HHSC to provide support to the 11 local ECI programs that are still in need of a contract with a CHIP provider for reimbursement of covered services. According to ECI, however, only 4 percent of infants and toddlers being served are eligible for CHIP.

The Seventy-sixth Legislature, 1999, directed ECI, with the assistance and advice of the HHSC, to select an appropriate automated system currently used by a state agency to plan, manage and maintain records of client services. The TKIDS system was designed to collect client-level information, such as demographics and income level of families. Information on family income collected through the TKIDS system can help ECI and local providers determine if Medicaid and CHIP can be used to fund additional services. The agency should complete implementation of the TKIDS automated database.

Private Insurance

Although IDEA regulations mandate that ECI ensure that IDEA, Part C is the payer of last resort, revenue from private insurance has been minimal. The federal government mandates that ECI providers can only bill private insurance when parents give written consent. The SAC report listed the amount of revenue from private insurance in fiscal year 1991 as $690,000, and in fiscal year 1997 as $290,745. For fiscal year 2002, private insurance revenue collections were approximately $560,000, which is still below revenue collected in fiscal year 1991. ECI has developed handouts and a video for local programs to

encourage use of private insurance. Providers are expected to encourage parents to give consent for billing to help offset the cost of comprehensive services; however, if parents would incur copayments, increased deductibles or premiums, or charges against lifetime caps, it is unlikely they would consent to claims against their policies.

According to the SAC report, at least seven states mandate the use of private insurance to pay for ECI services, and 22 states use private insurance to pay for at least some services. Most states link fees and access to third-party resources as a way to give families the option of using their health coverage or paying a fee for services. Illinois' ECI program posts information on its website listing providers enrolled with insurance companies to assist families in determining which providers are early-intervention credentialed and enrolled and are able to serve their children in compliance with all restrictions and requirements established by their insurance companies.

FEDERAL DEVELOPMENTS

The current federal provisions under Part C of IDEA expired on September 30, 2002. Although, it is too early to tell what changes in IDEA may result from the federal reauthorization, potential issues that may be addressed during the reauthorization process can be found in the proceedings of congressional hearings and the President's Commission on Excellence in Special Education's report. In summary, some of the issues regarding Part C follow:

- IDEA Parts B and C could be combined to provide a seamless system of services and support from birth to 21 years of age. States would still choose their lead agency, but the U.S. Department of Education would require state departments of education to monitor and enforce compliance and be held accountable for results from birth to 21 years of age. Opponents of this action expressed concerns about moving services for infants and toddlers to the schools and the potential for limiting the family focus and interagency collaboration that currently exist for the youngest age group.
- The President's commission recommends increased funding for the Infants and Toddlers Grant, as well as the Preschool Grant. It has been suggested IDEA could allow states and local districts to pool existing Part C Infant and Toddler Grants and Preschool Grants with School-age Grants to support a seamless system of early childhood intervention services. States and local districts could also be allowed to use Part B funds to provide pre-referral services.
- Flexibility was encouraged in the use of IDEA funds. Furthermore, a review of IDEA in association with other federal programs and funding sources (such as Medicaid, Early Head Start, Maternal and Child Health (Title V) and other programs to support Infant and Toddler and Preschool programs under IDEA) was also encouraged.
- IDEA Part B is permanently reauthorized, while Part C is not. Some argue that all of IDEA should be authorized for a specified number of years to allow needed changes to be made. Others seek permanent authorization for Part C to recognize the worthiness of the early childhood intervention program and justify increases in funding.

During the 107th Congress, several bills were introduced to increase funding for infants and toddlers. One such piece of legislation would authorize the appropriation of $500 million in federal funds for federal fiscal year 2003 under Part C (and such sums as may be necessary for each succeeding fiscal year). The Secretary of Education would reserve 75 percent of the funds each year for quality incentive grants to state programs meeting performance objectives developed through the Secretary of Education's continuing improvement monitoring process. The balance would provide grants to state early childhood

intervention programs serving at-risk infants and toddlers and providing at least 3.5 percent of the children under the age of three years residing in the state with early childhood intervention services.

CONCLUSION

Additional federal funds are needed to fund early childhood intervention services. The federal government should provide states more flexibility in the design of services. Other budgetary challenges may also impact a state's ability or willingness to increase the state's share of funds to support ECI services.

The recommendations proposed in this report address a number of issues related to the provision of ECI services for children and their families in Texas. The funding decisions made regarding the ECI program may be enhanced by (1) considering implementation of a system of payments to augment other funds used to support the ECI program; (2) evaluating the provision of all services at clients' homes; (3) examining the Medicaid reimbursement structure; and (4) determining the potential effect of service coordination services and transition services on the ECI budget.

Healthcare and Psychiatric Costs at the Texas Youth Commission

This report provides a brief overview of the Texas Youth Commission's (TYC) healthcare system, discusses why healthcare and psychiatric costs are increasing, and compares selected aspects of the agency's managed healthcare system to the Department of Criminal Justice's (TDCJ) managed healthcare system.

Significant Findings

- TYC's healthcare costs have been directly affected by an increase in the number of emotionally disturbed youth at their facilities and the absence of a capitation rate for psychiatric care in their current managed healthcare program. Currently, psychiatric services are provided on a fee-for-service basis.
- Like TDCJ, TYC is experiencing higher correctional psychiatric and healthcare expenses due to increasing costs for specialty care and pharmaceuticals.
- In general, TYC and TDCJ have similar healthcare programs. However, there are also significant differences. TDCJ contracts cover nonformulary psychotropic medications and psychiatric care, whereas TYC does not.

Comments

The Texas Youth Commission's healthcare system involves two major program components: (1) the managed healthcare program serving youth residing in TYC facilities and (2) a separate program serving youth in contract care facilities. TYC's managed healthcare program accounts for 86 percent of the agency's total healthcare costs, while services to youth in contract care facilities make up 14 percent. In fiscal year 2002, managed healthcare costs were approximately $13.6 million and contract care healthcare costs were approximately $2.1 million. The number of participants in fiscal year 2002 was 5,700. Under the managed healthcare program, TYC pays the contractors a capitation rate per youth per day. For youth in contract care facilities, TYC negotiates with local health services providers on a fee-for-service basis.

Background of TYC's Managed Healthcare System

Prior to 1996, TYC provided healthcare services through salaried nurses and contracts with local physicians and dentists. TYC purchased pharmaceuticals and contracted with local pharmacists to fill prescriptions at the facilities. Under this system, TYC had the autonomy and flexibility to meet youths' needs at the local level; however, this system did not provide the mechanisms necessary to control costs or to use resources as efficiently as they could be used under a managed healthcare system.

To address this issue, in 1996 TYC entered into an interagency cooperation agreement with the University of Texas Medical Branch at Galveston (UTMB) and Texas Tech University Health Sciences Center (TTUHSC) to provide medical and dental care under a correctional managed healthcare system. TYC chose to contract with UTMB and TTUHSC because the universities were already providing managed healthcare to TDCJ. TYC's healthcare system is characterized as a managed healthcare system because the agency pays a set amount per youth per day, and the agency has a utilization review board that must preapprove all specialty care and outpatient care that occurs within the system.

MANAGED HEALTHCARE CONTRACTS

TYC contracts directly with UTMB and TTUHSC. The contracts with UTMB and TTUHSC cover a two-year period coinciding with the state's two-year budget cycle. The correctional managed-care system covered by these contracts includes utilization management, review of specialty care using accepted medical and dental protocols, an established provider network, an internal quality improvement plan, nursing protocols, and a set capitation rate.

UTMB and TTUHSC provide healthcare services and staff, while TYC provides the infirmaries (physical locations) and medical equipment with a cost greater than $150 per item. Under these contracts, administrative activities remain with TYC's central office staff, but UTMB and TTUHSC assume responsibility for most medical services. TYC's medical director supervises psychiatrists and provides general guidance for the healthcare program. UTMB and TTUHSC have executive directors for youth services who supervise nursing staff, monitor daily expenditures, and direct day-to-day operations.

TYC monitors contract performance through a review of the contractors' quarterly financial reports, utilization data, vacancy rates, semiannual reports containing compliance levels on performance indicators, youth grievances and alleged mistreatment related to medical care. Further, TYC conducts on-site monitoring visits, which include staff interviews, infirmary observations and chart audits to assess contract compliance and quality-of-care indicators.

TYC has divided the state into two service areas. TTUHSC provides services in West Texas while UTMB serves East Texas. A map of TYC facilities and the two service areas are presented in Figure 1. TTUHSC provides healthcare at five institutions and one halfway house, while UTMB provides services to 10 institutions and eight halfway houses. As new facilities come on-line, they are served by the contractor assigned to their geographical area.

SERVICES PROVIDED UNDER TYC'S MANAGED HEALTHCARE SYSTEM

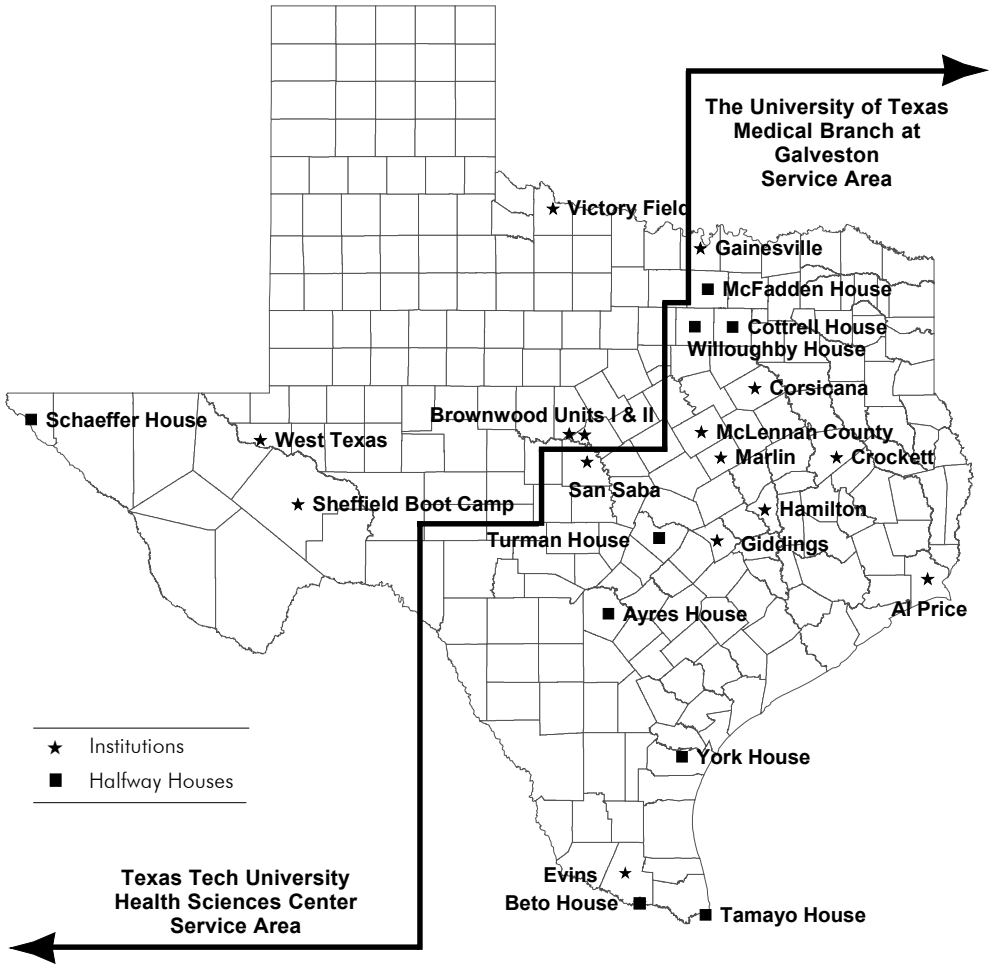
UTMB and TTUHSC operate medical infirmaries at each TYC institution and have 24-hour nursing care available to youth. Under the terms of their contracts, UTMB and TTUHSC provide the following services: all primary, secondary, and tertiary care; inpatient, outpatient, specialty and emergency care; formulary medications; and dental, optometry, laboratory, radiology, and other ancillary services. However, psychiatric care is not covered under the UTMB and TTUHSC contracts. These services are either provided on-site, through subcontracts with local hospitals and local providers, or at UTMB in Galveston.

CAPITATION RATES

The capitation rate included in the initial 1996 managed healthcare contracts was calculated using TYC's history of spending adjusted for inflationary costs. Currently, the capitation rate is based on the contractors' actual expenditures, expected inflationary factors, and changes in TYC's population requiring additional resources. The contractors' expenditures include the following: (1) salaries and benefits, (2) pharmaceuticals, (3) off-site care (services received at the local level such as physician services, outpatient procedures, emergency room services, and short-term hospitalization), (4) laboratory, (5) optometry, (6) overhead (including expenses for data processing, accounting, human resources, and other administrative services), (7) maintenance and operations and (8) travel expenses. Further, UTMB's capitation rate includes costs associated with the UTMB hospital, physicians, and overhead.

In 1998 the capitation rate for UTMB was set at $5.09 per youth per day and TTUHSC's rate was $5.07. Since 1998, the capitation rates have steadily increased each year. In fiscal year 2003, the rate will be $6.21 for UTMB and $6.35 for TTUHSC. The capitation rate is negotiated prior to each biennium for each year of the biennium and is paid quarterly in advance. In addition to the capitation rates, TYC also pays the contractor

FIGURE 1
TEXAS YOUTH COMMISSION FACILITIES



INSTITUTIONS	INSTITUTIONS	HALFWAY HOUSES
Al Price State Juvenile Correctional Facility	Hamilton State School (Bryan)	Ayres House (San Antonio)
Brownwood State School Unit I	McLennan County State Juvenile Correctional Facility (Mart)	Beto House (McAllen)
Brownwood State School Unit II	Marlin Orientation & Assessment Unit	Cottrell House (Dallas)
Corsicana Residential Treatment Center	San Saba State School	Edna Tamayo House (Harlingen)
Crockett State School	Sheffield Boot Camp	McFadden Ranch (Roanoke)
Evins Regional Juvenile Center (Edinburg)	Victory Field Correctional Academy (Vernon)	Schaeffer House (El Paso)
Gainesville State School	West Texas State School (Pyote)	Turman House (Austin)
Giddings State School		Willoughby House (Fort Worth)
		York House (Corpus Christi)

SOURCE: Texas Youth Commission.

the actual costs of nonformulary psychotropic medications plus 10 percent of the drug costs as an administrative fee. Under the contract, TYC also pays security costs associated with inpatient care at the UTMB hospital in Galveston, and the 4 percent or $100 per month minimum pay raise for eligible state employees (Article IX, General Appropriations Act, 2002–03 Biennium, Section 10.12[c][6]).

SUCCESS OF TYC'S MANAGED HEALTHCARE SYSTEM

As mentioned earlier, TYC's managed healthcare system was implemented to control costs and to provide better services to TYC youth through greater access to specialty services. Agency officials report that since the inception of the program in 1996, TYC youth have had greater access to specialty services (both at TYC facilities and off-site) and more contact with experienced healthcare staff. The agency indicates it has gained some control over costs. Acting through the correctional managed-care agreements, UTMB and TTUHSC preapprove medical protocols to determine medical necessity. The managed-care agreements also provide access to qualified practitioners for medical evaluation and psychiatric services. To control psychotropic medication costs and standardize psychiatric practices, managed-care agreements have started to use medication algorithms (decision flowcharts). Agency officials believe that all of these factors have contributed to better and less expensive medical care for TYC youth; however, managed healthcare costs for juveniles are still increasing. Between fiscal year 1998 and fiscal year 2002, managed healthcare costs have increased by 62 percent while at the same time participation in the program has increased by only 17 percent. By comparison, healthcare costs of TDCJ have increased 17 percent over the same period, with less than 2 percent increase in the number of inmates covered.

HEALTHCARE COSTS ARE INCREASING

Healthcare costs for juveniles are increasing for three reasons: (1) increasing costs for specialty and inpatient care, (2) increasing costs for pharmaceuticals, and (3) increasing costs of psychiatric services. Such increases are not unique to TYC or to the State of Texas. According to the June 2002 Correctional Healthcare Report published by the Civic Research Institute, the national cost of medical care is expected to rise at least 10 percent each year. Pharmaceutical costs are projected to rise nationally about 15 to 25 percent annually. Other factors, such as new technologies and the national nursing shortage, have also affected correctional managed healthcare.

Several factors are responsible for TYC's increased costs for specialty care and inpatient care. New technologies, such as laser procedures and imaging techniques, have been developed to decrease diagnosis and healing time. TYC has also been affected by the rising cost of pharmaceuticals. With the development of new prescription drugs, especially psychotropic drugs, TYC has experienced a large cost increase. Increasing salaries for skilled heathcare professionals have also contributed to TYC's medical care costs.

The expanded demand for psychiatric services has also contributed to an increase in TYC's healthcare costs. Emotionally disturbed youth currently comprise 44 percent of the TYC population. Based on agency projections, approximately 25 percent of the youth at TYC facilities need psychotropic medication. Keeping up with advancements in contemporary healthcare, psychiatrists prescribe newer medications to treat TYC youth. At this time, these drugs are not on the UTMB formulary.

A COMPARISON OF TYC'S AND TDCJ'S MANAGED HEALTHCARE SYSTEMS

In fiscal year 2002, TDCJ's managed healthcare costs were approximately $343.9 million. The number of participants in fiscal year 2002 was 132,000. In addition to payments based on capitation rates, TDCJ

pays for all Hepatitis B vaccinations and the 4 percent or $100 per month minimum pay raise for eligible state employees (Article IX, General Appropriations Act, 2002–03 Biennium, Section 10.12[c][6]). Table 1 shows a general program comparison between TYC and TDCJ.

SERVICES PROVIDED UNDER TDCJ'S MANAGED HEALTHCARE SYSTEM

Consistent with TYC, UTMB and TTUHSC provide TDCJ with the following services: all primary, secondary and tertiary care; inpatient, outpatient, specialty and emergency care; formulary medications; and dental, optometry, laboratory, radiology, and other ancillary services. In addition, TDCJ has special programs tailored to specific adult population needs: chronic care clinics (HIV, Hepatitis C, and hypertension), in-prison hospice programs, and various geriatric services. In contrast to TYC, psychiatric care (through their mental healthcare program) is covered under UTMB and TTUHSC contracts. These services are provided on an inpatient, outpatient, and specialized program basis.

WHY TDCJ'S MANAGED HEALTHCARE COSTS ARE INCREASING

TDCJ's managed healthcare costs are increasing for three reasons: (1) increased costs for specialty and inpatient care, (2) increasing costs of pharmaceuticals, and (3) the aging of the offender population. The first two reasons for the TDCJ increase mirror TYC's situation. TDCJ has also seen salary increases for specialized medical staff. Like TYC, TDCJ has also experienced increases in pharmaceutical costs, but the two agencies differ with regard to the types of drugs that are causing their increases. For TYC, pharmaceutical increases result from greater use of drugs that are prescribed for mental health conditions. TDCJ's pharmaceutical increase results largely from HIV medication costs. In fiscal year 2002 HIV medications accounted for about 41 percent of TDCJ's total drug costs. Also, the costs for Hepatitis C therapies have doubled in the past few fiscal years.

CONCLUSION

TYC has been working to provide their youth with contemporary professional standards in healthcare. While TYC indicates its managed healthcare system is providing adequate healthcare, higher costs for psychiatric care and nonformulary psychotropic drug coverage are driving up medical costs.

TABLE 1
COMPARISON OF CORRECTIONAL MANAGED HEALTHCARE PLANS

TEXAS YOUTH COMMISSION	TEXAS DEPARTMENT OF CRIMINAL JUSTICE
PROGRAM INCLUDES	**PROGRAM INCLUDES**
Managed healthcare system Contract care	Managed healthcare system
PARTICIPANTS	**PARTICIPANTS**
Fiscal year 2002 — 5,700	Fiscal year 2002 — 132,000
COSTS	**COSTS**
Fiscal year 2002 — $15.7 million	Fiscal year 2002 — $343.9 million
CONTRACT WITH	**CONTRACT WITH**
University of Texas Medical Branch Texas Tech University Health Sciences Center	Correctional Managed Healthcare Committee University of Texas Medical Branch Texas Tech University Health Sciences Center
CONTRACT COVERS	**CONTRACT COVERS**
Single capitation rate (per youth/per day) excludes psychiatric services Security costs Mandated pay raise	Various capitation rates based on type of service (per inmate/per day) Hepatitis B vaccinations Mandated pay raise Psychiatric care Psychotropic medications
CONTRACT DOES NOT COVER	
Psychiatric care under capitation - only fee-for-service Nonformulary psychotropic medications	
INCREASED COSTS DUE TO	**INCREASED COSTS DUE TO**
Specialty care/inpatient care Pharmaceutical costs Psychiatric services	Specialty care/inpatient care Pharmaceutical costs Aging of population

SOURCES: Texas Youth Commission; Department of Criminal Justice.

Maximizing Medicaid Reimbursement for School Health and Related Services

Special education and related services expenditures in Texas schools were $3.0 billion in All Funds for fiscal year 2001. The School Health and Related Services program allows school districts to claim Medicaid reimbursement for health-related services to children in special education. School districts can leverage local and state funds to draw federal Medicaid for health services being provided to children with disabilities. These funds can be an important funding source because special education costs exceed the federal assistance provided under the Individuals with Disabilities Education Act. This review examines operation of the current School Health and Related Services program, participation by school districts, and Medicaid reimbursement issues.

Significant Findings

- According to a study commissioned by the U.S. Department of Education, in fiscal year 2000, 44 percent of the nation's school districts collected a total of $648.0 million in federal Medicaid funds for special education students from low-income families. Texas' school districts accounted for about 6 percent of the national total ($41.2 million).
- In fiscal year 2001, 70 percent of school districts in Texas (809) filed claims to be reimbursed for School Health and Related Services; 57 school districts were not enrolled as providers; and 173 enrolled school districts did not file claims.
- Federal Medicaid reimbursement for Texas' School Health and Related Services program has more than doubled over the past seven years from $21.0 million in fiscal year 1995 to $44.6 million in fiscal year 2002.
- Of the school districts filing claims for School Health and Related Services, 59 percent (480) use billing agents. Of the school districts using billing agents, 55 percent contract with the Texas Association of School Boards, and 34 percent contract with Medical Claims Services of Texas.
- Fees paid by school districts to billing agents range from 7.0 to 12.5 percent of the federal Medicaid reimbursement for claims paid under the School Health and Related Services program.

Significant Concerns

- Although a large percentage of school districts are now enrolled in the School Health and Related Services program, there are enrolled school districts in high-poverty areas that are not billing for services.
- Medicaid reimbursement is not being claimed for a number of services provided to special education students by school districts. The Health and Human Services Commission and the Texas Education Agency are studying the feasibility of claiming federal Medicaid reimbursement under the School Health and Related Services program for additional services being provided to special education students, as well as for health services being provided to children outside the special education program.

RECOMMENDATIONS

- **Recommendation 1:** The Texas Education Agency should provide technical assistance to school districts in high-poverty areas that are not enrolled in the Medicaid School Health and Related Services program. Furthermore, the agency should examine the reasons some school districts are enrolled as Medicaid providers but are not billing for services.
- **Recommendation 2:** The Texas Education Agency and the Health and Human Services Commission should revise the memorandum of understanding between the agencies to include specific roles and responsibilities regarding monitoring, reporting, contracting and rate-setting functions.

COMMENTS

Medicaid is a federal and state partnership that provides matching federal funds for healthcare services provided to low-income and disabled individuals. Congress passed the Medicare Catastrophic Coverage Act of 1988 requiring that Medicaid reimbursement be available for special education and related services included in the Individual Education Plan (IEP) of children with disabilities. In addition, federal law established under the Individuals with Disabilities Education Act (IDEA) obligates schools to identify and provide services that are required to help a child benefit from special education. Schools are already paying for special education services with local and state funds that could be used to draw down federal Medicaid reimbursement.

SCHOOL HEALTH AND RELATED SERVICES

The Texas Medicaid State Plan was amended in 1992 to include the School Health and Related Services (SHARS) program. Currently, only 21 states have state plans approved by the Centers for Medicare and Medicaid Services (CMS) that enable school districts to be reimbursed by Medicaid for health services provided to children in special education.

The Health and Human Services Commission (HHSC) and the Texas Education Agency (TEA) share responsibility for the SHARS program in Texas. The Health Care Financing Division at the Texas Department of Health (TDH), partnering with TEA, initially operated the SHARS program before it was transferred to HHSC after the Seventy-seventh Legislative Session, 2001. HHSC has requested $1.4 million to administer the SHARS program for the 2004–05 biennium. HHSC uses these funds to pay the claims administrator for the costs of processing SHARS claims.

SHARS PROVIDERS

At the beginning of the SHARS program in fiscal year 1993, there were 246 school districts enrolled as providers. In fiscal year 2001, there were a total of 809 school districts billing for services in the SHARS program. There are 173 school districts (20 percent) enrolled in the SHARS program that are not currently billing for services. Figure 1 shows the participating school districts' distribution across the State of Texas. More than half of the school districts billing SHARS (459) are part of a school cooperative. School cooperatives are formed to pool financial and staff resources to provide special education and related services.

In fiscal year 2001, 30 school districts accounted for half of the federal revenue ($19.5 million) collected from the SHARS program. These represent the largest school districts in the state in terms of population. However, there are several small school districts that maximize reimbursement under the SHARS program.

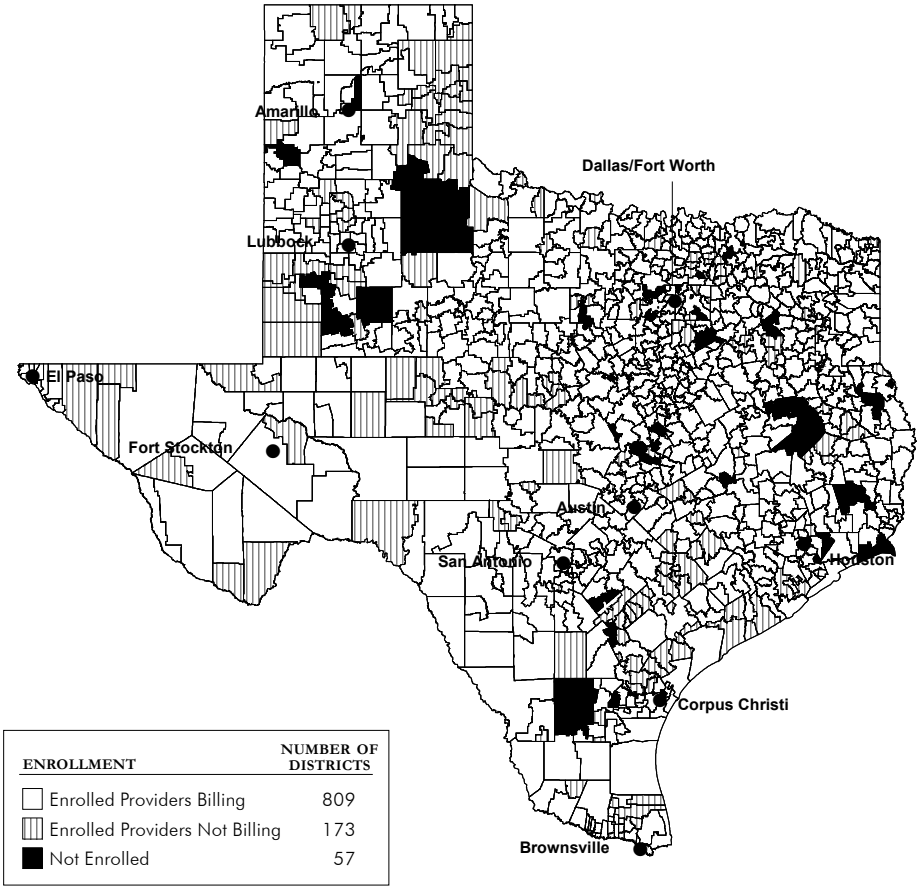
CERTIFICATION OF FUNDS

Matching funds are required to draw federal Medicaid funds. The federal share of the Medicaid program is known as the Federal Medical Assistance Percentage (FMAP). The FMAP fluctuates slightly each year; in fiscal year 2002 the FMAP was 60.17 percent and the

state share was 39.83 percent. School districts certify state and/or local funds used for special education services as the state share of expenditures for SHARS. Federal IDEA funds may not be counted as state match for Medicaid.

School districts bill the claims administrator the full cost of providing SHARS to Medicaid clients. The claims administrator mails each participating school district a letter listing quarterly expenditures of state and/or local funds for SHARS. Participants must sign the letter certifying the expended amount and return it to the claims administrator. The federal share of Medicaid reimbursement is then remitted to each district. For example, a provider that bills an hour of physical therapy at $40 will receive approximately $24 in federal funds.

FIGURE 1
SCHOOL DISTRICTS PARTICIPATING IN THE SCHOOL HEALTH AND RELATED SERVICES PROGRAM
FISCAL YEAR 2001



NOTE: Does not include charter schools.
SOURCES: Legislative Budget Board; National Heritage Insurance Company.

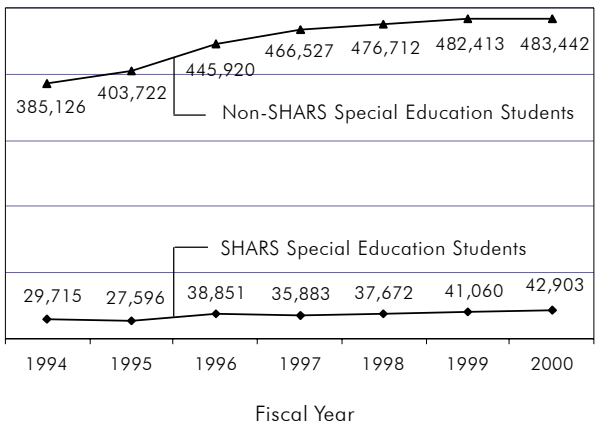
SHARS CLIENTS AND BILLING ACTIVITIES

For Texas, the number of children receiving special education and related services as a percentage of total children in public schools has remained constant for the past 5 years at about 12 percent. The number of children whose services were reimbursed by the SHARS program increased from 29,715 in fiscal year 1994 to 42,903 in fiscal year 2000 (see Figure 2). This increase is most likely attributable to the increase in school districts participating in the SHARS program after the fiscal year 1995. (An additional 212 school districts enrolled.) To be eligible for special education and related services, a student must be 3 to 21 years of age with a disability. A child with a disability must have specific conditions listed in federal regulations. In addition, the child with a disability must be evaluated in accordance with federal and state laws in order to determine the need for special education and related services.

The number of Medicaid-eligible special education students attending Texas schools is difficult to determine. The Texas Education Agency's Public Education Information Management System (PEIMS) collects data on the number of special education students and the funds expended to provide special education and related services. However, family income information is necessary to determine eligibility for Medicaid. TDH collects student Medicaid eligibility rates for school districts through the Medicaid Administrative Claiming Project (MAC). MAC is a program in which school districts are reimbursed for the federal share of Medicaid administrative activities performed in the district. According to TDH, 87 percent of school districts (1,043) participate in the MAC program.

According to a study commissioned by the U.S. Department of Education, an estimated $648 million was collected nationally from Medicaid for special education students from low-income families in fiscal year 2000. SHARS providers in Texas received $41.2 million in federal funds for Medicaid services provided in fiscal year 2000. Texas' amount accounted for little more than 6 percent of the estimated national total. As indicated in Figure 3, the amount of revenue collected under SHARS has increased to $44.6 million in fiscal year 2002.

FIGURE 2
SPECIAL EDUCATION STUDENTS IN TEXAS SCHOOLS



SOURCES: Texas Education Agency; National Heritage Insurance Company.

SERVICES COVERED UNDER SHARS

SHARS allows school districts to be reimbursed for 10 health-related services. Initially, only nine services were covered in 1992: occupational, physical, and speech therapy; medical diagnostic services; psychological services; assessments; audiology services; counseling services; and other school health services. Special transportation services were added to the Medicaid State Plan in 1994. The Medicaid State Plan requires that licensed, certified or professional therapists, psychologists, and medical personnel provide SHARS services. SHARS services can be delivered and billed in units of 15 minutes. Speech

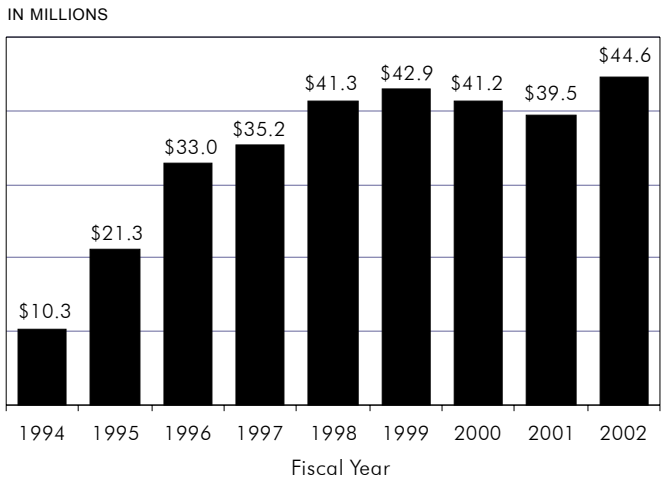
therapy and school health services made up the majority of the units billed in fiscal year 2000. Figure 4 shows that these two services accounted for 68 percent of the units billed and reimbursed by SHARS.

CURRENT DEVELOPMENTS

The Comptroller of Public Accounts (CPA) and HHSC executed a contract with a consultant group to review various programs administered by state agencies to maximize receipt of federal revenue. An initial review identified several existing services that could be added to the Medicaid State Plan. Federal reimbursement could be claimed for activities such as development of, or adjustments to, IEPs and monthly case management contacts to coordinate medical, social, educational, and other services. Vision assessments, personal assistance, and adaptive assistive devices approved in students' IEPs could be another source of federal Medicaid funds. The feasibility of adding additional therapies currently being provided by school districts to special education students, such as music therapy, recreation therapy, equestrian therapy, orientation and mobility services, and other related services will be analyzed. Reimbursement rates for existing services will be examined as well, to capture all allowable costs incurred by the school districts.

Eligibility for SHARS could also be extended beyond children in special education to include Medicaid-eligible children with special health needs. Students with special needs include those who are covered under Section 504 of the Rehabilitation Services Act of 1973 and those who have an Individual Health Services Plan (IHSP), such as

FIGURE 3
SCHOOL HEALTH AND RELATED SERVICES
FEDERAL MEDICAID FUNDS TO TEXAS

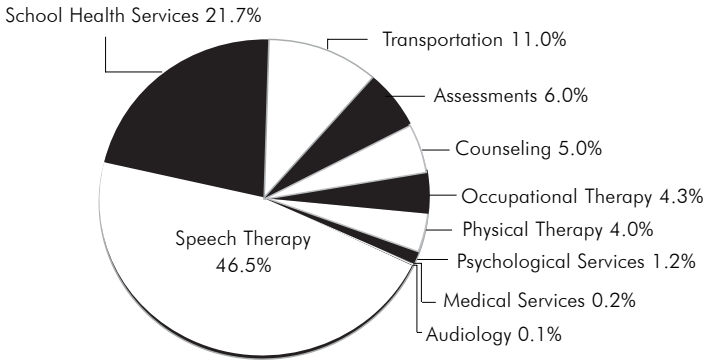


NOTE: Fiscal year 2001 may not include funds received after reporting period.
SOURCES: Health and Human Services Commission; National Heritage Insurance Company.

FIGURE 4
SCHOOL HEALTH AND RELATED SERVICES
NUMBER OF UNITS BILLED

FISCAL YEAR 2000

TOTAL = 4,889,329



SOURCE: National Heritage Insurance Company.

children with diabetes, attention deficit disorder, or asthma. Section 504 of the Rehabilitation Act of 1973 protects students who have physical or mental conditions that limit their ability to access and participate in an education program. These students are entitled to rights under Section 504, even though they may not fall into a disabilities category covered in special education. Section 504 mandates accommodations in order to help students benefit from their educational program.

SCHOOL DISTRICT BILLING AGENTS

Participation in the SHARS program is a complex undertaking for any school district. To receive Medicaid reimbursement, Medicaid-eligible special education students must be identified, qualified staff must provide the services, and detailed records on all services provided must be maintained. Given their lack of expertise in Medicaid billing and administration, many school districts that would not have normally participated in the Medicaid program turned to billing agents. To share resources needed to bill Medicaid, some districts have also formed cooperatives.

Of the school districts filing claims for SHARS, 59 percent (480) use billing agents. Of the school districts using billing agents, 55 percent contract with the Texas Association of School Boards (TASB) and 34 percent contract with Medical Claims Services of Texas. TASB applies a sliding scale based on the volume of claims when assessing fees to school districts, which currently ranges from 8.0 to 10.0 percent of the federal reimbursement for paid SHARS claims. Across all billing agents, fees range from 7.0 to 12.5 percent.

FEDERAL TECHNICAL ASSISTANCE

According to the U.S. General Accounting Office report in April 2000, CMS has provided little or inconsistent direction and oversight of Medicaid reimbursements for school-based claims. After this report was published, CMS developed draft guidance on Medicaid reimbursement for school-based claims. The draft guidance was released for public comment but was withdrawn due to many negative comments from school groups. School groups believed the draft guidance went beyond clarifying existing Medicaid policy, instead creating complicated new rules for schools. For example, the IDEA and Medicaid guidelines are in conflict with regard to which federal agency is responsible for covering medical costs related to special education. IDEA law includes language that indicates that all applicable federal funds should be accessed for special education and related services. However, Medicaid regulations include rules indicating that Medicaid is the payer of last resort. According to CMS, federal IDEA funds or private insurance must be used to cover medical costs of special education students. This disconnect between federal agencies adds to the challenges that exist for state agencies when they try to successfully maximize participation in the SHARS program.

INTERAGENCY RESPONSIBILITIES FOR SHARS ADMINISTRATION

In response to SHARS issues raised by the Legislative Budget Board in its *Staff Performance Report to the 74th Legislature* concerning limited provider participation, a memorandum of understanding (MOU) between TDH and TEA was developed. The MOU's purpose was to outline the roles and responsibilities of TDH and TEA regarding the implementation and management of the SHARS program by establishing the following:

- specific agency responsibilities for ensuring that school districts receive adequate technical assistance and policy clarification;
- a mechanism to identify and resolve issues that impede school districts from participating in the SHARS program;
- a mechanism for ensuring that the SHARS program and school district participation are considered in the development and implemen-

tation of state Medicaid policies and rate-setting procedures; and

- responsibility for developing policies and procedures, which will serve as incentives for school district participation.

TEA has made strides in clarifying policies, such as developing detailed information on the requirements of personnel providing speech therapy services. In addition, TEA, TDH, and the claims administrator developed a question-and-answer document to post on their websites to help providers navigate the SHARS program requirements.

However, there are still some components of the SHARS program that need to be addressed. HHSC receives quarterly reports from the claims administrator listing provider-billing amounts. School districts that have not billed in several years are identified, yet TEA has not followed up to determine the circumstances related to the lack of billing.

The claims administrator's report of provider-billing amounts for fiscal year 2001 listed 430 school districts as nonactive providers. After reviewing the list of providers, only 173 providers did not bill during fiscal year 2001. The 430 school districts listed included school districts that had billed for SHARS services and several school districts with different provider numbers. The claims administrator's quarterly reports need to be updated to accurately reflect the providers enrolled and billing.

In addition, TEA has not communicated with nonparticipating school districts in order to maximize SHARS reimbursement. TEA could identify obstacles preventing school districts from participating in SHARS and provide technical assistance to address the obstacles. A survey of nonparticipating school districts indicated that the extensive paperwork is a discouraging feature of SHARS. TEA can offer assistance to school districts in learning ways to overcome this barrier. Recommendation 1 requires TEA to provide technical assistance to school districts in high poverty areas that are not enrolled in the Medicaid SHARS program, and to examine the reasons some school districts are enrolled as Medicaid providers, but are not billing for services.

RATE SETTING AND CLAIMS ADMINISTRATOR'S CONTRACT RESPONSIBILITIES

Until fiscal year 2001, TDH performed the rate-setting process for SHARS via an MOU with TEA. The last MOU on file was drafted in 1996 with TDH. The SHARS functions under TDH moved when the Medicaid Program relocated to HHSC. TEA is in the process of preparing a new MOU for coordination with HHSC.

SHARS rules state that reimbursement rates must be reviewed at least every five years. However, there are three exceptions to the five-year rule. Prospective rates, cost-related rates, and rates that reflect the cost of efficient service provision can be adjusted annually for inflation. SHARS reimbursement rate adjustments for inflation were most recently made in September 2002. According to HHSC staff, the last comprehensive review and analysis was conducted approximately four years ago.

Under the current MOU, HHSC is responsible for conducting rate analysis functions and for communicating proposed rate and rule changes to TEA. The HHSC posts anticipated rate changes to the TEA web site, holds open meetings, and implements the rate change through the Medicaid claims administrator. TEA publishes the new rate to school districts, and the Medicaid claims administrator applies the rate and provides educational workshops to providers and billing agents as required by contract.

Rate changes sometimes require Medicaid rule changes. If a Medicaid rule change is required, additional steps are added to the approval process, including (1) presenting the rule to the Medical Care Advisory Council; (2) posting the proposed rule for comments in the *Texas Register*; and (3) securing final approval from the necessary authorities.

HHSC is also responsible for monitoring the claims payment system for SHARS. Therefore, HHSC has incorporated contract performance requirements related to SHARS into the HHSC Medicaid claims administrator contract. Only small sections of the Medicaid claims administrator contract specifically mention SHARS for items such as the method and timelines for claim submission, quarterly reporting requirements, and the process whereby school district funds are certified. Recommendation 2 directs TEA and HHSC to revise the MOU between the agencies to include specific roles and responsibilities regarding monitoring, reporting, contracting and rate-setting functions.

An audit conducted by the CMS in fiscal year 2000 indicates that contractors for the Texas SHARS program, which includes the claims administrator and district billing agents, performed better than contractors in most other states based on accuracy of claims and appropriateness of services billed.

CONCLUSION

SHARS in Texas is a well administered program for school districts currently participating. An audit conducted in fiscal year 2000 by the U.S. Department of Health and Human Services verified that claims filing and processing are fundamentally sound, and that services provided are within parameters set by the program.

The recommendations proposed in this report address a number of issues concerning the relationship between the managing state agencies and the claims administrator. The effectiveness of the SHARS program could be enhanced by redrafting the MOU to better define the roles and responsibilities of HHSC and TEA and by reviewing the performance requirements of the contract with the claims administrator. Federal Medicaid reimbursement could be maximized by adding coverage under SHARS for additional services currently being provided to special education students, extending SHARS eligibility to other children with special healthcare needs, and providing technical assistance to school districts not currently participating in the Medicaid program.

Mitigating Medical Equipment Costs in State Programs

This review focuses on the issue of increasing costs for durable medical equipment and supplies in Texas healthcare programs. Among programs surveyed, Texas expended $146.9 million in durable medical equipment and supplies in fiscal year 2001. As some forms of treatment migrate from hospitals and nursing homes to the patients' residences, durable medical equipment and supplies are poised to become a major cost driver. This report examines current spending, utilization management, and purchasing practices in several state programs and proposes measures for controlling costs.

Significant Concerns

- State durable medical equipment and supply costs are rising 10 to 21 percent per year.
- As a requirement of the General Appropriations Act for the 2002-03 biennium, the Health and Human Services Commission recently initiated a plan to save $7.3 million in General Revenue Funds for durable medical equipment and supplies. The estimated savings, however, will not be fully realized in the current biennium.
- The Texas Comptroller's *Health Care Claims Study*, published in January 2001, estimated the overpayment percentage of Medicaid claims for durable medical equipment and supplies at 18.73 percent. This is the highest of all provider types reviewed in the study.
- In addition to cost increases, consumer demand for home healthcare is expected to increase durable medical equipment and supply spending 12 percent by fiscal year 2010.
- Due to the state's dependency on distribution networks for durable medical equipment and supplies, options for controlling costs through factory purchasing and volume discounts are limited.
- Medicaid rules do not include standards of practice or certification requirements for providers of durable medical equipment and supplies.

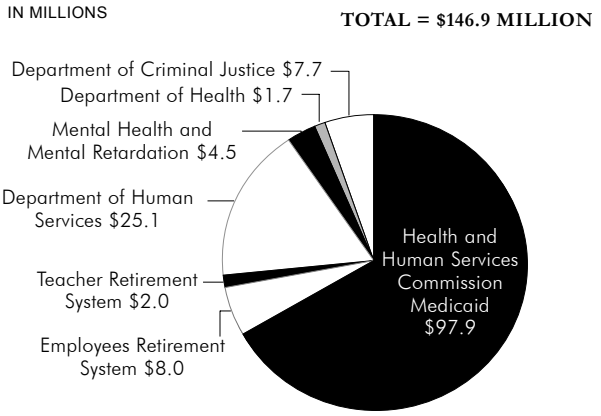
Recommendations

- **Recommendation 1:** The Health and Human Services Commission should continue to work with community stakeholders and the medical equipment and supplies industry to implement rules and policies for improving benefit management for durable medical equipment and supplies.
- **Recommendation 2:** The Department of Health, in conjunction with state agencies that purchase durable medical equipment and supplies, should establish a centralized price-tracking database and a preferred product list.
- **Recommendation 3:** The Health and Human Services Commission should amend Medicaid program rules to include standards of practice and/or certification requirements for providers of durable medical equipment and supplies.

Comments

Costs for durable medical equipment (DME) and supplies in Texas continue to rise. Figure 1 illustrates the fiscal year 2001 cost of DME purchases made in the Medicaid program, the Employees Retirement System (ERS), the Teacher Retirement System (TRS), the Department of Human Services (DHS), the Department of Mental Health and Mental Retardation (TDMHMR), the Department of Health (TDH), and the Department of Criminal Justice (TDCJ).

FIGURE 1
STATE PROGRAM COSTS FOR DURABLE MEDICAL EQUIPMENT AND SUPPLIES
ALL FUNDS, FISCAL YEAR 2001



SOURCES: Health and Human Services Commission; Employees Retirement System; Teacher Retirement System; Department of Human Services; Department of Mental Health and Mental Retardation; Department of Health; and Department of Criminal Justice.

About two-thirds of DME spending in state health programs occurs in the Medicaid program.

MEDICAID DME

Medicaid patients usually receive their medical equipment or supplies after a physician has prescribed a product and contacted a medical equipment or medical supply provider. The physician or supplier may be required to get prior authorization for the requested item. The medical equipment and medical supply providers generally purchase products from manufacturers, wholesalers or cooperative purchasing groups. Depending on the type of DME being supplied, items can be provided through a home health service, delivered to the client (either directly by the DME provider or using a carrier service), or obtained by the client at an approved retail establishment. The delivery of complicated medical equipment is generally accompanied by a technician who installs the product and instructs the client and family on use of the equipment. The client or guardian must sign a form acknowledging receipt of the product, and the Medicaid claims administrator is required to verify product delivery.

Medicaid rarely purchases DME directly from the manufacturer due to a number of factors including the need to coordinate product distribution, assemble products, educate clients and maintain equipment. Medicaid conducts retrospective reviews of product utilization.

For September 2000 through January 2002, 22 counties accounted for 85 percent of total Medicaid DME costs and 70 percent of total Medicaid enrollment (see Figure 2). Table 1 provides actual expenditures for the 22 counties and compares Medicaid expenditures to Medicaid enrollment in each county. Variance between Medicaid enrollment and expenditures among counties is largely due to the difference in the average age of their residents.

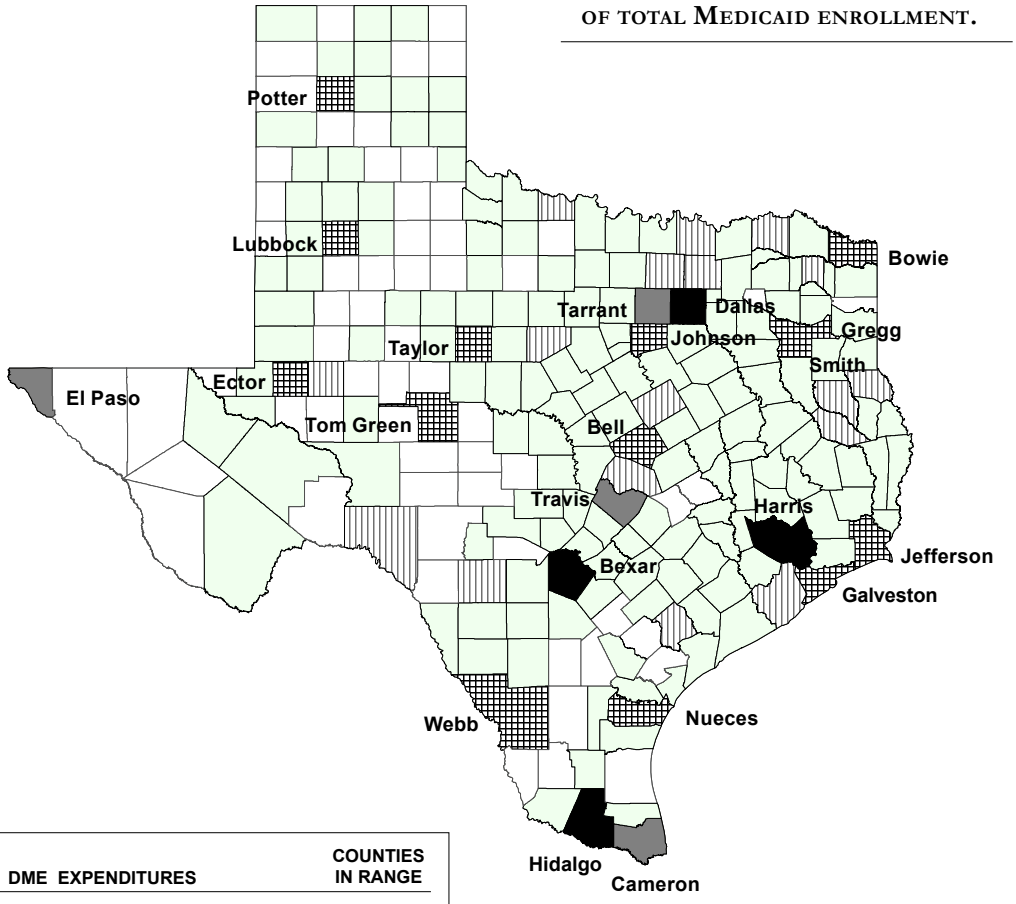
CURRENT COVERAGE CRITERIA

Current coverage criteria for management of Medicaid DME benefits are contained in the Texas Administrative Code, Title 1, Part 15, and Section 354.1039 for Medicaid home health services. Among other criteria, to qualify for Medicaid reimbursement, the provision of DME must meet the following conditions:

- be medically necessary due to illness or injury or to improve function (as documented in the recipient's plan of care);
- be previously authorized unless otherwise specified by the department;
- meet the recipient's existing medical and treatment needs;
- be considered safe for use in the home; and
- be provided through an enrolled home health agency under a current physician's plan of care or an enrolled DME supplier under a signed and dated physician's prescription.

FIGURE 2
MEDICAID EXPENDITURES FOR DURABLE MEDICAL EQUIPMENT, BY COUNTY
SEPTEMBER 2000 THROUGH JANUARY 2002

TWENTY-TWO COUNTIES ACCOUNT FOR 85 PERCENT OF TOTAL DME EXPENDITURES AND 70 PERCENT OF TOTAL MEDICAID ENROLLMENT.



DME EXPENDITURES			COUNTIES IN RANGE
$10,000,001	to	$22,200,000	4
$5,000,001	to	$10,000,000	4
$1,000,001	to	$5,000,000	14
$500,001	to	$1,000,000	17
$1	to	$500,000	154
$0			61

SOURCES: Legislative Budget Board; Health and Human Services Commission.

TABLE 1
DURABLE MEDICAL EQUIPMENT EXPENDITURES COMPARED TO MEDICAID ENROLLMENT
SEPTEMBER 2000 THROUGH JANUARY 2002

	DME EXPENDITURE		MEDICAID ENROLLMENT	
COUNTY	RANKING	AMOUNT (IN MILLIONS)	RANKING	NUMBER
TOP 22 COUNTIES				
Harris	1	$22.2	1	530,331
Bexar	2	$20.8	3	273,300
Hidalgo	3	$15.1	4	250,413
Dallas	4	$13.6	2	316,969
Tarrant	5	$6.4	6	170,999
Travis	6	$6.2	8	88,506
El Paso	7	$6.2	5	203,812
Cameron	8	$5.6	7	141,147
Jefferson	9	$4.5	11	51,335
Lubbock	10	$3.9	12	45,703
Nueces	11	$3.6	10	74,998
Bell	12	$2.9	15	32,919
Potter	13	$2.8	18	28,498
Johnson	14	$2.1	38	15,123
Ector	15	$2.0	17	29,908
Gregg	16	$2.0	24	21,936
Webb	17	$1.9	9	75,629
Taylor	18	$1.9	22	22,298
Smith	19	$1.7	19	28,219
Bowie	20	$1.3	34	16,844
Tom Green	21	$1.3	29	19,574
Galveston	22	$1.2	14	34,549
SUBTOTAL, TOP 22 COUNTIES		**$129.2**		**2,525,624**
TOTAL, ALL COUNTIES		**$152.8**		**3,595,678**

SOURCES: Legislative Budget Board; Health and Human Services Commission.

Table 2 lists the top 10 DME items in terms of Medicaid expenditures. These 10 items made up 90 percent of all Medicaid DME expenditures in fiscal year 2001.

MEDICAID COST CONTAINMENT

Pursuant to Section 33(h), Special Provisions relating to All Health and Human Services Agencies, 2002-03 General Appropriations Act, HHSC attempted to launch a competitive bidding process and released a request for proposals (RFP) on May 15, 2002. However, public comments received by HHSC on the RFP raised significant questions about whether the desired results would be achieved. HHSC withdrew the RFP on July 5, 2002. Among the many comments, DME providers suggested that across-the-board rate reductions and competitive bidding would reduce the number of providers willing to participate in Medicaid and create barriers to care for Medicaid recipients.

HHSC has been working with DME suppliers and Medicaid client advocates to explore other ideas for achieving $7.3 million in General Revenue Fund savings. HHSC has proposed the following specific recommendations.

- Restrict rental or purchase of totally electric beds to those persons whose needs cannot be met by a semiautomatic bed.
- Limit the supply of underpads to a monthly quantity. Quantities beyond the limit will be allowed with prior authorization and documentation to support the additional amount.
- Limit the supply of diapers, briefs, undergarments, liners, etc. to a monthly quantity. Quantities beyond the limit will be allowed with prior authorization and documentation to support the additional amount.
- Limit the supply of all sizes of wipes to a monthly quantity. Quantities beyond the limit

TABLE 2
TOP TEN EXPENDITURES FOR MEDICAID MEDICAL EQUIPMENT AND SUPPLIES

IN MILLIONS

ITEM	FISCAL YEAR 2001 EXPENDITURES
Incontinence supplies	$35.0
Wheelchairs	23.0
Oxygen and related supplies	13.5
Enteral products	5.4
Diabetic supplies	5.4
Beds	2.0
Tracheal supplies	1.3
Seating systems	1.0
Intravenous supplies	0.9
Bath equipment and supplies	0.8
TOTAL EXPENDITURES	**$88.3**

SOURCE: Health and Human Services Commission.

will be allowed with prior authorization and documentation to support the additional amount.

- Limit the supply of gloves, incontinence supplies, and tubing to a monthly quantity. Quantities beyond the limit will be allowed with prior authorization and documentation to support the additional amount.
- Discontinue rental of oxygen analyzers as a separate item. The item would be included in the charge for the monthly oxygen service.
- Discontinue rental of porta-lungs. Consider other ventilators instead of porta-lungs.
- Discontinue reimbursement for refills as a separate item. The refills would be included in the charge for the monthly oxygen service.
- Discontinue reimbursement of cannulas and tubing as a separate item. These items would be included in the charge for the monthly oxygen service.
- Discontinue rental of pulse oximeters for persons over 21 years of age. Testing would be the responsibility of the home health agency.
- Consider purchase of continuous positive airway pressure ventilators and bi-level positive airway pressure ventilators and discontinue long-term monthly rental.
- Limit the number of ventilator extension sets per month. Quantities beyond the limit will be allowed with prior authorization and documentation to support the additional amount.
- Increase the expected life of custom manual wheelchairs by one year.
- Allow for the separate purchase of a wheelchair seating system when the wheelchair base is in good condition.
- Consider coverage of scooters for the adult population when the device meets the needs of the client.
- Limit options in the purchase of hospital beds.
- Discontinue the purchase of sterile items for home use (e.g., gloves, dressings, gauze, etc.).

Although HHSC hopes to achieve savings without affecting access to DME and supplies, providers and advocates feel that some changes may compromise product quality. DME provider groups and client advocates do not agree with all of the HHSC-proposed policy changes. Nevertheless, HHSC will move ahead with full implementation after it considers final comments from DME provider groups and advocates on the current proposed policy changes. Full implementation is expected by the end of fiscal year 2003. Recommendation 1 states that HHSC should continue to work with the DME industry and community stake holders to implement rules and policies aimed at improving benefit management and reducing costs of DME and supplies.

BENEFIT MANAGEMENT PRACTICES FOR THE EMPLOYEES RETIREMENT SYSTEM AND TEACHER RETIREMENT SYSTEM

State employees have three options for healthcare coverage through ERS. Health Select Plus, Health Select, and health maintenance organizations all have benefit management plans in place. Benefits provided through TRS are managed by the plan administrator, Aetna Insurance Company. Both TRS and ERS plans require that DME be prescribed by a physician. Prior authorization is not required for all types of equipment and supplies. Copayments are required by both agencies' health plans and vary from 10 to 20 percent.

Covered items for state employee and teacher healthcare programs include rental, purchase, or repairs for wheelchairs; canes, crutches, and walkers; bed pans, urinals, and commodes; hospital beds and mattresses; respiratory or oxygen-related equipment; and many more items deemed medically necessary. Table 3 lists the top 10 DME items in terms of expenditures by ERS in fiscal year 2002. These 10 items account for roughly half of fiscal year 2002 DME expenditures at ERS.

TABLE 3
TOP TEN EXPENDITURES FOR EMPLOYEE RETIREMENT SYSTEM MEDICAL EQUIPMENT AND SUPPLIES

IN MILLIONS ITEM	FISCAL YEAR 2002 EXPENDITURES
Glucose test strips	$1.0
Hearing aids	1.0
Oxygen concentrators	0.9
Continuous positive airway pressure ventilator	0.6
Standard electric wheelchairs	0.5
External insulin pumps	0.3
Negative pressure wound therapy, electrical pumps	0.2
Surgical trays	0.2
Infusion sets for external insulin pump	0.2
Disposable drug delivery systems	0.2
TOTAL EXPENDITURES	**$4.6**

SOURCE: Employees Retirement System.

DME PRICING STRATEGIES

In addition to patient utilization controls, healthcare programs in Texas should implement coordinated strategies for DME pricing to leverage purchasing power and further reduce costs. Three approaches could be analyzed: (1) creation of a DME price-tracking database; (2) development of a preferred product list; and (3) negotiated manufacturer rebates.

State healthcare programs should compile all DME and supply pricing information into a central database. TDH is currently developing a single database for drug prices with information from all agencies. DME and medical supply pricing information could be incorporated as an adjunct to the TDH drug price database. The data is proprietary to the companies providing the information and not available for public release, but it may be used by agencies to insure that each agency pays the lowest price for the same product and service. Recommendation 2 states that TDH, in conjunction with state agencies that purchase DME and supplies, should establish a centralized price-tracking database and a preferred product list.

Some states have implemented preferred drug lists to negotiate better pricing for pharmaceutical products. A similar listing could be developed among state healthcare agencies for DME and supplies. The preferred product list would allow the state to negotiate favorable pricing for certain products. Providers would have to supply the preferred products on the list whenever possible. If a provider in a certain area did not have access to a preferred product, then an alternate product could be substituted at an agreed price. A preferred product list could be a good management tool allowing state healthcare

programs to control costs through consolidation of purchasing and possible access to substantial product rebate dollars.

State pharmaceutical purchasing programs receive provider discounts and manufacturer rebates for the purchase of drugs. State healthcare programs currently receive DME discounts, but they should analyze the possibility of securing manufacturer rebates as well. DME providers have expressed concern that manufacturers would attempt to recoup the value of rebates out of DME provider profit margins. However, there is no evidence to indicate that manufacturers would penalize providers for direct state-negotiated rebates.

QUALITY CONTROL ISSUES

The Texas Comptroller's *Health Care Claims Study*, published in January 2001, estimated an overpayment percentage of 18.7 percent for Medicaid DME and supplies. This is the highest of all provider types reviewed in the study.

From a sample of 100 provider records, 20 records indicated the following:

- Six did not send the requested medical record (after three requests through certified, return receipt, mail).
- One sent the record but it did not include documentation for the service(s) rendered on the sample day.
- Six sent the records but there was no documentation of the service(s) within the record.
- Six were clerical errors.
- One was defined by the study as potential fraud or abuse and referred for investigation.

In addition to the overpayment rate, questions concerning overutilization and medical necessity documentation were the most prevalent issues found. HHSC's Office of Program Integrity is working with the Medicaid program and the DME and supply industry to limit supplies and control utilization of DME. These strategies are expected to save money and allow for stronger monitoring of providers.

The state has made great strides in identifying fraud and abuse in Medicaid and other state healthcare programs. However, all state healthcare payors would benefit if the Medicaid program implemented standards of practice or certification requirements for DME and supply providers.

Medicare currently requires licensing of DME and supply providers that service the Medicare population. Potential provider candidates are required to pay licensing fees. Most DME and supply providers agree that some form of standards of practice and/or certification requirement greatly improves the quality and integrity of their business. Standards of practice requirements reduce risk of injury to patients, reduce the cost to the state for replacement of poorly installed or maintained equipment, and discourage unscrupulous providers from entering the market. The Medicaid program already tracks hospital certifications and conducts credential reviews of participating providers. The cost of tracking and verifying DME and supply provider credentials would be offset by reducing the risk of inexperienced and unscrupulous businesses serving state clients. Table 4 lists the types of DME licensing and certification currently required by Medicare and provided through TDH. Recommendation 3 states that HHSC should amend Medicaid program rules to include standards of practice or certification requirements for providers of DME and supplies.

DEMAND FOR HOME-BASED CARE

The U.S. Bureau of the Census has reported that by the year 2030, the 65 and over age group will represent about 20 percent of the population, or approximately 56 million people. Texas is no exception to this trend, particularly as seniors continue to be attracted to our warm climate and relatively low cost of living. Recent studies in Maine, Pennsylvania and Michigan showed that most people would rather receive care at home than in nursing homes and hospitals. Savings from

TABLE 4
TEXAS DURABLE MEDICAL EQUIPMENT LICENSES AND REGISTRATIONS FOR MEDICARE

TYPE OF LICENSE / REGISTRATION
Texas Resale Permit (sales tax)
TDH Bedding License
TDH Wholesale Distributor of Drugs
TDH Wholesale Device Distributor
TDH Medical Device Distributor
TDH Drug Manufacturer
FDA Registration of Device Establishment
FDA Registration of Drug Establishment

NOTE: FDA = Food and Drug Administration.
SOURCE: Department of Health; Medical Equipment Suppliers Association.

reduced utilization of institutional facilities could be used to provide home care. The aging baby boomer population has the potential to increase demand for the DME and supply industry.

The weak economy, group-purchasing organizations, and mature markets have reduced current profit outlooks. Medical equipment companies have responded by merging and acquiring firms to reduce costs and enhance market position. Industry acquisitions will allow corporations to capture market share in certain specialty areas, perhaps driving up costs.

DME and supply companies will adapt to these changes and implement effective selling programs to market their products. For example, one of the largest DME manufacturers and distributors plans to create a patient information data management system linking patients, physicians, and its own devices via the Internet and wireless devices. The concept will increase consumer demand and awareness for DME products in much the same way drug advertising promotes demand for new pharmaceutical products.

CONCLUSION

DME and supplies for home healthcare are not the major cost driver in the current healthcare market. However, DME and supply costs, as well as the rate of utilization, are expected to grow over the next 10 years. Also, DME and supply costs may become more of a concern as technology continues to expand patient choices for nontraditional care. Costs are already rising faster than inflation, and the use of these services has grown in all age and healthcare categories.

Implementation of cost-saving strategies for Medicaid DME may save approximately $7.3 million in General Revenue Funds over the 2004–05 biennium. Other state health programs should also seek cost savings by improving benefit management, establishing a centralized, price-tracking database, and pursuing volume discounts and/or manufacturer rebates for DME and supplies. Finally, a Medicaid requirement that DME and supply providers receive certification and/or meet standards of practice could improve quality and accountability in the DME industry and reduce program costs.

A Prescription for Drug Savings in State Programs

The purchase of pharmaceutical drugs is a cost driver in the state budget. In fiscal year 2002, the Health and Human Services Commission, the Department of Health, the Department of Mental Health and Mental Retardation, the Department of Criminal Justice, the Employees Retirement System, and the Teacher Retirement System spent a total of $1.3 billion in General Revenue Funds on prescription drugs. This was a 20.3 percent increase over fiscal year 2001. In response to escalating pharmaceutical costs, Texas initiated several cost containment strategies during the 2002–03 biennium. Given recent evidence of savings performance in other states, it is necessary to examine the successes and shortcomings of these initiatives and offer new approaches for enhanced savings.

Significant Findings

- Prescription drugs provided through the Medicaid program total $1.1 billion in General Revenue Funds ($3.4 billion All Funds) projected expenditures for the 2002–03 biennium.
- The Health and Human Services Commission projects $35.2 million in General Revenue Funds savings compared to appropriations for prescription drugs over the 2002–03 biennium.

Significant Concerns

- Texas has not achieved cost savings comparable to other large states, such as Florida, Michigan and Georgia that have adopted preferred drug lists. Texas could save an estimated $270 million in General Revenue Funds through supplemental rebates and changes in market share for the 2004–05 biennium based upon savings achieved by other states.
- Delays in implementing federal audit findings, due to rulemaking procedures and supplemental studies, resulted in approximately $8.3 million in lost General Revenue Funds for Medicaid over the 2002–03 biennium.
- The Employees Retirement System and the Teacher Retirement System have two separate contracts with the same pharmacy benefit manager. The amount and percentage of rebates retained by the pharmacy benefit manager is unknown to either agency.
- Public health pricing, also known as 340B pricing, is usually the lowest pricing available for pharmaceuticals. Medicaid pays 14.3 percent more for HIV/AIDS medications than the Department of Health's HIV program, which uses public health pricing.
- Under federal law, public health pricing is not available for inpatient prescription drugs or psychiatric hospitals.
- Texas spent approximately $468.0 million in General Revenue Funds on prescription drugs for low-income Medicare beneficiaries in the 2002–03 biennium, out of total Medicaid Vendor Drug projected expenditures of $1.1 billion in General Revenue Funds for the 2002–03 biennium. Congress is considering legislation to offer prescription drugs through Medicare, which could provide fiscal relief to the state budget.

Recommendations

- **Recommendation 1:** The Legislature should consider directing state agencies to imple-

ment a statewide preferred drug list with a prior authorization program and supplemental rebates to achieve cost savings in drug expenditures.

- **Recommendation 2:** The Employees Retirement System, the Teacher Retirement System, and other agencies that will contract with a pharmacy benefit manager should consider negotiating these contracts to require disclosure of rebate information. Disclosure would enable accurate monitoring of drug prices, rebates, and fees.
- **Recommendation 3:** State agencies should consider expanding the use of federal public health drug pricing (340B). To maximize public health pricing for Medicaid-eligible HIV/AIDS clients, the Health and Human Services Commission should examine strategies for providing prescription drugs through entities qualified for public health drug pricing. Similar strategies should be explored for other Medicaid clients.
- **Recommendation 4:** The Legislature should consider memorializing Congress to allow public health service pricing for psychiatric hospitals and inpatient drugs.

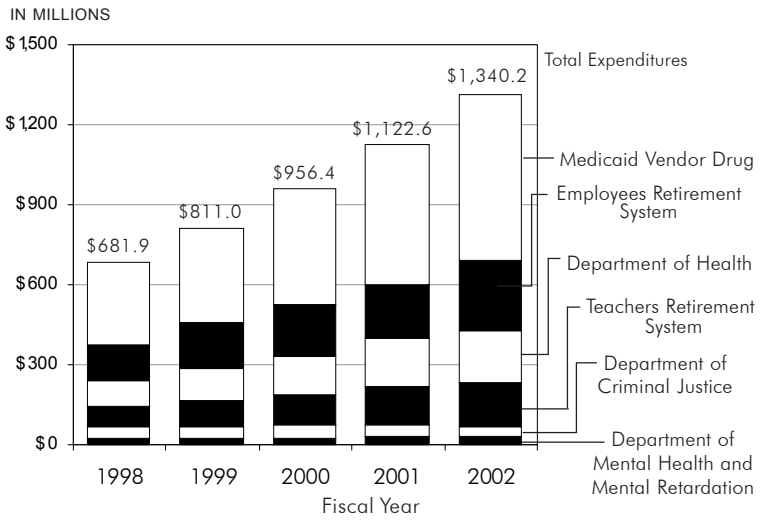
Comments

Since fiscal year 1998 state expenses for prescription drugs have risen 16 to 20 percent annually. As Figure 1 shows, the Medicaid program accounts for almost half of the state's purchases of prescription drugs.

State agencies do not deliver pharmaceutical benefits in the same manner. The Department of Mental Health and Mental Retardation (TDMHMR), the Department of Health (TDH), and the Department of Criminal Justice (TDCJ) are direct purchasers of drugs. The Medicaid Vendor Drug Program (VDP) at the Health and Human Services Commission (HHSC), the Employees Retirement System (ERS), and the Teacher Retirement System (TRS) use the pharmacy benefit manager (PBM) model. PBMs are usually third parties that administer the drug benefit using drug utilization management and the negotiation of rebates. Two programs at TDH, Kidney Health Care and Children with Special Health Needs, do not purchase drugs directly but instead reimburse pharmacies.

The Medicaid program also purchases medicine that is administered by physicians outside the VDP. Claims for these drugs are filed through the Medicaid claims administrator. Prior authorization is required for some physician-administered medications. The cost of these injected drugs was $67.8 million (All Funds) in fiscal year 2002.

FIGURE 1
DRUG EXPENDITURES, BY AGENCY
GENERAL REVENUE



NOTES: Does not include drugs administered by a physician that are not paid by the Medicaid Vendor Drug program.
The Children's Health Insurance Program accounts for expenditures beginning in 2002.
Employees Retirement System's expenditures include Health Select and Health Select Plus plans.
SOURCE: Agency Requests for Information.

Table 1 shows the top 10 drugs purchased by HHSC, TDH, TDMHMR, TDCJ, ERS, and TRS in fiscal year 2001. The cost of the top 10 drugs represents 63 percent of the total expenditure for pharmaceutical drugs purchased by these state agencies. Gastrointestinal, anti-allergy, and mood-altering drugs seem to be the three fastest growing categories.

TABLE 1
TOP 10
PRESCRIPTION DRUG EXPENDITURES
FISCAL YEAR 2001

IN MILLIONS GENERIC DRUG	BRAND NAME	TOTAL EXPENDITURES
Olanzapine	Zyprexa	$62.0
Omeprazole	Prilosec	40.1
	Prevnar	40.1
Risperidone	Risperdal	36.8
Celecoxib	Celebrex	30.0
Atorvastatin	Lipitor	25.7
Loratadine	Claritin	23.1
	Varicella	23.1
Lansoprazole	Prevacid	19.9
Fluoxetine	Prozac	17.4

SOURCES: Health and Human Services Commission; Employees Retirement System; Teacher Retirement System; Department of Criminal Justice; Department of Mental Health and Mental Retardation; Department of Health.

Children's Health Insurance Program

The Children's Health Insurance Program (CHIP) provides unlimited prescriptions for clients. The CHIP pharmaceutical benefit was carved out of health plans in 2002 and processed through the Medicaid VDP system. In fiscal year 2002, the cost of the drug benefit was $38.6 million in General Revenue Funds for a six-month period. HHSC has negotiated approximately a 14.0 percent voluntary rebate from drug manufacturers for CHIP. Manufacturers have been reluctant to participate; HHSC has collected only $110,000 in voluntary rebates as of November 2002.

Medicaid Vendor Drug Program

Federal law attempts to contain costs in the Medicaid program by setting limits on Medicaid reimbursement for drugs and requiring rebates from drug manufacturers. The federal government sets the maximum allowable cost (MAC) for certain drugs. For example, the MAC for generic drugs is 150 percent of the least expensive drug having the same therapeutic equivalency. For brand-name drugs or drugs without a MAC, states must determine the cost. Issues around proprietary pricing data make it difficult for states to obtain and share pricing data; therefore, it is not uncommon for states to pay very different prices for the same drug.

Additionally, federal law requires drug manufacturers to participate in a national rebate program in order to receive reimbursement for outpatient drugs supplied to Medicaid recipients. The rebates are approximately 15.1 percent of the average manufacturer price (AMP) for brand-name drugs and 11.0 percent of the AMP for generics. The AMP is not publicly available.

Cost Containment Approaches

The Seventy-seventh Legislature, 2001, sought to control the rising costs of drugs in programs under the umbrella of HHSC through several cost containment strategies in the General Appropriations Act, for the 2002–03 Biennium. These strategies are now projected to save $35.2 million in General Revenue Funds for the 2002–03 biennium, which is $18.9 million less than was anticipated in the GAA. Table 2 details these various cost containment strategies.

A federal audit of the VDP was completed in February 2002. HHSC delayed implementation of the federal audit recommendations to conduct a study of pharmacy dispensing fees. HHSC officials were concerned that pharmacy drug dispensing fees would be negatively impacted by reducing the Medicaid drug prices. The Medical Care Advisory Committee met on November 14, 2002 and concurred with proposed drug reimbursement rates and pharmacy dispensing fees.

TABLE 2
PHARMACEUTICAL COST CONTAINMENT
IN 2002–03 GENERAL APPROPRIATIONS ACT

STRATEGY / DESCRIPTION	GENERAL REVENUE: ANTICIPATED RIDER SAVINGS	GENERAL REVENUE: AGENCY PROJECTED SAVINGS
HEALTH AND HUMAN SERVICES COMMISSION		
BEST PRICE STRUCTURE		
Base negotiations on pharmacists' actual prices as determined by an audit.	$22.0	$15.9
SUPPLEMENTAL REBATES		
Secure supplemental rebates from drug manufacturers in therapeutic categories.	14.0	0.0
MEDICAID COPAYMENTS		
Charge copayments for drugs for all non-institutionalized Medicaid recipients except children. No client can be refused due to inability to pay.	3.0	4.6*
INCREASE UTILIZATION REVIEW		
Require the agency to improve utilization and benefit management, such as tracking prescription refills and requiring prior authorization for certain expensive or heavily utilized drugs.	6.0	11.7
PHARMACEUTICAL DISPENSING MACHINES		
Install sophisticated machinery to measure and fill prescriptions.	3.2	0
NEW GENERATION PSYCHOTROPIC MEDICATIONS		
Provide drug treatment for schizophrenia and bipolar disorder to allow the patient to return to a normal and productive life, thus offsetting the drug costs by reducing the number of months or years a patient may be dependent on other social services.	5.9	Waiver pending
DISEASE MANAGEMENT/DRUG THERAPY		
Monitor drug use to ensure compliance with a prescribed plan of care. Effective in managing costs for diseases such as tuberculosis.	Not in the rider	Undetermined
PHYSICIAN EDUCATION		
Educate providers about proper prescribing policies and monitor provider prescribing behaviors.	Not in the rider	3.0
TOTAL	**$54.1**	**$35.2**

*Implementation of copayments have been delayed pending the outcome of litigation.
SOURCE: Legislative Budget Board.

The HHSC commissioner has approved the changes and new rates were implemented in December 2002. As a result of the rule changes, HHSC projects drug price savings to be approximately $15.9 million in General Revenue Funds for fiscal year 2003. Pharmacy dispensing fees will increase by $1.3 million in General Revenue Funds in fiscal year 2003. There were delays in implementing the federal audit findings, due to rulemaking procedures, supplemental studies, and audits. The delay and an increase in dispensing fees resulted in approximately $8.3 million in General Revenue Funds in lost savings for Medicaid Vendor Drug over the 2002–03 biennium.

In addition to savings in drug pricing, increased utilization review is projected to save $11.7 million in General Revenue Funds in the 2002–03 biennium. HHSC also approved and implemented copayments for some Medicaid clients, but the initiative was put on hold per court order at the time of this writing. A waiver request to permit reimbursement for cost effective psychotropic medication was submitted to the federal government and is pending approval. Cost savings through supplemental rebates for therapeutic categories and pharmaceutical dispensing machines were not pursued by HHSC, while two approaches not outlined in the 2002–03 General Appropriations Act, disease management and physician education, are being implemented.

Interagency Council on Pharmaceuticals Bulk Purchasing

House Bill 915, Seventy-seventh Legislature, 2001, created the Interagency Council on Pharmaceuticals Bulk

Purchasing (Council), composed of representatives from HHSC, TDH, TDMHMR, ERS, TRS, the General Services Commission (now known as the Building and Procurement Commission), and TDCJ's Correctional Managed Health Care Committee. The Council was directed to perform the following functions relative to drug cost containment:

- Develop uniform procedures for purchasing drugs;
- Designate one agency to be the central purchasing agency;
- Investigate options for better purchasing power; and
- Recommend other cost-saving initiatives.

The Council is adopting price disclosure rules as approved by TDH. Price disclosure rules would be implemented in fiscal year 2003 and would require agencies that purchase drugs to report pricing on a monthly basis. Under the new rule, the Bureau of Food and Drug Safety at TDH would collect the drug price data, manage the drug price database, and provide regular reports to participating state agencies and the Council. The data will be used to ensure that agencies are paying similar prices for the same drugs. Data, however, may not be available as public information due to the confidentiality of trade secrets.

In relation to the price disclosure rule, the Council is also developing drug-purchasing procedures for state agencies. In November 2002, the ceiling for drug purchases was expected to be 5 percent above the best price paid by similar agencies (using PBMs or direct purchasing models). In December 2002, the Council's draft procedures only require agencies to compare prices. In order to make a price comparison, an agency is required to prepare a list of its top 50 drugs by expenditure volume for the previous fiscal year and submit the expenditure report to participating agencies. Compliance guidelines are not addressed.

According to the Council's procedures, agencies must also consult with other agencies at least 120 days prior to releasing a request for proposals or renewing a contract and must include a provision allowing other agencies or subcontractors to participate in the contract. Agencies must also adopt utilization controls and disease management guidelines that other agencies have used effectively. This provision, for example, could be used by TDMHMR to coordinate the community mental health centers' drug purchasing activities to achieve savings through bulk purchasing.

As of November 2002, the Council has decided to make two recommendations to the legislature. House Bill 915 required that one state agency be designated as the sole pharmaceutical purchasing agency for Texas. The Council recommends that this requirement be deleted. Also, the Council may recommend that its administrative functions be taken over by HHSC. Currently, TDH maintains the administrative functions.

Per the fiscal note of House Bill 915, the activities of the Council are anticipated to save $13.6 million in General Revenue Funds for the 2002–03 biennium. Table 3 describes cost-savings activities accomplished by the Council membership.

Statewide Preferred Drug List

A preferred drug list is a hierarchy of drugs in which a tier of drugs is exempted from prior authorization requirements. The preferred drug list contains generic and brand-name drugs recommended to prescribing practitioners. All drugs must be approved by the U.S. Food and Drug Administration, and a committee of practitioners and pharmacists regularly reviews and updates the list. States can require drug manufacturers to enter into supplemental rebates in order to be included on the preferred list. Drugs on the preferred drug list are as effective as non-preferred drugs but are generally not as costly because of drug-pricing agreements with manufacturers. Preferred drug lists provide states with a mechanism to drive the market. Also, creation of such lists and their use across programs can have the effect of bulk purchasing

TABLE 3
OTHER COST CONTAINMENT INITIATIVES RELATED TO PRESCRIPTION DRUGS

AGENCY / INITIATIVE / DESCRIPTION	GENERAL REVENUE PROJECTED SAVINGS
DEPARTMENT OF HEALTH (TDH)	
Joint Vendor Contracts	
Combine vendor purchasing of certain drugs with TDMHMR	$0.7
Immunization	
Negotiate immunization distribution contract	0.1
Kidney Health Care	
Limit Renagel drug and renegotiate Renagel rebate	1.9
SUBTOTAL	**$2.7**
DEPARTMENT OF MENTAL HEALTH, MENTAL RETARDATION (TDMHMR)	
Joint Vendor Contracts	
Combine vendor purchasing of certain drugs for with TDH	$0.3
Gastrointestinal/Acid Reflux Drugs	
Control utilization of expensive gastrointestinal drugs through better utilization control and price monitoring	0.4
SUBTOTAL	**$0.7**
DEPARTMENT OF CRIMINAL JUSTICE AND TEXAS YOUTH COMMISSION	
Drug List Management	
Switch high cost drugs for similar lower cost items and generics	$12.5
SUBTOTAL	**$12.5**
EMPLOYEES RETIREMENT SYSTEM	
Prior Authorization List Enhancement	
Add prior authorization for medications not previously included	$0.3
Improved Utilization Monitoring	
Monitor quantity of drugs against prescription time limits Prescriptions used before refills made	2.0
SUBTOTAL	**$2.3**
TEACHER RETIREMENT SYSTEM	
Negotiation of Price Discounts	
Renegotiate contracts for increased discounts on certain drugs	$11.0
Mail Order Prescriptions	
Increase copayments for mail order prescriptions	3.0
SUBTOTAL	**$14.0**
TOTAL	**$32.2**

Source: Legislative Budget Board.

without requiring that programs overhaul entire distribution networks.

A preferred drug list offers states two avenues of cost savings. The prior authorization component directs the consumer to less expensive, but effective drugs, and the supplemental rebates provide discounts on drugs.

While some state drug-purchasing agencies, such as ERS and TRS, have programmatic listings for preferred drugs, there is no consolidated or coordinated effort across state agencies to create a statewide, preferred drug list in Texas. The preferred drug list approach has begun to yield significant savings in Michigan, Georgia, and Florida. For example, Michigan has saved $3.60 per prescription drug claim in its Department of Community Health (that includes Medicaid). Michigan saved $42 million in All Funds this year. Georgia saved $68 million in All Funds over the 2001–02 biennium from an integrated initiative including Medicaid, public health programs, and the state employee health plan. Requiring supplemental rebates to be considered for the preferred drug list, Florida expects to save over $214 million in All Funds for the state's Medicaid program in 2002. Tennessee recently announced implementation of a preferred drug list for Tenncare, the state's Medicaid and indigent healthcare program. Anticipated savings total $100 million in All Funds for one year.

After one year of operation of a preferred drug list and prior authorization program, Florida found an 80 percent shift in market share toward a less expensive drug in the therapeutic category

of proton pump inhibitors. Assuming a similar shift in market share for all therapeutic categories, Texas could save an estimated $87 million in General Revenue Funds for the 2004–05 biennium in Medicaid. The second avenue of savings is supplemental rebates. For example, if Texas adopted a statewide preferred drug list with a supplemental rebate program similar to Florida's, the state could save an estimated $183 million in General Revenue Funds for the biennium.

One drawback to the preferred drug list approach is the potential for litigation. Pharmaceutical manufacturers have challenged the constitutionality of state-preferred drug lists as regulation of interstate commerce. The pharmacy industry has also challenged preferred drug lists on the basis of patient/doctor choice. However, the legality of a state's preferred drug list has been upheld in U.S. federal appellate courts in several cases. The Court of Appeals for the Eleventh Circuit found that Florida's preferred drug list met the federal Medicaid statutory requirement of a 24-hour response to a request for prior authorization and an emergency exception that results in the dispensing of at least a 72-hour supply of drugs. States have considerable leeway in setting the criteria for drugs to be included in a preferred drug list. Such criteria may include both clinical efficacy and economic considerations. Notably, a preferred drug list does not eliminate coverage for expensive, but necessary, drugs.

On September 18, 2002, the Centers for Medicare and Medicaid issued a letter to state Medicaid directors reiterating that a state may subject covered outpatient prescription drugs to prior authorization as a means of encouraging drug manufacturers to enter into supplemental agreements.

Given the savings achieved by other states and the survival of constitutional challenges, it is recommended that Texas implement a statewide, preferred drug list (Recommendation 1). A preferred drug list could be created by statute or accomplished by administrative rule.

Pharmaceutical Benefit Management Contracting

Pharmaceutical Benefit Management (PBM) is an integrated approach to delivering pharmaceutical services. PBM goes far beyond dispensing prescriptions and negotiating discounts with pharmaceutical companies. PBM services offer a broad range of clinical, mail, data, and customer services. To increase savings, disease management and provider education programs should also be included in a PBM's contract responsibilities. The PBM may also negotiate drug prices and rebates.

Although some PBM companies may be affiliated with drug or healthcare companies, it may be more effective to contract with PBM companies that are independent from pharmaceutical manufacturers, retail pharmacies, and health plan sponsors. The PBM model could work in conjunction with a preferred drug list. There is disagreement as to whether paying PBMs a percentage to negotiate rebates is as cost effective as a preferred drug list. The State of Tennessee recently found it could use its consolidated power to get better rebates than the PBMs. Several state programs received rebates up to 20 percent.

Currently, TRS and ERS have separate contracts with the same PBM company. Under its arrangement with the PBM, both receive a specific dollar amount in rebates for purchases through retail pharmacies. The PBM retains the remainder of the rebate to cover its administrative expenses. The amounts of the rebates negotiated by the PBM are not disclosed to ERS and TRS. Many provisions of these contracts are also considered confidential, including the term of TRS' contract. The term of ERS' contract is three years. The contract expires August 31, 2005.

PBMs may have other sources of income such as manufacturer-paid educational contracts to conduct physician training about the PBMs' formularies or bonus payments above negotiated rebates for market share gains for a particular manufacturer. Disease management programs, designed to assist and educate

clients about their disease and drug regimen, are also a source of income for PBMs. All sources of income to PBMs should be disclosed to any state agency that contracts for PBM services. Such disclosure may prevent conflict of interest and insure that the PBM purchases drugs at a fair price.

An arrangement by which the agency would retain a percentage, rather than a set dollar amount, would likely result in increased savings. Allowing the PBM to retain a portion of the rebate would still give the PBM an incentive for aggressive negotiation. It is recommended that state agencies negotiate contracts with PBMs to require disclosure of rebate information (Recommendation 2). CHIP has negotiated a 14.0 percent voluntary rebate, and VDP performs administrative functions. ERS receives an estimated 8.0 percent rebate, and TRS receives an estimated 4.8 percent rebate. A single source contract could provide administrative cost savings, effective enforcement of the state preferred drug list, and more negotiating leverage for pricing and rebates.

Public Health Pricing (340B)

States can also achieve savings on outpatient drugs through the federal public health pricing program (340B). Drug manufacturers who want to participate in the Medicaid program must offer discounts of 25 to 40 percent to specified safety-net healthcare providers. Drug pricing, however, cannot be subject to both a 340B discount and a Medicaid rebate. Public health pricing usually results in the lowest price for drugs. Thus, it is recommended that the state consider expanding the use of 340B pricing (Recommendation 3).

The following entities may participate in the 340B program:

- federally qualified health centers (FQHC) and FQHC look-alikes;
- health centers for residents of public housing;
- health centers for homeless;
- migrant health centers;
- community health centers;
- family planning projects;
- entities receiving Ryan White grants;
- state-operated AIDS Drug Assistance Programs;
- black lung clinics;
- hemophilia treatment centers;
- urban Indian clinics;
- native Hawaiian health centers;
- school-based programs;
- entities receiving certain federal funds for treatment of sexually transmitted diseases or tuberculosis; and
- disproportionate share hospitals with a disproportionate share adjustment percentage greater than 11.75 percent.

Psychiatric hospitals and inpatient drugs do not qualify for 340B prices. Congressional action in this area would benefit the state (Recommendation 4). In order to qualify for 340B prices, a person must be a patient of a 340B facility and must purchase drugs at that facility or an affiliated pharmacy. Per federal guidelines, 340B facilities may contract with multiple pharmacy service providers and supplement in-house pharmacy services with contracted services. To establish pharmacy networks, the 340B participants must apply to the federal Office of Pharmacy Affairs as a demonstration project. TDH uses 340B pricing for many programs such as the Kidney Health Program.

HIV/AIDS Drugs

Eligible persons with HIV or AIDS may receive drugs through Medicaid or TDH's HIV medication program, which is funded through federal Ryan White grants (matched with state funds at 33.3 percent). TDH does not serve Medicaid managed-care participants, but provides medications for other Medicaid recipients after they have exceeded the three-prescription per month limit.

TDH purchases drugs for the HIV program at 340B prices. The Medicaid drugs are at the VDP price. TDH compared the prices between the programs and found that the 340B prices were 14.3 percent less than the Medicaid prices. Currently, Texas has 469 health facilities that are classified as 340B facilities. Given the price differential, HHSC should examine strategies for providing Medicaid prescription drugs through entities qualified for public health drug pricing.

Correctional Managed Care

During the Seventy-seventh Legislature, 2001, the Legislature passed Senate Bill 347 requiring TDCJ and the Texas Youth Commission to secure 340B pricing for inmates' pharmaceutical drugs. TDCJ's budget was reduced by $10 million for the biennium. The University of Texas Medical Branch provides care to roughly 75 percent of the incarcerated population and secured 340B pricing in April 2002. Texas Tech University Health Science Center serves the remaining inmate population, and efforts are underway to secure 340B pricing for these inmates.

Medicare Prescription Drug Program

In 2002, the U.S. Congress considered several proposals to create or subsidize a prescription drug plan for Medicare recipients. Should such an initiative pass it could reduce the state's pharmaceutical costs, particularly for low-income persons who are dually eligible for both Medicaid and Medicare. It is estimated that Texas will spend approximately $468.0 million in General Revenue Funds over the current biennium on medications for low-income Medicare recipients whose drug costs are paid through the Medicaid program.

Patents

One cost driver for pharmaceutical drugs is the high cost of brand-name drugs. A patent runs for 17 years from the issue date, or 20 years from first filing. A facet of the patent process is thought to hinder the entry of generics into the market. The criticism is directed toward a provision of law that authorizes a court to grant a brand manufacturer an automatic 30-day extension upon the filing of a suit for patent infringement. The stay can sometimes be extended for additional 30-day periods. Figure 3 illustrates this criticized provision of the patent law.

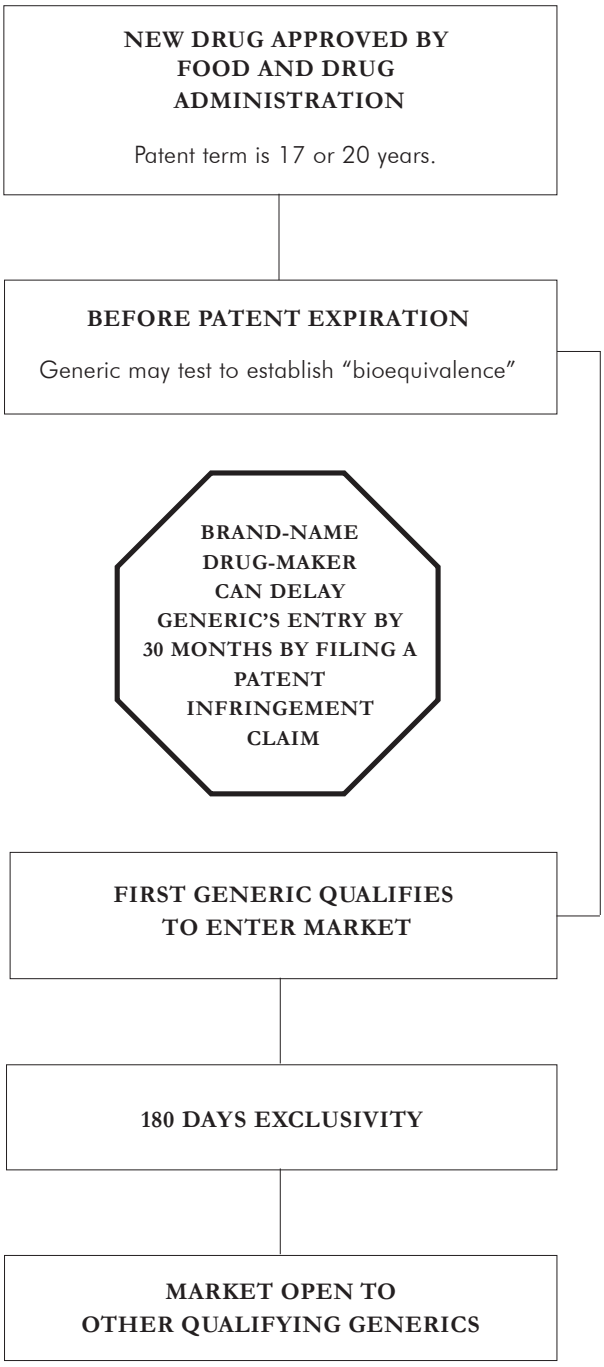
The U.S. Senate passed a bill that would have required a drug manufacturer to prove the allegations of the infringement claim prior to the grant of the 30-day stay. This bill is not expected to pass the House of Representatives. The administration has promulgated a proposed rule that would limit the number of stays for which a drug manufacturer can petition to one.

Conclusion

Texas laid the groundwork to consolidate, manage, and secure pharmaceutical cost savings for all state agencies in the Seventy-seventh Legislature, 2001. Implementation of the cost containment directives is projected to save $35.2 million in General Revenue Funds for Medicaid and other state programs. A drug price-tracking system via the Interagency Council on Pharmaceutical Bulk Purchasing is being developed, and pharmaceutical management among state healthcare agencies has improved. These and other initiatives are projected to save $32.2 million in General Revenue Funds.

Nevertheless, compared to other large states, Texas has not been aggressive in implementing innovative pharmaceutical cost-saving strategies. Through the implementation of a preferred drug list and other strategies, Florida expects cost savings of nearly $240 million over the biennium. Georgia's consolidation of Medicaid and most state agencies into a redesigned benefit plan has garnered nearly $58 million in savings since 2001. Tennessee's plan to consolidate drug formularies into a single preferred drug list is expected to net approximately $100 million in savings next year.

FIGURE 3
TYPICAL PATENT PROCESS OF PHARMACEUTICAL DRUGS



SOURCE: Legislative Budget Board.

Texas' position as a large volume purchaser of pharmaceuticals should enhance its ability to achieve savings far exceeding the target set in the 2002–03 biennium. Tightening drug benefit management contracts, negotiating rebates and better pricing, expanding the state's use of 340B pricing, and creating a statewide preferred drug list can achieve savings without preventing clients from receiving medically necessary drugs.

TANF Reauthorization and Related Funding Issues

Authorization of federal welfare programs expires December 31, 2002, and Congress has considered a number of changes to existing law. States may be expected to meet a higher standard for engaging welfare clients in work activities. The federal waiver granted to Texas to operate the state's welfare reform program expired in March 2002. As a result, Texas has phased out waiver policies inconsistent with the existing federal welfare reform law. At the same time, available reserves of federal Temporary Assistance for Needy Families (TANF) funds are diminishing. This report provides an update on the state's post-waiver welfare reform efforts, highlights the estimated fiscal impact and policy implications for Texas of proposed work participation requirements in welfare reauthorization legislation, and reviews the state's TANF funding dilemma.

Significant Concerns

- The U.S. House-passed welfare reauthorization bill mandates that states terminate assistance completely for families out of compliance with work requirements (rather than Texas' current practice of levying a reduction in cash assistance benefits).
- Preliminary fiscal impact estimates from the Department of Human Services and the Texas Workforce Commission indicate costs for meeting the higher work participation rates required in the House-passed bill total $492.1 million over the five-year reauthorization period ($25.6 million for Choices employment services and $466.5 million for child care).
- Savings of $176.0 million in cash assistance and related staff, however, reduce the cost to $316.1 million.
- The House-passed bill would provide increased federal child-care funds to Texas of approximately $370.8 million over the five-year period. To draw all available funds the state would need approximately $54.1 million in state match.
- The House-passed bill would increase the amount of federal child-care funds set aside for quality improvement activities by $60.5 million over the five-year period. About $310.3 million of the funds could be used to address the child-care costs for serving the additional clients subject to work requirements.
- Based on baseline recommendations of the Legislative Budget Board, the available TANF reserves at the end of the 2004–05 biennium will decline to an estimated $58.9 million. Unmet requests for TANF total $377.6 million.
- TANF Supplemental Funds, established for states with high population growth and low benefit levels, have not increased since fiscal year 2001. If funding were reinstated as originally designed in the 1996 federal welfare law, by fiscal year 2005 Texas would receive more than double its current allotment ($110.9 million instead of $52.7 million).
- Social Services Block Grant funding to Texas has declined from $193 million in fiscal year 1995 to $125 million in fiscal year 2002. If national funding for the Social Services Block Grant (Title XX) were restored to pre-federal welfare reform levels, annual funding to Texas would increase by $81.5 million.

Recommendations

- **Recommendation 1:** To address the possibility of increased federal mandates related to work participation requirements for welfare clients, the Legislature should amend Article IX, Sec. 10.03, Contingency Appropriation and Limitation on Expenditure: Temporary Assistance for Needy Families (TANF) Federal Funds of the General Appropriations Act, for the 2002–03 biennium, to allow funds appropriated to agencies within Article II to be transferred to the Texas Workforce Commission.
- **Recommendation 2:** The Legislature should consider petitioning Congress to maintain the flexibility provided in the existing federal welfare program, reinstate TANF Supplemental Funds as designed in the original legislation, increase federal child-care funding, and restore Social Services Block Grant Funds to fiscal year 1995 funding levels.

Comments

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) redesigned the federal welfare system by replacing the Aid to Families with Dependent Children (AFDC) program with the Temporary Assistance for Needy Families (TANF) block grant program and authorized child-care block grants to states. States were given broad authority and flexibility to design programs in exchange for meeting federal provisions including five-year lifetime limits on federal benefits and work participation requirements for welfare clients.

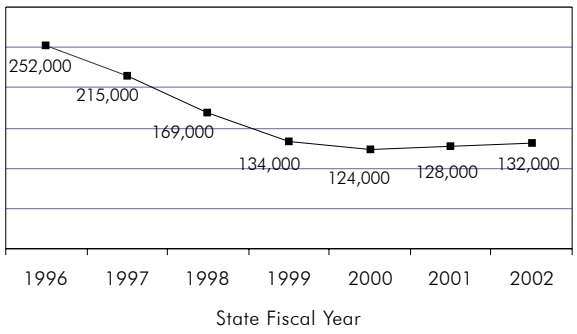
Overview of Welfare Reform in Texas

Prior to federal welfare reform, the Seventy-fourth Legislature, 1995, passed House Bill 1863 establishing time-limited benefits, requiring welfare recipients to participate in work activities, and creating the Texas Workforce Commission (TWC). TWC oversees operation of the Choices employment program (formerly known as the Job Opportunities and Basic Skills, or JOBS program), as well as child care, through a system of local workforce development boards. The Department of Human Services (DHS) continues to be responsible for client eligibility determinations.

Since enactment of PRWORA and implementation of House Bill 1863, Texas has experienced significant reductions in the welfare caseload (see Figure 1). In fiscal year 2001 the average monthly number of TANF cases in Texas was about 132,000—about half the number of cases in fiscal year 1996. While the overall TANF caseload has declined, like many states an increasing share of the caseload is comprised of child-only cases in which children are the sole recipients of TANF cash assistance in Texas.

In January 2002 DHS issued a report (*Texas Families in Transition Surviving without TANF: An Analysis of Families Diverted from or Leaving TANF*) showing that during the periods between April 1998 through June 1999 and from July through September 2000, 70 percent of the clients leaving TANF were employed at some time in the year following their exit, although only one-third held jobs in all four quarters after

FIGURE 1
TANF CASH ASSISTANCE CASES



SOURCE: Department of Human Services.

leaving TANF. Included in that study is a statewide survey of TANF leavers during this period that indicated 46 percent of all respondents reported employment with an average hourly wage of $7.20. Positions in clerical work, retail work, food services, and healthcare were heavily represented. The study further suggests that Choices services, subsidized child care, and post-TANF Medicaid benefits enhanced families' income and employability.

Work Requirements for Welfare Clients

PRWORA requires states to have a certain percentage of their TANF caseload involved in work activities, as measured by a state's participation rate. In fiscal year 2003 the required participation rates are 50 percent for all families and 90 percent for two-parent families. States that fail to meet the participation rates are subject to a penalty equal to 5 percent of their TANF grant (increasing further in subsequent years of continued failure). States are able to offset their work participation rate requirement with a caseload reduction credit based upon the percentage reduction in a state's TANF caseload since 1995. Due to the significant reductions in TANF caseloads since state fiscal year 1996, Texas has enjoyed a caseload reduction credit that has effectively eliminated any federal work participation rate requirements.

Texas was granted a waiver from existing federal regulations to implement state welfare reform, which subsequently expired in March 2002. Consequently, some waiver policies have been discontinued to conform to current federal law. For example, in fiscal year 1996 the state's waiver exempted single parents with children under the age of five from work participation. Yet the federal law only allowed states to remove single parents with children under the age of one from work participation calculations. Texas subsequently phased in work requirements to conform with federal policies by the time the state's waiver expired.

In the initial years of welfare reform, employment services were not available in many rural counties and welfare clients were not required to participate in work activities—another inconsistency with federal policy. In anticipation of the state's waiver expiration, TWC has worked with local workforce boards on implementation of the Rural Expansion Initiative, extending full service to those rural counties where services have been limited or unavailable. In phase one of the initiative, TWC provided financial incentives for 10 workforce development boards to develop the necessary infrastructure to expand Choices services into 28 rural counties. To date, 71 rural minimum service counties remain, but they are expected to provide the full array of workforce services available for Choices clients by July 2003.

Effective July 1, 2002, TWC implemented rulemaking designed to further align the Texas Choices program with post-waiver federal law while strengthening the "work-first" philosophy. The amount of time clients are allowed to remain in job search activities is now more limited, and clients are expected to participate in community service. The amount of community service hours to be worked is based on the number of hours at minimum wage needed to earn the dollar equivalent of the family's TANF, food stamps and child-care benefits.

Welfare Reauthorization Work Requirement Provisions

Both the House and Senate bills increase work participation rates from 50 to 70 percent over a five-year period (fiscal years 2003 through 2007), eliminate separate requirements for two-parent families, and require states to develop Family Self-sufficiency Plans or Individual Responsibility Plans for all parents and caretakers. They differ, however, as to (1) sanctions on families that fail to comply with work requirements, (2) the number of hours of participation required of individual families; (3) activities counted as participation; and (4) caseload reduction calculations. Table 1 provides a summary of the provisions in the House and Senate bills related to work requirements.

TABLE 1
TANF WORK PARTICIPATION PROVISIONS

PROVISION / CURRENT LAW	HOUSE BILL	SENATE FINANCE BILL
UNIVERSAL ENGAGEMENT Families must be engaged in work activities determined by the state within 24 months. State option to develop Individual Responsibility Plans.	States must develop Family Self-sufficiency Plans, detailing work activities, for all parents and caretakers within 60 days of receiving cash assistance, effective fiscal year 2003.	States must develop Individual Responsibility Plans for all parents and caretakers within 60 days of receiving cash assistance, effective fiscal year 2004. Plans must detail work activities, work supports, and child well-being. Provides $120 million over 4 years for implementation of universal engagement requirement.
FULL FAMILY SANCTION States may partially reduce a family's grant or terminate assistance completely for failing to comply with requirements.	States must terminate assistance completely for noncompliant families.	Individual Responsibility Plans must be reviewed periodically, including prior to imposition of a sanction.
WORK PARTICIPATION RATES In fiscal year 2002, 50 percent of all families must participate in work activities. The two-parent family rate is 90 percent in fiscal year 2002.	50 percent in fiscal year 2003; 55 percent in fiscal year 2004; 60 percent in fiscal year 2005; 65 percent in fiscal year 2006; and 70 percent in fiscal year 2007. Eliminates separate two-parent family rate.	50 percent in fiscal year 2003; 55 percent in fiscal year 2004; 60 percent in fiscal year 2005; 65 percent in fiscal year 2006; and 70 percent in fiscal year 2007. Eliminates separate two-parent family rate.
WORK ACTIVITIES Single parents with a child under age six must participate 20 hours per week. Other single parents must participate 30 hours per week. Two-parent families must participate 35 hours per week. The following activities may count toward the first 20 hours: paid or unpaid work;	All families must engage in a 40-hour work week, 24 hours of which must be in direct work activities which include subsidized or unsubsidized employment; on-the-job training; supervised work experience; or supervised community service.	All families must engage in a 30-hour work week, 24 hours of which must be in priority activities which include those listed in current law, plus time-limited rehabilitative services (e.g., mental health, substance abuse, or domestic violence treatment); full-time job search up to eight weeks; vocational education up to 24 months; post-secondary education (up to 10 percent of the caseload).

TABLE 1
TANF WORK PARTICIPATION PROVISIONS *(CONTINUED)*

PROVISION / CURRENT LAW	HOUSE BILL	SENATE FINANCE BILL
WORK ACTIVITIES *(CONTINUED)*		
on-the-job training; work experience; community service; job search (up to six weeks); and providing child care for other participants. Job skills training and education related to employment may count toward the remaining hours.	States have the discretion to determine self-sufficiency activities that will count towards the remaining 16 hours.	States have the discretion to determine self-sufficiency activities that will count towards the remaining six hours.
CASELOAD REDUCTION / EMPLOYMENT CREDIT		
States are allowed to reduce their work participation rate by one percentage point for every percentage point decline in caseload since fiscal year 1995 (not attributable to eligibility rule changes).	Modifies the existing caseload reduction credit so that states receive credit toward meeting work participation rates for caseload decline over the preceding three years. A "Super Achiever" credit is available to states that have reduced their caseloads by more than 60 percent since 1995.	Replaces the caseload reduction credit with an employment credit equal to the number of recipients leaving welfare for employment. A larger credit would be earned for families with higher earnings. Credits are capped at 35 percent in fiscal year 2004 declining to 20 percent in fiscal year 2007.
WORK PARTICIPATION EXEMPTIONS		
States may exempt single parents with children under age one.	Maintains current law, plus states may opt to exclude families in the first month they receive assistance.	Maintains current law, plus states may exclude persons caring for a disabled family member (no more than 10 percent of caseload) and adults who become eligible for Supplemental Security Income during the fiscal year.

SOURCE: Legislative Budget Board.

A number of federal mandates in reauthorization bills related to work participation would have a significant impact on the welfare caseload in Texas. Under current law, states have the discretion to sanction families that fail to comply with work requirements by partially reducing a family's grant, rather than terminating assistance completely (referred to as a "full-family sanction"). The House-passed bill eliminates the partial sanction option, which Texas presently utilizes. It is projected that a full-family sanction would initially mean a reduction in welfare cases, but that the severity of the penalty would bring more families currently in sanction status into compliance with the new requirements. The Senate Finance bill does not mandate a full-family sanction, but would impose a review of a family's situation prior to imposition of a sanction.

As Table 1 shows, the number of hours families must participate in work activities would increase from the existing 20 hours to 30 hours in the Senate Finance bill, and 40 hours in the House bill. Activities that count toward meeting the requirement are more limited in the House version. Both bills allow states to count "self-sufficiency activities" for some of the required hours (16 hours in the House and 6 hours in the Senate). These "self-sufficiency activities" could be hours spent in volunteer work. Both the House and Senate Finance bills also modify the existing caseload reduction credit (although in different ways), making it more difficult for states to achieve the required work participation rates.

DHS and TWC have made preliminary fiscal impact projections of work-related provisions in the House-passed bill, based on October 2002 as the effective date and assuming immediate application of a full-family sanction (see Table 2). Raising the required work participation rates would increase the number of clients to whom the state would have to provide employment and child-care services, but savings in cash assistance would occur as additional families are employed and exit the welfare rolls. The adult welfare caseload is projected to decrease by 47 percent over the five-year period due to bill provisions. Cash assistance savings over five years total $176.0 million. Savings in related eligibility determination staff would total another $17.4 million. Serving the additional clients with Choices employment services would cost $25.6 million over the authorization period. TWC assumed there would be no cost to the state for hours beyond the 24 "direct work" activities. Choices child care and transitional child care would cost an additional $466.5 million, leaving a net cost of $316.1 million. This cost could be offset by an estimated $310.3 million of additional federal funds for child care provided in the House bill (see section on "Federal Reauthorization of Child Care"). To receive all federal child-care funds, however, the state would need to provide $54.1 million in state match over the five-year authorization period.

Child Care

TWC establishes general rules of operation for child care and allocates funding to local workforce development boards to provide child-care services to Choices clients and families at-risk of needing welfare assistance. Each local board develops its own policies for child-care services within the limitations of TWC

TABLE 2
ESTIMATED FISCAL IMPACT OF HOUSE-PASSED WORK REQUIREMENT PROVISIONS

IN MILLIONS

PROVISION	2003	2004	2005	2006	2007	TOTAL FIVE YEARS
Cash Assistance	($17.9)	($24.8)	($29.2)	($37.5)	($49.1)	($158.6)
Eligibility Determination Staff/Automation	($1.2)	($3.5)	($3.5)	($4.1)	($5.1)	($17.4)
Choices Employment Services	$0.0	$0.0	$17.8	$6.7	$1.1	$25.6
Choices Child Care	$0.0	$20.7	$52.4	$35.2	$27.2	$135.6
Transitional Child Care	$0.0	$38.3	$89.5	$94.1	$109.1	$330.9
TOTAL	**$(19.1)**	**$30.7**	**$127.0**	**$94.4**	**$83.2**	**$316.1**

NOTES: Estimates based on October 2002 implementation date. Assumes funding for Texas Workforce Commission in fiscal years 2003 and 2004 would not be reduced from current levels.
SOURCES: Department of Human Services; Texas Workforce Commission.

rules and federal laws that govern child-care funding. While TANF clients receive priority for child-care services, boards may set their own policies regarding income eligibility, child-care waiting lists, and quality improvement activities.

States are currently allocated federal funding for child care from three funding streams:

- Mandatory entitlement funds are based on historical child-care expenditures under the AFDC program ($59.8 million to Texas in fiscal year 2002).
- Matching entitlement funds are based on the number of children in the state under the age of 13 ($121.4 million to Texas in fiscal year 2002), and as the name implies, require state matching funds.
- Discretionary funds are based on the number of children in the state under age 5, the number of children receiving free and reduced school lunch, and per capita income ($199.7 million to Texas in fiscal year 2002).

WELFARE REFORM AUTHORIZATION OF CHILD CARE

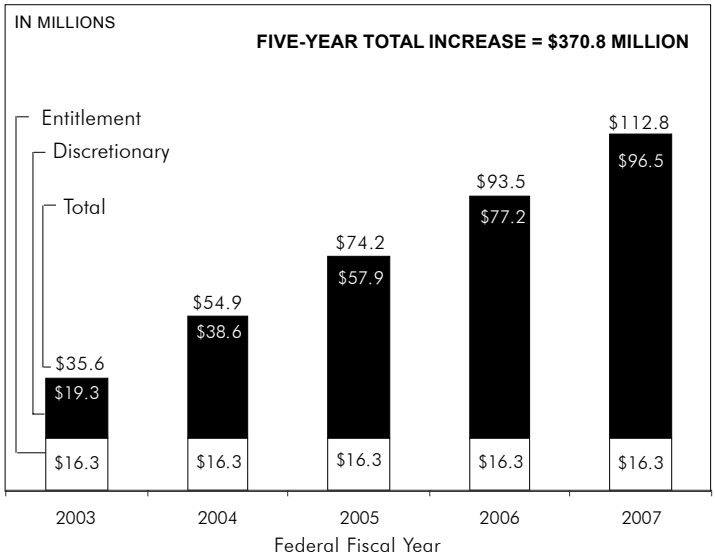
The House-passed welfare reform bill would increase matching entitlement funds and discretionary funds. Compared to fiscal year 2002, matching entitlement funds to Texas would increase about $16.3 million each year, but would require approximately $10.8 million in state match annually. Discretionary funding would grow each year from an estimated increase of $19.3 million in fiscal year 2003 to $965 million in fiscal year 2007. Figure 2 shows that over the five-year reauthorization period, the estimated increases to Texas total $370.8 million. The Senate Finance Committee version of welfare reauthorization would provide significantly more entitlement funding than the House bill, rather than increasing discretionary funding.

Under current law states must set aside 4 percent of all federal child-care funds for quality improvement activities, such as monitoring and enforcement of licensing standards, information and referral programs, and training and technical assistance. The House-passed bill would increase this amount set aside to 6 percent. About $60.5 million of the five-year increase would be committed towards quality improvement activities rather than for child care itself.

Major TANF Funding Provisions

Since 1997, Texas has a received an annual TANF block grant of $486.3 million, based on the state's historical expenditures for the former Aid to Families with Dependent Children program. Both the House-passed reauthorization bill and the Senate Finance bill maintain the same block grant funding level through

FIGURE 2
INCREASED ALLOCATION TO TEXAS FOR CHILD CARE UNDER THE U.S. HOUSE-PASSED WELFARE REAUTHORIZATION BILL



NOTE: Entitlement funds would require an additional $10.8 million annually in state match funds.
SOURCE: Legislative Budget Board.

fiscal year 2007. States must maintain 80 percent of 1994 state expenditures, or 75 percent if the state meets work participation standards. At 80 percent, Texas' maintenance of effort is $251.4 million. TANF federal funds can be carried forward from one fiscal year to the next.

In Texas, any available TANF funds not specifically appropriated to state agencies are appropriated to a Contingency Fund, accessible with approval from the Governor and the Legislative Budget Board (Article IX, Sec. 10.03. General Appropriations Act, 2002–03 Biennium). Given the costs associated with increased work requirements proposed in federal reauthorization bills, and the limited availability of federal TANF funds, more flexibility is needed to address changes that could occur at the federal level. If Congress mandates higher work participation rates, savings from cash assistance could be redirected to employment services or child care. The Legislature should amend the TANF Contingency Fund rider to allow funds appropriated to agencies within Article II to be transferred to TWC.

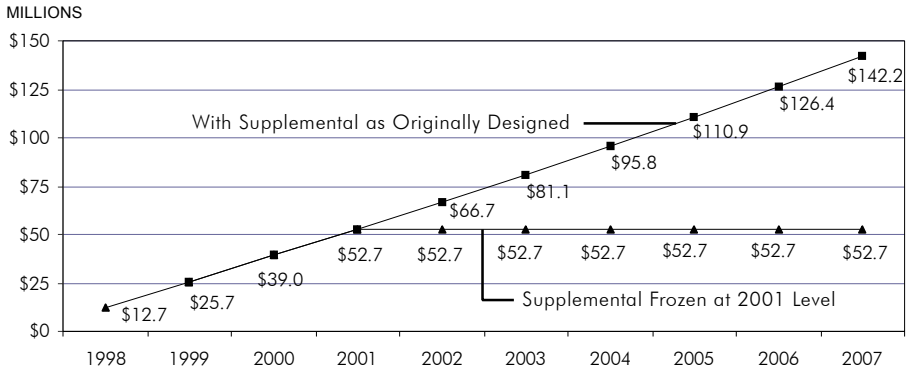
TANF SUPPLEMENTAL FUNDS

TANF Supplemental Funds were also established to address the disparities in TANF funding among states. An annual 2.5 percent increase to block grants was authorized for states with high population and low benefit levels. Supplemental Funds to Texas increased from $12.7 million in fiscal year 1998 to $52.7 million in fiscal year 2002. Authorization for Supplemental Funds, however, expired in fiscal year 2001. Congress continued to appropriate Supplemental Funds but froze appropriations at the fiscal year 2001 level. Although no bills introduced to date continue growth in Supplemental Funds as originally intended, Figure 3 shows the impact if Supplemental Funds were reinstated as designed in the 1996 federal welfare law, compared to maintaining funds at the 2001 level. Texas' allocation would more than double by fiscal year 2005, from $52.7 million to $110.9 million. The Texas Legislature should urge Congress to reinstate the growth in TANF Supplemental Funds as originally designed.

TANF PERFORMANCE BONUSES

Current federal welfare reform law authorized $200 million per year (starting in fiscal year 1999) for "high performance bonuses" to states with the best records in assisting TANF recipients with employment. In fiscal years 1999 and 2000, bonuses went to the top 10 states in categories covering performance and improvement in job entry and success in the workforce. Texas

FIGURE 3
TEXAS ALLOCATION OF TANF SUPPLEMENTAL FUNDS FOR HIGH GROWTH/LOW BENEFIT STATES



SOURCE: Legislative Budget Board.

received high performance bonuses of $16.3 million for fiscal year 1999, $24.3 million for fiscal year 2000, and $24.3 million for fiscal year 2001. Recently Texas also received a bonus award of $19.8 million for achievements in reducing out-of-wedlock births.

Both the House-passed reauthorization bill and the Senate Finance bill eliminate the high performance bonuses as well as the out-of-wedlock performance bonus. The House bill would instead authorize the following:

- $100 million a year for bonuses to reward employment achievement;
- $100 million a year for a competitive grant program to promote family formation and healthy marriages;
- $100 million a year for research, demonstration and technical assistance on promoting healthy marriages; and
- $20 million a year for fatherhood and marriage promotion programs.

The Senate Finance Committee bill would authorize:

- $200 million a year for a competitive business link partnership program to increase low-income parents' wages, operate transitional jobs programs, and capitalize self-sustainable social services;
- $200 million a year for a competitive grant program to promote healthy marriages, reduce teen pregnancy, and reduce domestic violence;
- $25 million a year for employment programs for noncustodial parents; and
- $25 million a year for policy reviews and demonstrations related to noncustodial parents.

DISTRIBUTION OF TANF AMONG STATE AGENCIES

Texas allocates the total TANF funding across eight state agencies to fund a broad range of eligible activities, including cash assistance, employment services, child protective services and at-risk prevention, family planning, adult education, early childhood intervention services, and children's mental health services. Figure 4 illustrates the specific TANF funding appropriations to state agencies for state fiscal year 2002.

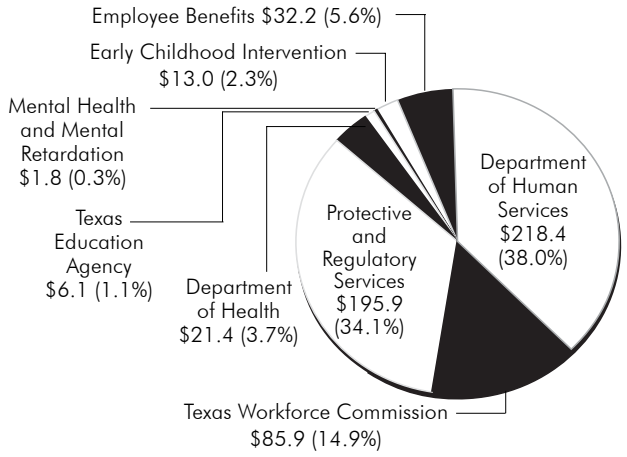
DECLINING BALANCES

During the initial years following federal welfare reform, as the welfare caseload dropped, the state's allotments of TANF federal funds exceeded expenditures. Beginning in fiscal year 2000, however, use of TANF exceeded the state's annual award, and accumulated balances began to decline. As Figure 5 shows, at the end of fiscal year 2003, it is estimated that TANF reserves will total approximately $134.4 million. Based on baseline recommendations by the

FIGURE 4
TANF DISTRIBUTION
FISCAL YEAR 2002

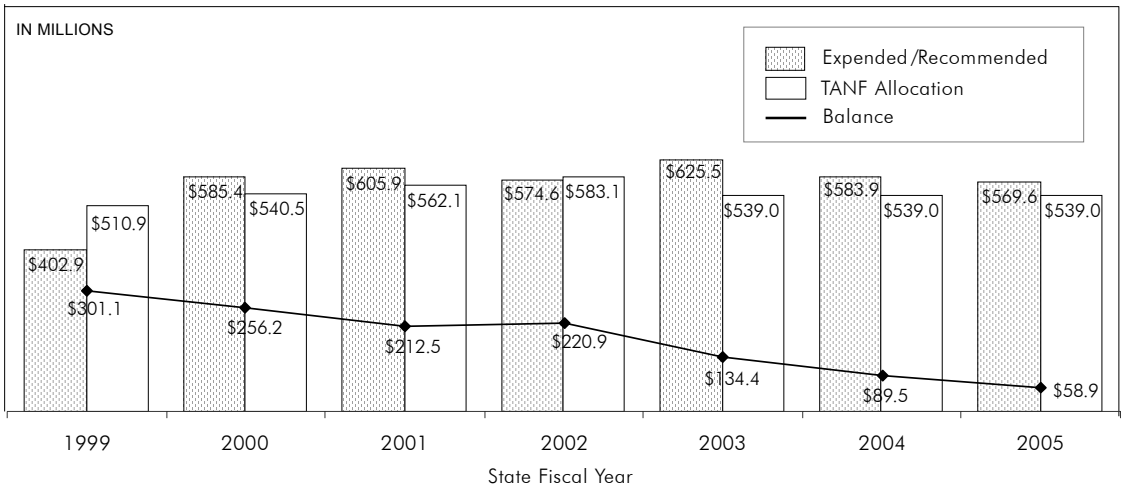
IN MILLIONS

TOTAL = $574.6 MILLION



SOURCE: Legislative Budget Board.

FIGURE 5
TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF)
FEDERAL FUNDING LEVELS IN TEXAS



NOTES: Beginning in fiscal year 2003, assumes block grant at $486.3 million, supplemental funds at $52.7 million, and no penalties, contingency funds or bonuses. Fiscal years 2004 and 2005 reflect baseline recommendations.
SOURCE: Legislative Budget Board.

Legislative Budget Board (LBB), the balance is projected to decline to $58.9 million by the end of the 2004–05 biennium. This estimate assumes that $37.2 million of TANF is used to address a fiscal year 2003 shortfall at the Department of Protective and Regulatory Services.

However, there are a number of demands that remain unaddressed. Table 3 summarizes agency requests for fiscal years 2003 through 2005 that exceed LBB baseline recommended funding levels, totalling $377.6 million.

Social Services Block Grant Funding

Nationally, Social Services Block Grant (Title XX) funding has decreased from $2.8 billion in fiscal year 1996 to $1.7 billion in fiscal year 2002. Under the 1996 federal welfare reform legislation, national funding levels were to drop to $2.4 billion for fiscal years 1996 through 2002 but then be restored to $2.8 billion by fiscal year 2003. Instead, congressional appropriations have dropped to $1.7 billion nationally, and funding to Texas has decreased from $193.0 million in fiscal year 1995 to $125.0 million in fiscal year 2002, forcing the state to examine alternative funding streams. The state partially addressed this reduction in federal funding by using $21.4 million of federal TANF funds. In Texas now, over 90 percent of Title XX funds are used for adult protective services and community care for the elderly and disabled. As part of welfare reform reauthorization, several bills were introduced that proposed restoring Title XX funding to $2.8 billion, which would increase funding to Texas by $81.5 million. The Texas Legislature should consider supporting these efforts.

Conclusion

Over the last few years, the state's welfare policies have been modified to bring state practices into conformity with federal law. Federal reauthorization bills being considered by Congress would mandate higher standards for achieving work participation rates than currently exist. States would be required to provide employment services and child care to more welfare clients. Cash assistance savings would accrue to partially

TABLE 3
TANF REQUESTS EXCEEDING
LBB BASELINE RECOMMENDATIONS

IN MILLIONS	FISCAL YEAR			
REQUEST	**2003**	**2004**	**2005**	**TOTAL**
TEXAS WORKFORCE COMMISSION				
Choices with expired waiver		$24.9	$29.7	$54.6
Child care for at-risk population		86.7	89.4	176.1
PROTECTIVE AND REGULATORY SERVICES				
Baseline request		43.6	48.7	92.3
Maintain service levels		0.8	0.9	1.7
EARLY CHILDHOOD INTERVENTION				
Baseline Request	4.0	2.0	2.0	8.0
DEPARTMENT OF HUMAN SERVICES				
Baseline Request		3.2	2.5	5.6
Disregard step-parent income for the first 6 months of marriage		0.4	0.5	1.0
Modify vehicle policies for single parents		11.2	17.7	28.8
Maintain 2003 workload level in eligibility determination		1.4	2.0	3.4
Automation infrastructure		1.0	1.0	2.0
Improve contract management		0.3	0.1	0.4
TEXAS EDUCATION AGENCY				
Baseline Request		0.4	0.0	0.4
EMPLOYEES RETIREMENT SYSTEM				
Address health insurance costs		1.1	2.2	3.3
TOTAL REQUESTS	**$4.0**	**$176.8**	**$196.8**	**$377.6**

NOTE: Totals may not add because of rounding.
SOURCE: Legislative Budget Board.

offset the costs of services, and proposed federal legislation provides additional child-care funds as well.

Texas' reserves of federal TANF funds are diminishing, and requests for funds for the 2004–05 biennium far outstrip available funds. The Legislature could extend the flexibility of using TANF balances to address changes that might occur during federal reauthorization by modifying the TANF Contingency Fund appropriation rider in Article IX, Section 10.03 of the General Appropriations Act, 2002–03 (Recommendation 1).

Congress could provide fiscal relief related to funding for welfare programs by maintaining the flexibility in the existing federal welfare program, reinstating TANF Supplemental Funds as designed in the original legislation, increasing child-care funding, and restoring Social Services Block Grant funding to fiscal year 1995 spending levels (Recommendation 2).

Texas Integrated Eligibility Redesign System: An Update

The 2002–03 General Appropriations Act contains three riders within the Department of Human Services (DHS) bill pattern related to the Texas Integrated Eligibility Redesign System or TIERS: Rider 1, Capital Budget, which provides capital authority for the project; Rider 25, Enhanced Federal Funding for Administration of the Food Stamp Program, which authorizes the use of enhanced federal funds for the project; and Rider 43, Texas Integrated Eligibility Redesign System (TIERS), which requires periodic reporting and makes funding subject to the approval of the Legislative Budget Board and Governor. This review provides a brief background of the project, details its funding and accomplishments, and gives an update on the current schedule for implementation of the TIERS system.

Comments

The Department of Human Services currently operates a legacy mainframe system called System for Application, Verification, Eligibility, Referrals, and Reports, or SAVERR. Although it was state-of-the-art when implemented in 1977, the system was only designed for four programs (systems or services). It has since been expanded to support over 50 services,[1] and has been adapted for sharing data with more than 20 state agencies, including the Department of Health, the Health and Human Services Commission, the Department of Mental Health and Mental Retardation, the Department of Protective and Regulatory Services, Office of the Attorney General and the Rehabilitation Commission.[2] Table 1 shows some of the major differences between the legacy mainframe systems currently operated by the DHS (SAVERR) and the TIERS system.[3]

Texas Integrated Enrollment Services (TIES)

House Bill 2777, Seventy-fifth Legislature, 1997, provided a structure for the start of the Texas Integrated Enrollment Services project, as it would be

TABLE 1
DIFFERENCES BETWEEN SAVERR AND TIERS

SAVERR	TIERS
Separate applications for different services	Single, integrated interview for simultaneous applications
Focuses on individual client needs	Focuses on needs of entire family
Requires application and an interview	Provides self-screening for potential eligibility for services
Requires manual administration tasks	Provides automated administration tasks
Fragments databases and system rules	Consolidated databases allowing better organization of client data
Difficult to make additions/changes	Flexible and scalable for new programs and/or agencies

SOURCE: Health and Human Services Commission.

[1]TIERS Oversight Committee Meeting Notes, March 27, 2001, Suzanne Biermann.

[2]Texas Eligibility Redesign System –http://www.dhs.state.tx.us/programs/TIERS/index.html.

[3]TIERS Oversight Committee, Meeting Notes, March 27,2001 – http://www.dhs.state.tx.us/programs/TIERS/HHSCOC/2001Mar27notes.pdf.

initially called. The bill provided for the Health and Human Services Commission (HHSC) in consultation with DHS, Department of Health (TDH) and the Texas Workforce Commission (TWC) to "develop and implement a plan for the integration of services and functions relating to eligibility determination and service delivery by health and human service agencies."[4] Further, the bill directed that the plan "must include a re-engineering of eligibility determination business process, streamlined service delivery, a unified and integrated process for the transition from welfare to work, and improved access to benefits and services for clients."[5]

The bill also established the Texas Integrated Enrollment Services Legislative Oversight Committee. The committee includes three members of the Senate appointed by the Lieutenant Governor and three members of the House appointed by the Speaker of the House of Representatives. One of the charges to the committee is to "advise the HHSC in the development of the plan and monitor the implementation and efficiency of the TIES project."[6]

Commissioners for the HHSC, TDH, and DHS and the Executive Director of the Texas Workforce Commission established the House Bill 2777 Project Charter. The plan included the project definition, goals and scope as well as guidelines for the initial project staff and management approach.

Texas Integrated Eligibility Redesign System

Further review of the TIES program objectives narrowed the scope of the project, and TIES became the Texas Integrated Eligibility Redesign System or TIERS. The project focuses on the redesign and replacement of SAVERR, the Generic Worksheet and the Long-term Care Worksheet. These systems currently support public assistance eligibility determination.[7]

The significant differences between TIERS and its predecessor TIES include the following:[8]

- TIERS initially would support only DHS services, but would be flexible enough in its design to add other programs and agencies in the future; and
- The business process re-engineering that would have changed how DHS delivers its services (i.e., eliminating most face-to-face contact) would not be pursued.

TIERS Funding

Initial funding for the TIERS project was estimated to be $362.0 million in All Funds and included federal participation, state matching funds, and Revenue Bond Proceeds. The current cost estimate for the project is approximately $301.5 million in All Funds, as shown in Table 2. The project design and implementation phases were projected to be completed by fiscal year 2007. Continued review and updating of project timelines reduced that original timeframe by two years with implementation projected to be completed in fiscal year 2005. The estimated cost for fiscal years 2000 through 2005 is included in Table 2. Amounts for fiscal years 2004–05 are the requested amounts included in the DHS Legislative Appropriations Request.

Differences between appropriated amounts and actual expenditures are generally due to project fund carry forwards and changes in hardware and software costs. Project funds are included in appropriations in the first year in the Capital Budget rider with a second rider (see attachments) providing more detailed requirements for expenditures. Unexpended project funds in the first year can be carried forward to the second year of the biennium. Unexpended balances in the 2000–01 biennium were reappropriated for use in the 2002–03 biennium for the same purpose.

[4]House Bill 2777, Seventy-fifth Legislature, 1997.
[5]Ibid.
[6]Ibid.
[7]http://www.dhs.state.tx.us/programs/TIERS/.
[8]Ibid.

TABLE 2
TEXAS INTEGRATED ELIGIBILITY AND REDESIGN SYSTEM EXPENDITURES

IN MILLIONS

FISCAL YEAR	ALL FUNDS[1]	GENERAL REVENUE–RELATED FUNDS[2]
EXPENDED		
2000	$6.0	$2.6
2001	31.7	19.4
2002	67.4	32.5
PROJECTED		
2003	73.1	39.9
2004	111.3	56.6
2005	12.0	10.8
TOTAL	$301.5	$161.8

[1]All Funds include Federal Funds, state matching funds, and revenue bond proceeds.

[2]General Revenue–Related Funds include General Revenue, Earned Federal Funds, and revenue bond proceeds.

SOURCE: Department of Human Services.

Changes in hardware and software costs and changes in the implementation schedule for TIERS have allowed the projected expenditures for these areas to be lowered, thereby reducing the overall cost for TIERS.

Table 3 reflects some of the major changes from the initial cost estimate.

SEVENTY-SIXTH LEGISLATURE, 1999

The Seventy-sixth Legislature, 1999, appropriated $54.8 million in All Funds to DHS to begin implementation of the Texas Integrated Eligibility Redesign System (TIERS) project (see Attachments, Rider 36). The conceptual design and the technical framework were started and provided the basis to build the next stages of the project.

The start-up funding for the 2000–01 biennium (see Table 4) allowed DHS to initiate the project and provide validation of the following aspects of the DHS work to date: policy integration and simplification, completion of the conceptual design of the entire system, creation of the detailed design of the

TABLE 3
MAJOR COST CHANGES FROM INITIAL ESTIMATE

IN MILLIONS

HEADING / EXPLANATION OF CHANGE	COST
INITIAL ESTIMATE	**$362.0**
QAT STATUS REPORT 12/00 – 02/01	**$352.1**
◆ Original estimated cost of $362.0 million in All Funds was changed due to the reduction in the original software maintenance period from 10 years to 7	
QAT MONITORING REPORT 3/01 – 5/01	**$289.3**
◆ Computer hardware costs reduced due to West Texas DROC contract	
◆ Shortened project time-line and reduced software maintenance period	
◆ Telecommunications/hardware costs reduced	
◆ Voice telecommunications removed from project	
◆ Refined estimate for out years	
QAT MONITORING REPORT 12/01	**$317.6**
◆ Original projections were based on cost estimates for deliverables to be provided by Deloitte Consulting (the primary TIERS vendor). The current life cycle cost includes the agreed upon costs Deloitte will charge for the deliverables.	
◆ Debt service costs were not included in the original estimate. The current life cycle cost includes debt service payments of $44.7 million for revenue bond funds paid through 02/06/06 ($9.8 million for fiscal year 2000–01 and $34.9 million for fiscal year 2002–03).	
◆ A new cost of $5.4 million was added. This cost covers a Deloitte contract amendment, which adds 4.5 months to the original TIERS software development and rollout schedule.	
QAT MONITORING REPORT 9/02	**$301.5**
◆ Cost of leased personal computers decreased from $48.00 per month to $38.00	
◆ Reduction in MIS hours for fiscal year 2004–05	
◆ Reduction in contract / programming staff	

SOURCE: Legislative Budget Board.

TABLE 4
TEXAS INTEGRATED ELIGIBILITY APPROPRIATIONS

IN MILLIONS METHOD OF FINANCE	FISCAL YEARS 2000–01
State Funds	$19.3
Federal Funds	25.7
Bond Proceeds – Revenue Bonds	9.8
TOTAL	**$54.8**

SOURCE: Legislative Budget Board.

scheduling and screening modules, and the acquisition of Independent Verification and Validation services (IV&V).[9] The IV&V services are used as an independent outside source to ensure that project deliverables meet the specifications and criteria requested.

The first product from the TIERS project to be implemented was the State of Texas Assistance and Referral System (STARS). The Internet-based system allows people to self-screen for potential eligibility across multiple health and human service programs, not just DHS programs. Part of the design—the rules engine and user screens—serves as the foundation for the TIERS eligibility system.[10] Routine maintenance activities are currently being performed. Four updates were scheduled for October 2002, which included changes associated with new food stamp limits, information and referral information, and additional information on the results page.[11]

SEVENTY-SEVENTH LEGISLATURE, 2001

The Seventy-seventh Legislature, 2001, appropriated $114.8 million in All Funds for TIERS for the 2002–03 biennium. In addition, approximately $12.1 million in All Funds appropriated in fiscal years 2000–01 for TIERS was carried forward from fiscal year 2001 into fiscal year 2002 (see Attachments, Riders 25.c. (3), and 43, and Tables 5 and 6).

The main focus for the biennium was the continued design work on the entire TIERS system. This included detailed design and coding of the system and progressing to the implementation of the replacement of the Generic Worksheet (GWS) used by the DHS staff for intake of client eligibility information.

A decision was made to adjust the implementation dates for the pilot of the GWS. Additional testing was initiated for the integration of the separate SAVERR and TIERS data for use in the GWS and the accuracy of various interface transactions. Deployment of the system and the replacement of the GWS is still scheduled to be completed in fiscal year 2005 in the DHS Regions.

The TIERS Scheduler has been piloted in the Austin and San Marcos offices. The Scheduler gives eligibility staff access to an automated system for scheduling client interviews and allows the immediate updating and rescheduling of client appointments. All staff within an office have access to client scheduling times and dates and are able to more efficiently and quickly answer scheduling questions clients may have.[12]

TABLE 5
TEXAS INTEGRATED ELIGIBILITY APPROPRIATIONS

IN MILLIONS METHOD OF FINANCE	FISCAL YEARS 2002–03
State Funds	$17.9
Federal Funds	75.0
Bond Proceeds – Revenue Bonds	36.5
Bond Debt Service	7.4
TOTAL	**$136.8***

*Does not include additional funds pursuant to Rider 25, Enhanced Funding.
SOURCE: Legislative Budget Board.

[9]DHS 2004–05 Legislative Appropriations Request, substrategy-TIERS.
[10]From http://www.dhs.state.tx.us/programs/TIERS.
[11]http://www.dhs.state.tx.us/programs/tiers/HHSCOC/2002Sept24notes.pdf.
[12]http://www.dhs.state.tx.us/programs/tiers/HHSCOC/2002Sept24notes.pdf.

TABLE 6
TEXAS INTEGRATED ELIGIBILITY
RIDER APPROPRIATIONS

IN MILLIONS CAPITAL BUDGET ITEM	FISCAL YEARS 2002–03 RIDER APPROPRIATION	FISCAL YEAR 2002 1ST AND 2ND QUARTERS	FISCAL YEAR 2002 3RD AND 4TH QUARTERS	FISCAL YEAR 2003 1ST AND 2ND QUARTERS	FISCAL YEAR 2003 3RD AND 4TH QUARTERS
A. Acquisition of Information Resource Technologies					
(1) Texas Eligibility Redesign System	$92.9	$25.0	$18.0	$17.0	$0
(2) Texas Eligibility Redesign System Bond Purchases	36.5	8.4	12.2	19.7	0
B. Acquisition of Capital Equipment and Items					
(2) Debt Service for Revenue Bonds	7.4	1.1	2.4	2.8	0
TOTAL	**$136.8**	**$34.5**	**$32.6**	**$39.5**	**$0**
CUMULATIVE FUNDING		**$34.5**	**$67.1**	**$106.6**	**$106.6**
REMAINING FUNDING		**$102.3**	**$69.7**	**$30.2**	**$30.2**
METHOD OF FINANCE					
GENERAL REVENUE FUNDS	**$11.4**	**$12.4**	**$10.3**	**$11.1**	**$0**
Carry forward from fiscal years 2000–01 (GR)[1]	6.5	—	—	—	
Debt service from enhanced funding[2]	3.3	—	—	—	
FEDERAL FUNDS	**$61.1**	**$11.0**	**$13.4**	**$16.9**	**$0**
TANF Federal Funds[3]	10.0	2.2	2.6	1.9	0
Carry forward from fiscal years 2000–01 (Federal Funds)[1]	3.9	—	—	—	
Debt service from enhanced funding[2] (Federal Funds match)[2]	4.1	0.5	0.5	0.5	
OTHER FUNDS (BONDS)	**$34.9**	**$8.4**	**$5.8**	**$9.2**	**$0**
Carry forward from fiscal years 2000–01 (Bonds)[1]	1.6	—	—	—	
TOTAL, METHOD OF FINANCE	**$136.8**	**$34.5**	**$32.6**	**$39.6**	**$0**

[1]Carry forward funds not included in Rider 43 TIERS: Fiscal Year 2002 = $12.1 million.
[2]Debt service amounts not included in Rider 43 TIERS: Fiscal Year 2002 = $10.0 million.
[3]TANF federal fund not included in Rider 43 TIERS: Fiscal Year 2002 = $7.4 million.
SOURCE: Legislative Budget Board.

REQUESTED FUNDING FOR FISCAL YEARS 2004–05

The DHS fiscal years 2004–05 Legislative Appropriations Request included an All Funds request of $127.4 million for the TIERS project (See Table 7). The amount includes $4.2 million for debt service on Revenue Bond proceeds. Accomplishments planned for fiscal years 2004–05 include completing the statewide rollout of the Long-term Care portion of TIERS and ultimately retiring the old System for Application, Verification, Eligibility, Referrals and Reporting (SAVERR). All data, program rules, reporting rules, historical eligibility data, and ancillary eligibility subsystems will be moved off the mainframe and into the new TIERS client-server environment.[13] The department will continue to work with

[13]DHS 2004–05 Legislative Appropriations Request, Administrator's Statement.

TABLE 7
TEXAS INTEGRATED ELIGIBILITY
REQUESTED APPROPRIATIONS

IN MILLIONS METHOD OF FINANCE	FISCAL YEARS 2004–05*
State Funds	$50.4
Federal Funds	55.8
Bond Proceeds – Revenue Bonds	17.0
Bond Debt Service	4.2
TOTAL	**$127.4**

*Does not include debt service on Revenue Bond Proceeds.
SOURCE: Department of Human Services.

external users who interface and use TIERS data, both state and federal, to ensure an uninterrupted transition from SAVERR to TIERS.

CONCLUSION

The TIERS project remains under Quality Assurance Team review and continues to make satisfactory progress toward full implementation in fiscal year 2005. Although there have been minor delays in the pilot of the Generic Worksheet, which were anticipated given the size and complexity of the project, the majority of the project timeframes that were set have been met or exceeded.

The State of Texas Assistance and Referral System or STARS system was implemented and is fully functional, allowing individuals to determine online if they are qualified for various programs across multiple Health and Human Service agencies.

The TIERS Scheduler has been successfully piloted in the Austin and San Marcos offices and will be included in the Generic Work Sheet rollout schedule.

As shown in Table 8, estimated expenditures for the TIERS project, for fiscal years 2000 expended through 2003 budgeted, total $178.3 million. This estimate includes funds expended and encumbered for the project.

TABLE 8
TEXAS INTEGRATED ELIGIBILITY
EXPENDED AND BUDGETED FUNDING

IN MILLIONS METHOD OF FINANCE	FISCAL YEARS 2000–03
General Revenue Funds	$32.8
Bonds	36.2
Enhanced Federal Funds	25.3
SUBTOTAL, GENERAL REVENUE	**$94.3**
Federal Funds	84.0
TOTAL, ALL FUNDS	**$178.3***

*Includes approximately $12.8 million in All Funds carry forward from fiscal year 2001.
SOURCE: Department of Human Services.

ATTACHMENTS

SEVENTY-SEVENTH LEGISLATURE, 2001, RIDERS RELATED TO THE TIERS PROJECT

25. Enhanced Federal Funding for Administration of the Food Stamp Program. Enhanced federal funding is defined as funding from the federal government which exceeds the normal federal contribution toward administrative costs. The authority to expend enhanced federal funding for administrative costs paid in a prior fiscal year is subject to the following conditions:

a. Within 30 days of receiving notice of the state's eligibility for enhanced federal funding, as a result of exceeding national accuracy standards for determining client eligibility and benefit levels, the Department of Human Services shall notify the Legislative Budget Board and the Governor;

b. At least 14 days prior to any meeting of the Board of Human Services to budget the enhanced federal funds, the Department of Human Services shall provide documentation of the proposed use of these funds to the Legislative Budget Board, the Governor, and Health and Human Services Commission. The report shall identify the impact on established performance targets, measures, and full-time equivalent positions, and shall be prepared in a format specified by the Legislative Budget Board.

c. In the event that the state receives enhanced federal funds, the Department of Human Services is appropriated all enhanced federal funds received by the agency subject to all limitations in this rider and to the following:

(1) a portion of these funds, not to exceed $2.0 million of these funds for the biennium, shall be used by the Department of Human Services for the development and operation of a nutrition education and outreach program, or for activities that otherwise improve low-income consumers' access to basic nutrition and healthy foods;

(2) a portion of these funds, $5.0 million for the biennium, shall be used by the Department of Human Services to provide bonuses to position classifications whose efforts directly contributed to meeting these performance standards, or to position classifications who meet or exceed customer service performance standards developed by the department, or whose efforts directly contributed to increasing the percentage of eligible persons who receive Food Stamps; and

(3) any additional amounts shall be used by the Department of Human Services, and matched with appropriate federal funds, in order to continue the Texas Integrated Eligibility Redesign System (TIERS) project. The Department of Human Services' capital budget authority shall be increased by the amount of funds received and expended for the TIERS project, subject to the department notifying the Legislative Budget Board and the Governor, in addition to notifications above, of the department's intent to utilize enhanced federal funds for capital purposes in the TIERS project.

d. Before an employee can be eligible for a bonus, the employee must have been employed in the program for the related twelve months, remains employed in the program, and whose performance meets expectations.

e. Bonuses given to employees will not affect their eligibility for a merit salary increase or a promotion.

f. The department shall prepare quarterly reports summarizing the department's progress in implementing the outreach program required in section (c) and file those reports with the standing committees of the Senate and House of Representatives having primary jurisdiction over health and human services.

43. Texas Integrated Eligibility Redesign Systems (TIERS). Out of funds appropriated above in fiscal years 2002–03 in Strategy B.1.2, CSS Eligibility and Issuance Services, the Department of Human Services is allocated (for the biennium) $11,400,000 in General Revenue, $61,100,000 in Federal Funds, and $34,900,000 in Revenue Bond Proceeds, totaling *$107,400,000*[1] in All Funds are contingent upon approval by the Legislative Budget Board and the Governor. The department shall make quarterly reports to the Legislative Budget Board and the Governor on the TIERS project as well as quarterly budgeted amounts, actual expenditures, and the status of contracted services, as well as any other information requested. All contracts relating to this project shall include performance measures.

To fund the plan, the department may seek funding from the most cost-effective type of financing, including but not limited to cash acquisition, commercial financing, and financing provided by the Texas Public finance Authority. Following approval of the plan by the Legislative Budget Board and the Governor the Texas Public Finance Authority may issue revenue bonds or other debt obligations to finance the design, development, acquisition, and implementation of automated data processing systems to support the plan. As provided by Government Code, Chapter 1232, Vernon's Texas Civil Statutes, in recognition that cost estimates are not final at the time that the project is authorized for financing and that bonds may be issued to fund associated costs, including reasonably required reserve funds, capitalized interest, administrative costs of the authority and debt issuing expenses, the principal amount of any issuance of debt for this purpose may be in an amount not to exceed one and one-half the amount of the expected cost for the project being financed. From the proceeds of the issuance and sale of such bonds or debt obligations, such amounts as may be necessary to fund the associated costs of issuances are hereby appropriated to the Texas Public Finance Authority for the fiscal biennium beginning September 1, 2001. From any funds appropriated to the Department of Human Services for the purpose of implementing the project, an amount not to exceed $7,398,800 (amounts needed for debt service) for the biennium in all funds may be transferred to the Texas Public Finance Authority for lease payments to the Texas Public Finance Authority to pay debt service on the obligations issued by the Texas Public Finance Authority on behalf of the department for the above-mentioned project.

[1]Amount changed to reflect total.

ATTACHMENTS *(CONTINUED)*

SEVENTY-SIXTH LEGISLATURE, 1999, RIDERS RELATED TO THE TIERS PROJECT

36. Appropriation: Texas Integrated Eligibility Redesign Systems (TIERS) Financing. Out of funds appropriated above in fiscal year 2000 in Strategy B.1.2., CSS Eligibility & Issuance Services, the Department of Human Services is allocated (for the biennium) $19,300,000 in general revenue, $25,700,000 in federal funds, and $9,800,000 in revenue bond proceeds, totaling $54,800,000 in all funds, contingent upon approval by the Legislative Budget Board and the Governor of a plan for integration of services authorized by House Bill 2777, Seventy-fifth Legislature, Regular Session. The plan shall include dates, milestones, and costs of the project period. The Department shall make quarterly reports to the Legislative Budget Board and the Governor on these items as well as quarterly budgeted amounts, actual expenditures, and the status of contracted services, as well as any other information requested. All contracts relating to this project shall include performance measures. To fund the plan, the Department may seek funding from the most cost-effective type of financing, including but not limited to cash acquisition, commercial financing, and financing provided by the Texas Public Finance Authority. Following approval of the plan by the Legislative Budget Board and the Governor, the Texas Public Finance Authority may issue revenue bonds or other debt obligations to finance the design, development, acquisition, and implementation of automated data processing systems to support the plan at an estimated project cost of $10,000,000. As provided by Article 601d, Vernon's Texas Civil Statutes, in recognition that cost estimates are not final at the time that the project is authorized for financing and that bonds may be issued to fund associated costs, including reasonably required reserve funds, capitalized interest, administrative costs of the authority and debt issuing expenses, the principal amount of any issuance of debt for this purpose may be in an amount not to exceed one and one-half the amount of the expected cost for the project being financed. From the proceeds of the issuance and sale of such bonds or debt obligations, such amounts as may be necessary to fund the associated costs of issuances are hereby appropriated to the Texas Public Finance Authority for the fiscal biennium beginning September 1, 1999. From any funds transferred to the Department of Human Services for the purpose of implementing the plan approved under House Bill 2777, Seventy-fifth Legislature, Regular Session, and from any funds appropriated to the Department of Human Services, an amount not to exceed $1,500,000 (amounts needed for debt service) for the biennium in all funds may be transferred to the Texas Public Finance Authority for lease payments to the Texas Public Finance Authority to pay debt service on the obligations issued by the Texas Public Finance Authority on behalf of the department for the above-mentioned project.

TEXAS' RAINY DAY FUND

This review provides a historical account of Texas' Economic Stabilization Fund, a reserve fund commonly known as the Rainy Day Fund. It addresses the current fiscal situation of Texas and other states and the decision to use reserve funds to meet state budgetary needs.

SIGNIFICANT FINDINGS

- As of December 31, 2002, there was a balance of $995.2 million in the Economic Stabilization Fund (ESF).
- In fiscal year 2002, the fund received $83.6 million from natural gas tax-related revenue.
- The Comptroller of Public Accounts estimates that with its accrual of interest, the ESF balance will exceed $1 billion by the close of the 2002–03 biennium.
- The presence of a reserve fund (ESF) and its size as a percentage of the state's budget are criteria used by bond credit agencies in bond rating considerations.

COMMENTS

During the 1980s, a decline in economic activity in Texas created a shortfall in state revenue and serious funding problems for the Texas budget. The economic downturn was driven by the plummeting price of oil, the crash of the real estate market, and the savings and loans failures. With memories of the economic crisis still fresh, the Seventieth Legislature, 1987, created the Economic Stabilization Fund (ESF), which was adopted by a constitutional amendment by voters in November 1988.

The Economic Stabilization Fund is commonly known as the Rainy Day Fund. Across the country, such funds were created with the intent of making them the first line of defense for state budgets against problems created by declining revenues and rising needs for public services during a recession. By the early 1990s, buoyed by recent economic expansion, many states set aside reserve accounts or rainy day funds. The National Conference of State Legislators (NCSL) reports that 41 states currently have a rainy day fund.

CURRENT STATE FISCAL SITUATIONS AND USES OF RAINY DAY FUNDS

Currently, almost all states are experiencing fiscal problems. NCSL's *State Budget and Tax Actions 2002, Preliminary Report* states that at the end of fiscal year 2002, 43 states reported budget gaps due to lower-than-expected revenues and spending overruns. Texas was one of seven states that did not report any budget gaps (Table 1). NCSL reported that nearly every state had to take action to eliminate budget gaps by the end of the fiscal year 2002, and many states have already taken action to address their current budget gaps in fiscal year 2003.

As shown in Table 2, to address budget gaps, 19 states chose to tap their rainy day fund in fiscal year 2002, and as of November 2002, 12 states had tapped their reserve funds in fiscal year 2003. NCSL reported they expected fewer states to draw from their rainy day funds in fiscal year 2003 because many considerably reduced or depleted their reserve fund to close budget gaps in fiscal year 2002. Furthermore, as states try to maintain their funds at a reasonable level, they are reluctant to appropriate from them again.

In the *Texas Economic Update, Spring 2002*, the Comptroller stated that although the economy in Texas has been adversely affected by the national recession, the Texas economy itself did not fall into a recession. Although the Comptroller will not officially announce the 2004–05 biennial revenue estimate until January 2003, in September 2002 she reported her projected $5 billion shortfall (not a deficit) is accurate.

TABLE 1
REPORTED BUDGET PROBLEMS
FISCAL YEARS 2002 AND 2003

BUDGET PROBLEM	STATES IN FISCAL YEAR 2002	STATES IN FISCAL YEAR 2003*
Reported budget gaps	43	31
Reported lower than expected revenue collections	26	33
Reported spending overruns	30	29

*Reported through October 2002, not the entire fiscal year.
SOURCE: National Conference of State Legislatures.

TABLE 2
STATE ACTIONS TO CLOSE BUDGET GAPS
FISCAL YEARS 2002 AND 2003

ACTION TO CLOSE BUDGET GAP	STATES IN FISCAL YEAR 2002	STATES IN FISCAL YEAR 2003*
Implementing targeted or across-the-board budget cuts	29	26
Tapping a variety of state funds	20	23
Tapping rainy day funds	19	12
Using tobacco settlement funds (securitization)	12	16
Increased taxes more than 1 percent	0	16
Raising fees	0	10
State employee travel bans	11	NA
State employee hiring freeze	11	NA
Layoffs	8	NA
Delaying capital projects	8	NA

*Reported through October 2002, not the entire fiscal year.
SOURCE: National Conference of State Legislatures.

CONSTITUTIONAL FUNDING REQUIREMENTS OF THE ECONOMIC STABILIZATION FUND

The four funding sources for the ESF, Section 49-g, Article 3, Texas Constitution, and the rules for obtaining revenue from those sources are as follows:

- The Comptroller must transfer to the ESF, "one-half of any unencumbered positive balance of general revenues on the last day of the preceding biennium," by no later than the 90th day of each biennium. The last such transfer occurred in fiscal year 1992. Since then, there have not been any unencumbered general revenues at the end of a fiscal biennium.
- The fund must receive an amount of General Revenue equal to 75 percent of any natural gas production tax revenue in excess of the amount collected in fiscal year 1987. Transfers related to excess natural gas revenue typically occur in the November following the fiscal year in which the excess was collected. Texas' fiscal years end on August 31st and begin on September 1st. Therefore, transfers related to excess collections in fiscal year 2000 were made in November 2000, which was fiscal year 2001. Recent increased collections of natural gas production taxes have caused the fund to grow significantly with deposits of $103.1 million in fiscal year 2001, $685.8 million in fiscal year 2002, and $83.6 million in fiscal year 2003.
- The fund must receive an amount of General Revenue equal to 75 percent of any oil production tax revenue in excess of the amount collected in fiscal 1987. This source has provided a single deposit of $118 million in fiscal year 1992. Again, this transfer would take place in November following the fiscal year in which the excess was collected.
- The Legislature may appropriate funds to the ESF. There have been no such appropriations.

APPROPRIATIONS FROM THE ESF

There are two methods for appropriating money from the Texas ESF:

- When a budget deficit develops in a biennium, or when the Comptroller estimates that revenue will decline from biennium to biennium, appropriations can be made from the ESF with three-fifths vote of the members present in each house. Spending from the fund cannot exceed the amount of the revenue shortfall or unanticipated deficit. To date, funds have not been appropriated from the fund in this way.
- The ESF may also be appropriated for any purpose, at any time, with a two-thirds vote of the members present in each house of the legislature. Senate Bill 11, Seventy-first Legislature, Sixth Called Session, 1990, transferred $28.9 million, the entire balance of the ESF, to the Foundation School Fund. During the Seventy-third Legislature, 1993, Senate Bill 171 authorized an emergency appropriation to spend money from the ESF for criminal justice programs. The bill allowed for the transfer of $119.0 million for the remainder of fiscal year 1993, and a total of $7.0 million in fiscal years 1994 and 1995 to the Department of Criminal Justice (TDCJ) to pay for the operation of additional prison capacity and intermediate-sanction facilities and county jails for housing state prisoners. Senate Bill 532, Seventy-third Legislature, 1993, appropriated $72.0 million from the ESF to TDCJ in fiscal years 1994 and 1995 to create a state jail system. Although the money was appropriated for fiscal years 1994–95, $0.5 million was expended in 1996. Table 3 provides revenue and expenditure history for the ESF.

Although appropriations from the ESF have been debated by lawmakers subsequent to the Seventy-third Legislative Session in 1993, none have been authorized.

RECOMMENDED SIZE OF THE ESF

The National Conference of State Legislators recommends that rainy day fund balances amount to 5 percent of General Appropriations. The National Association of State Budget Officers reports a national median of 4.5 percent. Texas' ESF balance as a percentage of General Revenue Fund appropriations were 3.0 percent in fiscal year 2002, which was far below the constitutional cap of 10 percent of the General Revenue Funds (minus certain types of income and funds) received during the previous biennium.

It is important to note that although the presence of a reserve fund and its percentage relative to the state's budget are criteria for bond credit agencies' ratings, there are currently disagreements about the consequences of tapping into a ESF. Supporters of tapping into the ESF point to the recent Standard and Poor's publication, *State of the States: Fiscal 2003 Presents Many Challenges*, which says, "Drawing down reserve funds is not a credit weakness on its own." On the other hand, opponents say the state's bond rating could be downgraded as a consequence of appropriating from the fund.

TABLE 3
ECONOMIC STABILIZATION FUND
REVENUE AND EXPENDITURES
FISCAL YEARS 1990 TO PRESENT

FISCAL YEAR	OIL-TAX-RELATED REVENUE	NATURAL-GAS-TAX-RELATED REVENUE	UNENCUMBERED BALANCES TRANSFERRED TO THE ESF	INTEREST	APPROPRIATIONS TO THE ESF	OTHER	TOTAL REVENUE	EXPENDITURES FROM THE ESF	ENDING BALANCE
1990	$0.0	$18.5	$0.0	$0.8	$0.0	$0.0	$19.3	$0.0	$19.3
1991	0.0	7.8	0.0	1.9	0.0	0.0	9.7	29.0	0.0
1992	118.0	18.4	20.2	6.8	0.0	0.0	163.4	0.0	163.4
1993	0.0	0.0	0.0	7.4	0.0	0.0	7.4	119.0	51.7
1994	0.0	31.0	0.0	3.0	0.0	0.0	34.0	56.6	29.1
1995	0.0	0.0	0.0	0.6	0.0	0.0	0.6	21.5	8.1
1996	0.0	0.0	0.0	0.4	0.0	0.0	0.4	0.5	8.0
1997	0.0	0.0	0.0	0.4	0.0	0.1	0.5	0.1	8.5
1998	0.0	47.5	0.0	2.3	0.0	0.0	49.8	0.0	58.3
1999	0.0	17.9	0.0	3.8	0.0	0.0	21.7	0.0	80.0
2000	0.0	0.0	0.0	4.7	0.0	0.0	4.7	0.0	84.7
2001	0.0	103.1	0.0	8.7	0.0	0.0	111.8	0.0	196.5
2002	0.0	685.8	0.0	21.6	0.0	0.0	707.4	0.0	903.9
2003	0.0	83.6	0.0	7.7	0.0	0.0	91.3	0.0	**995.2**
TOTAL	**$118.0**	**$1,013.7**	**$20.2**	**$70.0**	**$0.0**	**$0.1**	**$1,222.0**	**$226.8**	

SOURCE: Legislative Budget Board.

TEXAS STATE EXPENDITURES: 1983–2000

This review examines Texas state government expenditures from fiscal year 1983 to fiscal year 2000 as reported in two biennial publications of the Legislative Budget Board: *Legislative Budget Estimates* and *Fiscal Size-up*. Expenditure trends in four fund categories are examined: All Funds, General Revenue Funds, Federal Funds, and Other Funds (which include General Revenue-Dedicated Funds for purposes of this review). These trends are also examined for each functional area of Texas government including General Government, Health and Human Services, Education, The Judiciary, Public Safety and Criminal Justice, Natural Resources, Business and Economic Development, and Regulatory. Finally, using population and consumer price index data from the Comptroller of Public Accounts' Spring 2002 Economic Forecast, these expenditures are also adjusted for population growth and inflation.

During the past two decades, total state expenditures in Texas (All Funds) have increased steadily, from $13.8 billion in fiscal year 1983 to $49.4 billion in fiscal year 2000, an average annual growth rate of 7.8 percent (Table 1 and Figure 1). General Revenue Fund expenditures in Texas also increased steadily during this period, albeit at a slower rate. General Revenue Fund expenditures totaled $9.4 billion in fiscal year 1983 and $27.3 billion in fiscal year 2000, an average annual growth rate of 6.5 percent.

EXPENDITURES, INFLATION AND POPULATION

This growth in expenditures may look substantial, but must be viewed in the context that there was a significant amount of inflation during this period. The Consumer Price Index (CPI) increased by 72.8 percent between fiscal year 1983 and fiscal year 2000. Furthermore, Texas' population grew from 15.8 million in fiscal year 1983 to 20.8 million in fiscal year 2000. These economic and demographic factors increased both the cost of, and need for services provided by the state.

Caseload and enrollment growth often exceed the rate of growth of the general population. In addition, the cost of providing some services, such as healthcare, increases at a faster rate than the CPI. Although the CPI uses a "consumer" medical inflation factor, this has generally been much lower than the "employer" medical inflation factor, which more closely approximates the actual costs borne by the state. Adjusting expenditures for population growth and inflation (i.e., the CPI) is a good way to consistently compare expenditures over an extended time period. The combined population and inflation growth rate during the period fiscal year 1983 to fiscal year 2000 approximates both state revenue and the cost of providing a baseline level of services. Typically the term "real growth" means only adjusted for inflation, but it will be used in this review to mean adjusted for inflation and population.

The overall amount of real growth in expenditures for each of the fund categories is a useful measure of growth in Texas expenditures, and the allocation of the real growth among the functional areas reflects the state's funding priorities over the past two decades.

EXPENDITURES BY FUND CATEGORIES

After adjusting for population growth and inflation, total state expenditures (All Funds) increased from $13.8 billion in fiscal year 1983 to $21.7 billion in fiscal year 2000, an overall increase of 57.5 percent with an average annual growth rate of 2.7 percent (Table 2 and Figure 1). Likewise, General Revenue Funds increased from $9.4 billion in fiscal year 1983 to $12.0 billion in fiscal year 2000, resulting in an

overall increase of 28 percent with an average annual growth rate of 1.5 percent.

General Revenue Funds primarily consist of state tax revenue (e.g., sales tax, motor fuels tax, new vehicle sales tax), and are the only funding source over which the Texas Legislature has complete spending control. Approximately 85 percent of General Revenue Funds are spent in accordance with the state constitution or state law, a federal law, regulation or court decision, or a formula.

As depicted in Table 2, the increase in General Revenue Funds (adjusted) between fiscal year 1983 and fiscal year 2000 has lagged the increase in Federal Funds during this same period. Federal Funds (adjusted) increased from $2.7 billion in fiscal year 1983 to $6.3 billion in fiscal year 2000, resulting in a 5.1 percent average annual growth rate. Other Funds (adjusted) increased from $1.7 billion in fiscal year 1983 to $3.4 billion in fiscal year 2000, resulting in a 4.1 percent average annual growth rate.

The growth in Federal Funds has resulted from long-standing efforts to identify and secure additional federal funding for state programs; the federal expansion of federally-funded, state-administered

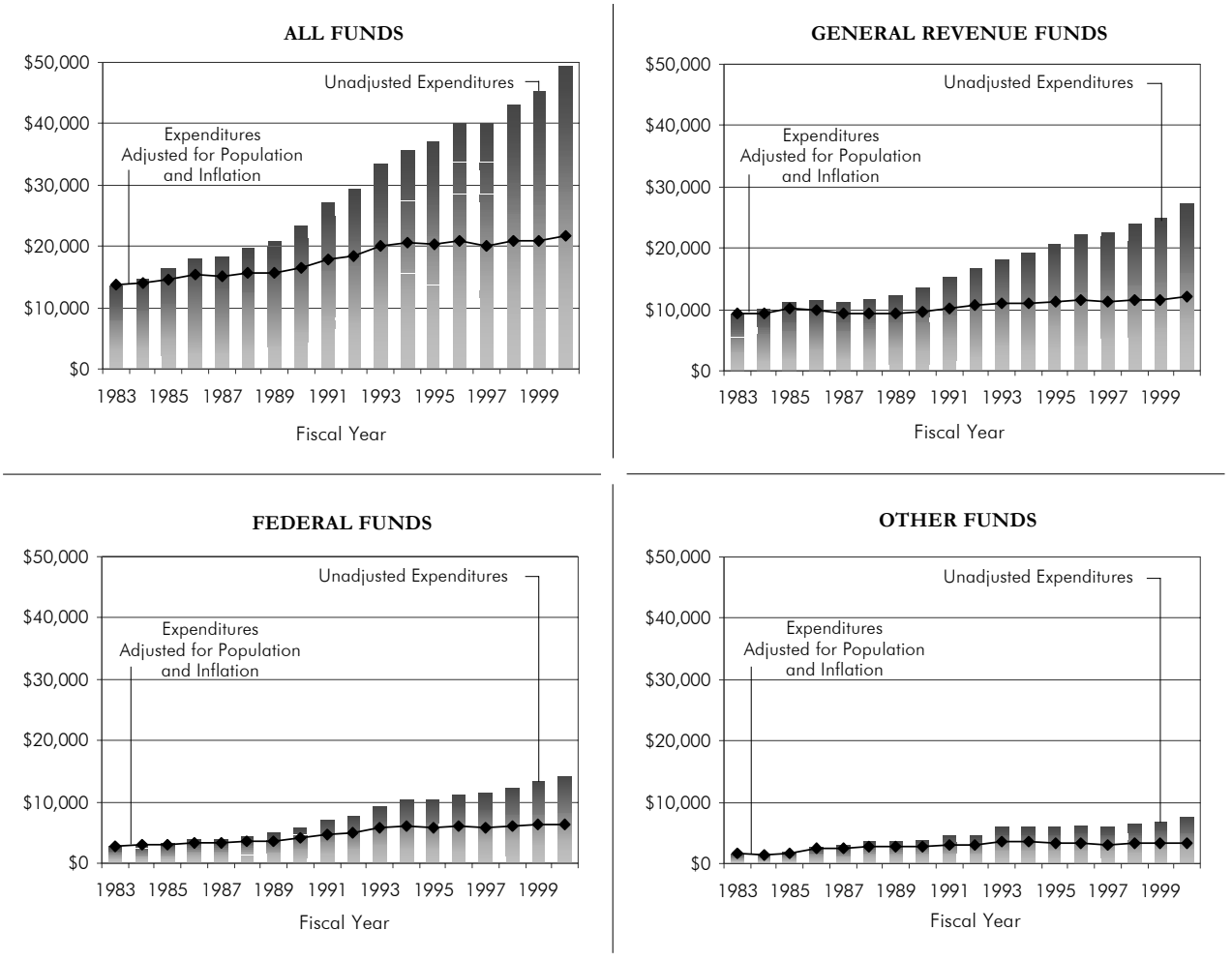
TABLE 1
UNADJUSTED EXPENDITURES BY METHOD OF FINANCE

IN MILLIONS YEAR	ALL FUNDS	GENERAL REVENUE FUNDS	FEDERAL FUNDS	OTHER FUNDS
1983	$13,767.4	$9,358.4	$2,692.9	$1,716.1
1984	14,740.2	10,067.9	3,079.5	1,592.8
1985	16,449.3	11,303.7	3,331.3	1,814.4
1986	18,073.3	11,435.3	3,822.9	2,815.2
1987	18,415.5	11,370.3	3,903.8	3,141.5
1988	19,850.0	11,894.9	4,377.2	3,577.8
1989	20,903.5	12,443.3	4,882.1	3,578.1
1990	23,373.3	13,860.6	5,732.7	3,780.0
1991	27,226.4	15,457.1	7,221.0	4,548.3
1992	29,367.5	16,876.3	7,821.9	4,669.3
1993	33,555.9	18,136.3	9,451.1	5,968.4
1994	35,764.4	19,285.0	10,304.4	6,175.1
1995	37,004.2	20,674.2	10,405.6	5,924.4
1996	39,986.4	22,238.0	11,356.9	6,391.6
1997	40,122.8	22,447.9	11,496.9	6,178.0
1998	43,014.5	24,006.7	12,317.7	6,690.1
1999	45,278.2	24,883.2	13,393.8	7,001.2
2000	49,452.9	27,321.7	14,399.5	7,731.7
Average Growth Rate:	7.8%	6.5%	10.4%	9.3%

NOTE: General Revenue–Dedicated Funds and General Revenue–Consolidated Funds are categorized as Other Funds for the purpose of this analysis.
SOURCE: Legislative Budget Board (*Legislative Budget Estimates, Fiscal Size-up*).

FIGURE 1
EXPENDITURES, BY METHOD OF FINANCE

IN MILLIONS



SOURCES: Legislative Budget Board; Comptroller of Public Accounts.

programs; and cost increases in certain programs (e.g., Medicaid) that have exceeded the CPI. The growth in Other Funds is primarily attributable to increases in the State Highway Fund (Fund 006) receipts and to higher education funds.

EXPENDITURES BY GOVERNMENT FUNCTION

From fiscal year 1983 to fiscal year 2000, the four government functions with the largest net dollar increases in All Funds (Table 3) were Education, which increased from $7.6 billion to $21.9 billion (a $14.4 billion increase), Health and Human Services, which increased from $3.0 billion to $14.6 billion (an $11.6 billion increase), Business and Economic Development, which increased from $1.8 billion to $6.3 billion (a $4.5 billion increase), and Public Safety and Criminal Justice, which increased from $687.4 million to $4.0 billion (a $3.3 billion increase).

The largest All Funds growth during this period after adjusting for population growth and inflation (Table 4) occurred in Health and Human Services (a $3.4 billion increase with an average annual growth rate of 4.5 percent), Public Safety and Criminal Justice (a $1.1

TABLE 2
EXPENDITURES, BY METHOD OF FINANCE
ADJUSTED FOR POPULATION GROWTH AND INFLATION

IN MILLIONS YEAR	ALL FUNDS	GENERAL REVENUE FUNDS	FEDERAL FUNDS	OTHER FUNDS
1983	$13,767.4	$9,358.4	$2,692.9	$1,716.1
1984	13,876.1	9,477.7	2,898.9	1,499.5
1985	14,669.1	10,080.3	2,970.8	1,618.0
1986	15,447.7	9,774.0	3,267.5	2,406.2
1987	15,206.8	9,389.1	3,223.6	2,594.1
1988	15,686.9	9,400.2	3,459.2	2,827.5
1989	15,646.8	9,314.1	3,654.3	2,678.3
1990	16,433.9	9,745.5	4,030.7	2,657.7
1991	17,942.4	10,186.4	4,758.7	2,997.3
1992	18,481.6	10,620.6	4,922.5	2,938.5
1993	20,129.5	10,879.6	5,669.6	3,580.3
1994	20,537.5	11,074.3	5,917.2	3,546.0
1995	20,313.8	11,349.3	5,712.2	3,252.3
1996	20,967.6	11,660.9	5,955.2	3,351.5
1997	20,097.5	11,244.1	5,758.8	3,094.6
1998	20,746.0	11,578.5	5,940.8	3,226.6
1999	20,901.5	11,486.7	6,182.9	3,231.9
2000	21,682.9	11,979.3	6,313.6	3,390.0
Average Growth Rate:	2.7%	1.5%	5.1%	4.1%

NOTE: Data for the population and inflation adjustments is derived from the Comptroller's Spring 2002 Economic Forecast.
SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

billion increase with an average annual growth rate of 5.6 percent), Education (a $2.0 billion increase with an average annual growth rate of 1.4 percent), and Business and Economic Development (a $950.4 million increase with an average annual growth rate of 2.5 percent). On an adjusted basis, these functional areas account for 93.9 percent of the increase.

The three government functions with the largest net increases in General Revenue Funds from fiscal year 1983 to fiscal year 2000 (Table 5) were Education, which increased from $6.5 billion to $16.8 billion (a $10.3 billion increase), Health and Human Services, which increased from $1.6 billion to $5.7 billion (a $4.1 billion increase), and Public Safety and Criminal Justice, which increased from $543.9 million to $3.3 billion (a $2.7 billion increase).

After adjusting for population growth and inflation, much of the growth in General Revenue Funds (Table 6) during this period occurred in Health and Human Services (a $913.1 million increase with an average annual growth rate of 2.7 percent), Education (an $896.6 million increase with an average annual growth

rate of 0.8 percent), and Public Safety and Criminal Justice (an $888.1 million increase with an average annual growth rate of 5.9 percent). The increase in General Revenue Funds for Public Safety and Criminal Justice is primarily due to the expansion of the state's prison system in the 1990s.

The three government functions with the largest net increases in Federal Funds from fiscal year 1983 to fiscal year 2000 (Table 7) were Health and Human Services, which increased from $1.4 billion to $8.6 billion (a $7.1 billion increase), Business and Economic Development, which increased from $632.0 million to $3.0 billion (a $2.4 billion increase), and Education, which increased from $618.9 million to $2.3 billion (a $1.7 billion increase). More than 95 percent of Federal Funds were allocated to these three functions in fiscal year 2000.

After adjusting for population growth and inflation, significant growth in Federal Funds (Table 8) during this period occurred in Health and Human Services (a $2.4 billion increase with an average annual growth rate of 5.9 percent), Business and Economic Development (a $677.6 million increase with an average annual growth rate of 4.4 percent), and Education (a $389.6 million increase with an average annual growth rate of 2.9 percent.)

From fiscal year 1983 to fiscal year 2000, the increase in Other Funds (Table 9) occurred largely in two functional areas: Education and Business and Economic Development. Education increased from $486.3 million to $2.8 billion (a $2.3 billion increase). The Other Funds category for Education consists of various higher education funds including tuition-based operating funds, hospital patient income, and the Available University Fund. Other Funds for Business and Economic Development increased from $888.4 million to $3.1 billion (a $2.2 billion increase). The Other Funds category for Business and Economic Development includes State Highway Funds (Fund 006).

After adjusting for population growth and inflation, much of the growth in Other Funds (Table 10) during this period occurred in Education (a $748.5 million increase with an average annual growth rate of 5.6 percent) and Business and Economic Development (a $477.9 million increase with an average annual growth rate of 2.6 percent).

PROPORTIONALITY AND EXPENDITURES

The proportion of adjusted All Funds expended by government functions relating to the total budget has remained essentially unchanged between fiscal year 1985 and fiscal year 2000 (Figure 2) except for Health and Human Services (which increased from 21.3 percent to 29.5 percent), Public Safety and Criminal Justice (which increased from 5.1 percent to 8.1 percent), and Education (which decreased from 55.8 percent to 44.4 percent).

The proportion of adjusted General Revenue Funds expended on the General Government, The Judiciary, Natural Resources and Regulatory functions has remained relatively unchanged since fiscal year 1985 (Figure 3). However, the proportion of adjusted General Revenue Funds expended on the Public Safety and Criminal Justice function nearly doubled during this period, from 6.2 percent to 12.0 percent. Again, this corresponds to the expansion of the state prison system in the 1990s. The Health and Human Services function also experienced a proportional increase, from 16.5 percent in fiscal year 1985 to 20.7 percent in fiscal year 2000, primarily due to state matching requirements for Federal Funds. Adjusted General Revenue Funds as a proportion of expenditures for Education and Business and Economic Development decreased during this period, from 70.1 percent to 61.6 percent, and from 2.4 percent to 0.7 percent, respectively. The Business and Economic Development proportional decrease in adjusted General Revenue Funds was due to the replacement of General Revenue Funds at the Department of Transportation with State Highway Fund monies.

TABLE 3
ALL FUNDS EXPENDITURES, BY FUNCTION

IN MILLIONS YEAR	GENERAL GOVERNMENT	HEALTH AND HUMAN SERVICES	AGENCIES OF EDUCATION	THE JUDICIARY	PUBLIC SAFETY AND CRIMINAL JUSTICE	NATURAL RESOURCES	BUSINESS AND ECONOMIC DEVELOPMENT	REGULATORY	THE LEGISLATURE	ALL FUNCTIONS
1983	$295.0	$3,002.6	$7,587.5	$54.4	$687.4	$215.1	$1,805.3	$71.5	$48.7	$13,767.4
1984	365.2	3,279.7	8,002.2	61.7	739.6	244.6	1,902.0	91.7	53.5	14,740.2
1985	372.6	3,506.7	9,174.3	64.2	840.2	232.1	2,096.5	102.1	60.7	16,449.3
1986	399.6	3,661.9	9,585.4	69.6	909.2	259.1	3,027.6	109.1	51.9	18,073.3
1987	386.6	3,918.4	9,616.5	69.7	930.2	292.8	3,025.1	115.5	60.7	18,415.5
1988	456.7	4,318.4	10,058.3	72.3	1,077.4	306.2	3,364.0	138.8	57.8	19,850.0
1989	536.4	4,862.0	10,451.2	75.6	1,190.5	302.1	3,265.4	152.0	68.4	20,903.5
1990	662.4	5,933.0	11,243.0	97.4	1,401.1	382.1	3,409.9	171.1	73.2	23,373.3
1991	770.1	8,002.4	12,347.0	101.4	1,995.9	437.6	3,304.4	177.2	90.5	27,226.4
1992	892.0	8,668.8	13,430.2	109.6	1,935.0	592.6	3,470.0	176.5	92.8	29,367.5
1993	938.2	10,050.4	14,805.0	114.5	2,562.1	597.8	4,201.2	188.0	98.8	33,555.9
1994	919.6	11,069.0	15,296.2	123.7	3,010.8	748.4	4,302.7	190.0	104.1	35,764.4
1995	940.0	11,913.6	15,395.1	122.7	3,252.3	790.8	4,288.1	195.6	106.0	37,004.2
1996	986.6	12,253.0	17,527.1	133.9	3,041.6	791.2	4,942.6	196.6	113.9	39,986.4
1997	929.5	12,850.7	17,196.8	135.3	3,259.8	759.0	4,683.6	193.2	114.9	40,122.8
1998	984.5	12,908.4	19,239.6	157.4	3,439.9	812.8	5,146.4	208.9	116.6	43,014.5
1999	1,086.6	13,960.8	19,505.7	170.0	3,766.2	848.8	5,598.1	211.9	130.0	45,278.2
2000	1,183.5	14,573.0	21,945.7	186.2	3,985.5	937.0	6,284.9	222.6	134.5	49,452.9
Average Growth Rate:	8.5%	9.7%	6.4%	7.5%	10.9%	9.0%	7.6%	6.9%	6.2%	7.8%

NOTES: Prior to fiscal year 1993, functional allocations are derived from agency expenditure amounts, organized by current functions, with adjustments for major program transfers (e.g., child care and employment services from the Department of Human Services to Texas Workforce Commission). Adjustments have also been made for items currently appropriated at the function level (including employee benefits, bond debt service, and revenue bond lease payments) which formerly had been allocated solely to the General Government function.

SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

TABLE 4
ALL FUNDS EXPENDITURES, BY FUNCTION
ADJUSTED FOR POPULATION GROWTH AND INFLATION

IN MILLIONS

YEAR	GENERAL GOVERNMENT	HEALTH AND HUMAN SERVICES	AGENCIES OF EDUCATION	THE JUDICIARY	PUBLIC SAFETY AND CRIMINAL JUSTICE	NATURAL RESOURCES	BUSINESS AND ECONOMIC DEVELOPMENT	REGULATORY	THE LEGISLATURE	ALL FUNCTIONS
1983	$295.0	$3,002.6	$7,587.5	$54.4	$687.4	$215.1	$1,805.3	$71.5	$48.7	$13,767.4
1984	343.8	3,087.5	7,533.1	58.0	696.3	230.3	1,790.5	86.4	50.4	13,876.1
1985	332.3	3,127.2	8,181.4	57.2	749.3	206.9	1,869.6	91.1	54.1	14,669.1
1986	341.5	3,129.9	8,192.8	59.5	777.1	221.4	2,587.8	93.3	44.3	15,447.7
1987	319.3	3,235.7	7,940.9	57.6	768.1	241.8	2,498.0	95.4	50.2	15,206.8
1988	361.0	3,412.7	7,948.8	57.1	851.5	242.0	2,658.5	109.7	45.7	15,686.9
1989	401.5	3,639.3	7,823.0	56.6	891.1	226.2	2,444.2	113.7	51.2	15,646.8
1990	465.8	4,171.5	7,905.0	68.5	985.2	268.7	2,397.5	120.3	51.5	16,433.9
1991	507.5	5,273.6	8,136.8	66.8	1,315.3	288.4	2,177.6	116.8	59.6	17,942.4
1992	561.3	5,455.5	8,451.9	69.0	1,217.7	372.9	2,183.8	111.1	58.4	18,481.6
1993	562.8	6,029.0	8,881.2	68.7	1,536.9	358.6	2,520.2	112.8	59.3	20,129.5
1994	528.1	6,356.3	8,783.7	71.0	1,728.9	429.7	2,470.8	109.1	59.8	20,537.5
1995	516.0	6,540.1	8,451.3	67.3	1,785.4	434.1	2,354.0	107.4	58.2	20,313.8
1996	517.3	6,425.1	9,190.6	70.2	1,594.9	414.9	2,591.7	103.1	59.7	20,967.6
1997	465.6	6,436.9	8,613.9	67.8	1,632.9	380.2	2,346.0	96.7	57.5	20,097.5
1998	474.8	6,225.8	9,279.3	75.9	1,659.1	392.0	2,482.1	100.7	56.3	20,746.0
1999	501.6	6,444.7	9,004.3	78.5	1,738.6	391.8	2,584.2	97.8	60.0	20,901.5
2000	518.9	6,389.6	9,622.2	81.6	1,747.5	410.9	2,755.7	97.6	59.0	21,682.9
Average Growth Rate:	3.4%	4.5%	1.4%	2.4%	5.6%	3.9%	2.5%	1.8%	1.1%	2.7%

NOTES: Prior to fiscal year 1993, functional allocations are derived from agency expenditure amounts, organized by current functions, with adjustments for major program transfers (e.g., child care and employment services from the Department of Human Services to Texas Workforce Commission). Adjustments have also been made for items currently appropriated at the function level (including employee benefits, bond debt service, and revenue bond lease payments) which formerly had been allocated solely to the General Government function.

SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

TABLE 5
GENERAL REVENUE FUNDS EXPENDITURES, BY FUNCTION

IN MILLIONS

YEAR	GENERAL GOVERNMENT	HEALTH AND HUMAN SERVICES	AGENCIES OF EDUCATION	THE JUDICIARY	PUBLIC SAFETY AND CRIMINAL JUSTICE	NATURAL RESOURCES	BUSINESS AND ECONOMIC DEVELOPMENT	REGULATORY	THE LEGISLATURE	ALL FUNCTIONS
1983	$202.3	$1,570.5	$6,482.2	$50.7	$543.9	$148.7	$284.8	$26.6	$48.7	$9,358.4
1984	245.8	1,759.4	6,827.4	60.3	614.9	154.1	318.3	34.2	53.5	10,067.9
1985	253.7	1,867.8	7,919.5	64.1	700.4	131.3	271.3	35.1	60.7	11,303.7
1986	261.7	1,938.6	7,984.5	67.4	740.4	167.1	187.5	36.1	51.9	11,435.3
1987	241.5	2,012.9	8,055.0	60.0	706.6	158.2	40.8	34.5	60.7	11,370.3
1988	285.7	2,186.7	8,226.5	58.3	819.6	176.9	47.9	35.7	57.6	11,894.9
1989	275.8	2,396.6	8,505.5	60.0	869.6	153.9	75.7	39.9	66.2	12,443.3
1990	346.4	2,784.7	9,193.7	83.2	1,069.9	176.6	86.6	48.2	71.4	13,860.6
1991	385.9	3,374.0	9,946.9	89.1	1,233.6	176.1	91.8	70.8	88.9	15,457.1
1992	391.6	3,688.8	10,769.9	92.6	1,512.8	163.4	98.7	68.0	90.3	16,876.3
1993	439.5	4,072.4	11,572.6	97.8	1,557.9	157.9	70.1	70.8	97.3	18,136.3
1994	460.3	4,428.6	11,925.5	100.8	1,952.4	154.4	81.3	80.7	100.9	19,285.0
1995	591.1	4,984.8	12,082.8	102.7	2,399.0	171.0	119.2	119.0	104.6	20,674.2
1996	597.1	4,900.6	13,564.1	113.4	2,515.0	169.8	146.2	119.5	112.3	22,238.0
1997	585.7	5,107.7	13,310.0	122.3	2,741.2	176.8	174.1	116.1	114.0	22,447.9
1998	618.3	5,017.3	14,781.9	142.0	2,835.0	196.3	172.5	128.3	115.2	24,006.7
1999	618.3	5,412.6	15,093.7	144.3	2,973.9	220.1	159.7	131.8	128.7	24,883.2
2000	691.4	5,664.6	16,829.3	153.4	3,265.9	265.0	181.6	137.7	132.8	27,321.7
Average Growth Rate:	7.5%	7.8%	5.8%	6.7%	11.1%	3.5%	(2.6)%	10.2%	6.1%	6.5%

NOTES: Prior to fiscal year 1993, functional allocations are derived from agency expenditure amounts, organized by current functions, with adjustments for major program transfers (e.g., child care and employment services from the Department of Human Services to Texas Workforce Commission). Adjustments have also been made for items currently appropriated at the function level (including employee benefits, bond debt service, and revenue bond lease payments) which formerly had been allocated solely to the General Government function.

General Revenue–Dedicated Funds and General Revenue–Consolidated Funds are categorized as Other Funds for the purpose of this analysis.

SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

TABLE 6
GENERAL REVENUE FUNDS EXPENDITURES, BY FUNCTION
ADJUSTED FOR POPULATION GROWTH AND INFLATION

IN MILLIONS

YEAR	GENERAL GOVERNMENT	HEALTH AND HUMAN SERVICES	AGENCIES OF EDUCATION	THE JUDICIARY	PUBLIC SAFETY AND CRIMINAL JUSTICE	NATURAL RESOURCES	BUSINESS AND ECONOMIC DEVELOPMENT	REGULATORY	THE LEGISLATURE	ALL FUNCTIONS
1983	$202.3	$1,570.5	$6,482.2	$50.7	$543.9	$148.7	$284.8	$26.6	$48.7	$9,358.4
1984	231.4	1,656.3	6,427.2	56.8	578.9	145.0	299.7	32.2	50.4	9,477.7
1985	226.2	1,665.6	7,062.4	57.1	624.6	117.1	241.9	31.3	54.1	10,080.3
1986	223.7	1,657.0	6,824.5	57.6	632.9	142.9	160.3	30.9	44.3	9,774.0
1987	199.5	1,662.1	6,651.5	49.5	583.5	130.7	33.7	28.5	50.1	9,389.1
1988	225.8	1,728.1	6,501.2	46.0	647.7	139.8	37.9	28.2	45.5	9,400.2
1989	206.4	1,793.9	6,366.6	44.9	650.9	115.2	56.7	29.9	49.6	9,314.1
1990	243.6	1,958.0	6,464.1	58.5	752.2	124.2	60.9	33.9	50.2	9,745.5
1991	254.3	2,223.5	6,555.1	58.7	812.9	116.1	60.5	46.7	58.6	10,186.4
1992	246.4	2,321.5	6,777.7	58.3	952.1	102.8	62.1	42.8	56.9	10,620.6
1993	263.6	2,443.0	6,942.2	58.6	934.6	94.7	42.1	42.5	58.4	10,879.6
1994	264.3	2,543.1	6,848.1	57.9	1,121.1	88.7	46.7	46.4	57.9	11,074.3
1995	324.5	2,736.4	6,633.0	56.4	1,316.9	93.9	65.4	65.3	57.4	11,349.3
1996	313.1	2,569.7	7,112.6	59.5	1,318.8	89.0	76.7	62.6	58.9	11,660.9
1997	293.4	2,558.4	6,667.0	61.2	1,373.1	88.5	87.2	58.2	57.1	11,244.1
1998	298.2	2,419.8	7,129.3	68.5	1,367.3	94.7	83.2	61.9	55.6	11,578.5
1999	285.4	2,498.6	6,967.6	66.6	1,372.8	101.6	73.7	60.9	59.4	11,486.7
2000	303.1	2,483.7	7,378.9	67.3	1,432.0	116.2	79.6	60.4	58.2	11,979.3
Average Growth Rate:	2.4%	2.7%	0.8%	1.7%	5.9%	(1.4)%	(7.2)%	4.9%	1.1%	1.5%

NOTES: Prior to fiscal year 1993, functional allocations are derived from agency expenditure amounts, organized by current functions, with adjustments for major program transfers (e.g., child care and employment services from the Department of Human Services to Texas Workforce Commission). Adjustments have also been made for items currently appropriated at the function level (including employee benefits, bond debt service, and revenue bond lease payments) which formerly had been allocated solely to the General Government function.

General Revenue–Dedicated Funds and General Revenue–Consolidated Funds are categorized as Other Funds for the purpose of this analysis.

SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

TABLE 7
FEDERAL FUNDS EXPENDITURES, BY FUNCTION

IN MILLIONS YEAR	GENERAL GOVERNMENT	HEALTH AND HUMAN SERVICES	AGENCIES OF EDUCATION	THE JUDICIARY	PUBLIC SAFETY AND CRIMINAL JUSTICE	NATURAL RESOURCES	BUSINESS AND ECONOMIC DEVELOPMENT	REGULATORY	THE LEGISLATURE	ALL FUNCTIONS
1983	$9.7	$1,410.1	$618.9	0.0	$6.4	$15.6	$632.0	$0.3	0.0	$2,692.9
1984	20.9	1,500.7	633.9	0.0	5.4	17.6	898.9	2.2	0.0	3,079.5
1985	19.1	1,616.4	649.5	0.0	9.6	11.2	1,021.6	3.9	0.0	3,331.3
1986	26.4	1,692.5	758.1	0.0	12.3	16.8	1,312.6	4.2	0.0	3,822.9
1987	20.6	1,857.9	728.9	0.0	10.4	19.4	1,262.2	4.4	0.0	3,903.8
1988	28.5	2,073.3	894.4	0.0	7.7	17.9	1,352.8	2.6	0.0	4,377.2
1989	34.4	2,401.0	949.5	0.0	14.8	28.0	1,450.9	3.4	0.0	4,882.1
1990	50.1	3,049.4	1,013.1	0.0	21.8	24.7	1,567.4	6.2	0.0	5,732.7
1991	51.7	4,371.3	1,125.0	0.0	21.7	58.7	1,590.9	1.7	0.0	7,221.0
1992	143.0	4,718.5	1,261.9	0.0	49.3	83.2	1,564.4	1.6	0.0	7,821.9
1993	178.3	5,654.4	1,620.9	0.0	55.7	120.3	1,819.6	2.0	0.0	9,451.1
1994	139.7	6,402.3	1,556.8	0.0	48.5	172.0	1,982.9	2.4	0.0	10,304.4
1995	160.0	6,603.1	1,666.8	0.0	29.1	83.8	1,860.1	2.8	0.0	10,405.6
1996	173.6	7,060.6	1,920.5	0.0	30.4	95.4	2,074.2	2.0	0.0	11,356.9
1997	187.9	7,468.7	1,701.6	0.0	66.6	92.2	1,977.9	2.0	0.0	11,496.9
1998	212.0	7,594.4	2,105.4	0.0	124.4	95.6	2,183.4	2.4	0.0	12,317.7
1999	216.2	8,252.6	2,026.4	0.0	181.7	95.0	2,619.3	2.6	0.0	13,393.8
2000	255.8	8,554.2	2,300.0	0.0	190.2	109.6	2,987.0	2.6	0.0	14,399.5
Average Growth Rate:	21.2%	11.2%	8.0%	N/A	22.1%	12.2%	9.6%	12.8%	N/A	10.4%

NOTES: Prior to fiscal year 1993, functional allocations are derived from agency expenditure amounts, organized by current functions, with adjustments for major program transfers (e.g., child care and employment services from the Department of Human Services to Texas Workforce Commission). Adjustments have also been made for items currently appropriated at the function level (including employee benefits, bond debt service, and revenue bond lease payments) which formerly had been allocated solely to the General Government function.

SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

TABLE 8
FEDERAL FUNDS EXPENDITURES, BY FUNCTION
ADJUSTED FOR POPULATION GROWTH AND INFLATION

IN MILLIONS

YEAR	GENERAL GOVERNMENT	HEALTH AND HUMAN SERVICES	AGENCIES OF EDUCATION	THE JUDICIARY	PUBLIC SAFETY AND CRIMINAL JUSTICE	NATURAL RESOURCES	BUSINESS AND ECONOMIC DEVELOPMENT	REGULATORY	THE LEGISLATURE	ALL FUNCTIONS
1983	$9.7	$1,410.1	$618.9	0.0	$6.4	$15.6	$632.0	$0.3	0.0	$2,692.9
1984	19.7	1,412.7	596.7	0.0	5.1	16.5	846.2	2.0	0.0	2,898.9
1985	17.0	1,441.4	579.2	0.0	8.6	10.0	911.1	3.4	0.0	2,970.8
1986	22.5	1,446.6	648.0	0.0	10.5	14.4	1,121.9	3.6	0.0	3,267.5
1987	17.0	1,534.2	601.9	0.0	8.6	16.0	1,042.3	3.6	0.0	3,223.6
1988	22.6	1,638.5	706.8	0.0	6.1	14.2	1,069.1	2.1	0.0	3,459.2
1989	25.8	1,797.2	710.7	0.0	11.1	21.0	1,086.0	2.5	0.0	3,654.3
1990	35.2	2,144.0	712.3	0.0	15.3	17.4	1,102.1	4.4	0.0	4,030.7
1991	34.0	2,880.7	741.4	0.0	14.3	38.7	1,048.4	1.1	0.0	4,758.7
1992	90.0	2,969.5	794.1	0.0	31.0	52.4	984.5	1.0	0.0	4,922.5
1993	106.9	3,391.9	972.3	0.0	33.4	72.2	1,091.6	1.2	0.0	5,669.6
1994	80.2	3,676.5	894.0	0.0	27.8	98.7	1,138.6	1.4	0.0	5,917.2
1995	87.8	3,624.8	915.0	0.0	16.0	46.0	1,021.1	1.5	0.0	5,712.2
1996	91.0	3,702.3	1,007.1	0.0	16.0	50.0	1,087.6	1.1	0.0	5,955.2
1997	94.1	3,741.1	852.3	0.0	33.4	46.2	990.7	1.0	0.0	5,758.8
1998	102.2	3,662.8	1,015.5	0.0	60.0	46.1	1,053.0	1.2	0.0	5,940.8
1999	99.8	3,809.6	935.4	0.0	83.9	43.9	1,209.1	1.2	0.0	6,182.9
2000	112.1	3,750.7	1,008.5	0.0	83.4	48.1	1,309.7	1.1	0.0	6,313.6
Average Growth Rate:										
	15.5%	5.9%	2.9%	N/A	16.3%	6.9%	4.4%	7.5%	N/A	5.1%

NOTES: Prior to fiscal year 1993, functional allocations are derived from agency expenditure amounts, organized by current functions, with adjustments for major program transfers (e.g., child care and employment services from the Department of Human Services to Texas Workforce Commission). Adjustments have also been made for items currently appropriated at the function level (including employee benefits, bond debt service, and revenue bond lease payments) which formerly had been allocated solely to the General Government function.

SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

TABLE 9
OTHER FUNDS EXPENDITURES, BY FUNCTION

IN MILLIONS YEAR	GENERAL GOVERNMENT	HEALTH AND HUMAN SERVICES	AGENCIES OF EDUCATION	THE JUDICIARY	PUBLIC SAFETY AND CRIMINAL JUSTICE	NATURAL RESOURCES	BUSINESS AND ECONOMIC DEVELOPMENT	REGULATORY	THE LEGISLATURE	ALL FUNCTIONS
1983	$83.1	$22.0	$486.3	$3.8	$137.2	$50.8	$888.4	$44.6	0.0	$1,716.1
1984	98.5	19.7	540.9	1.4	119.3	73.0	684.7	55.4	0.0	1,592.8
1985	99.8	22.6	605.2	0.1	130.2	89.6	803.6	63.2	0.0	1,814.4
1986	111.5	30.7	842.7	2.3	156.5	75.1	1,527.6	68.8	0.0	2,815.2
1987	124.5	47.6	832.6	9.7	213.2	115.1	1,722.1	76.6	0.1	3,141.5
1988	142.5	58.4	937.3	14.0	250.2	111.4	1,963.3	100.5	0.2	3,577.8
1989	226.2	64.3	996.2	15.6	306.0	120.2	1,738.8	108.6	2.2	3,578.1
1990	265.9	98.9	1,036.3	14.2	309.5	180.8	1,755.9	116.7	1.8	3,780.0
1991	332.5	257.0	1,275.2	12.3	740.6	202.7	1,621.6	104.7	1.6	4,548.3
1992	357.4	261.5	1,398.4	17.0	372.8	345.9	1,806.9	106.8	2.5	4,669.3
1993	320.5	323.6	1,611.5	16.7	948.4	319.7	2,311.4	115.2	1.5	5,968.4
1994	319.7	238.1	1,813.9	22.9	1,009.9	422.0	2,238.5	106.8	3.2	6,175.1
1995	188.9	325.8	1,645.5	20.0	824.2	535.9	2,308.9	73.8	1.4	5,924.4
1996	215.8	291.9	2,042.4	20.4	496.2	526.0	2,722.2	75.1	1.6	6,391.6
1997	155.9	274.3	2,185.2	13.1	452.0	490.1	2,531.6	75.1	0.9	6,178.0
1998	154.2	296.7	2,352.3	15.4	480.4	520.9	2,790.6	78.2	1.4	6,690.1
1999	252.2	295.5	2,385.6	25.7	610.5	533.7	2,819.1	77.5	1.3	7,001.2
2000	236.4	354.2	2,816.4	32.8	529.4	562.4	3,116.2	82.2	1.7	7,731.7
Average Growth Rate:	6.3%	17.8%	10.9%	13.6%	8.3%	15.2%	7.7%	3.7%	N/A	9.3%

NOTES: Prior to fiscal year 1993, functional allocations are derived from agency expenditure amounts, organized by current functions, with adjustments for major program transfers. Adjustments have also been made for items currently appropriated at the function level (including employee benefits, bond debt service, and revenue bond lease payments) which formerly had been allocated solely to the General Government function.
General Revenue–Dedicated Funds and General Revenue–Consolidated Funds are categorized as Other Funds for the purpose of this analysis.

SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

TABLE 10
OTHER FUNDS EXPENDITURES, BY FUNCTION
ADJUSTED FOR POPULATION GROWTH AND INFLATION

IN MILLIONS

YEAR	GENERAL GOVERNMENT	HEALTH AND HUMAN SERVICES	AGENCIES OF EDUCATION	THE JUDICIARY	PUBLIC SAFETY AND CRIMINAL JUSTICE	NATURAL RESOURCES	BUSINESS AND ECONOMIC DEVELOPMENT	REGULATORY	THE LEGISLATURE	ALL FUNCTIONS
1983	$83.1	$22.0	$486.3	$3.8	$137.2	$50.8	$888.4	$44.6	0.0	$1,716.1
1984	92.7	18.5	509.2	1.3	112.3	68.7	644.6	52.2	0.0	1,499.5
1985	89.0	20.1	539.7	0.1	116.1	79.9	716.6	56.3	0.0	1,618.0
1986	95.3	26.3	720.3	1.9	133.8	64.2	1,305.6	58.8	0.0	2,406.2
1987	102.8	39.3	687.5	8.0	176.0	95.1	1,422.0	63.2	0.0	2,594.1
1988	112.6	46.1	740.8	11.1	197.7	88.0	1,551.6	79.4	0.1	2,827.5
1989	169.3	48.2	745.7	11.6	229.0	90.0	1,301.5	81.3	1.6	2,678.3
1990	187.0	69.5	728.6	10.0	217.6	127.2	1,234.6	82.0	1.2	2,657.7
1991	219.1	169.4	840.3	8.1	488.0	133.6	1,068.7	69.0	1.0	2,997.3
1992	224.9	164.5	880.1	10.7	234.6	217.7	1,137.1	67.2	1.6	2,938.5
1993	192.2	194.1	966.7	10.0	568.9	191.8	1,386.6	69.1	0.9	3,580.3
1994	183.6	136.7	1,041.6	13.1	580.0	242.3	1,285.4	61.3	1.9	3,546.0
1995	103.7	178.8	903.3	11.0	452.4	294.2	1,267.5	40.5	0.8	3,252.3
1996	113.1	153.0	1,070.9	10.7	260.2	275.8	1,427.4	39.4	0.8	3,351.5
1997	78.1	137.4	1,094.6	6.5	226.4	245.5	1,268.1	37.6	0.4	3,094.6
1998	74.4	143.1	1,134.5	7.4	231.7	251.2	1,345.9	37.7	0.7	3,226.6
1999	116.4	136.4	1,101.3	11.9	281.8	246.4	1,301.4	35.8	0.6	3,231.9
2000	103.6	155.3	1,234.8	14.4	232.1	246.6	1,366.3	36.1	0.7	3,390.0
Average Growth Rate:	1.3%	12.2%	5.6%	8.2%	3.1%	9.7%	2.6%	(1.2)%	N/A	4.1%

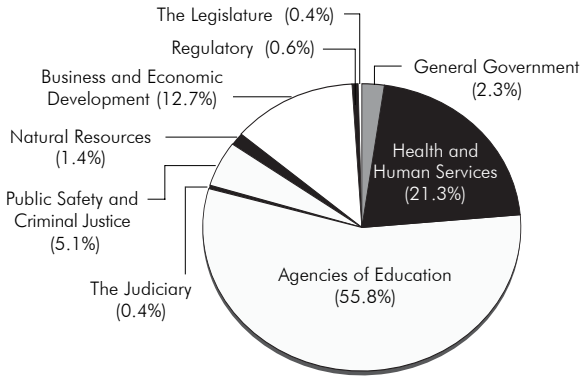
NOTES: Prior to fiscal year 1993, functional allocations are derived from agency expenditure amounts, organized by current functions, with adjustments for major program transfers. Adjustments have also been made for items currently appropriated at the function level (including employee benefits, bond debt service, and revenue bond lease payments) which formerly had been allocated solely to the General Government function.
General Revenue–Dedicated Funds and General Revenue–Consolidated Funds are categorized as Other Funds for the purpose of this analysis.

SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

FIGURE 2
ALL FUNDS EXPENDITURES, BY FUNCTION
ADJUSTED FOR POPULATION GROWTH AND INFLATION

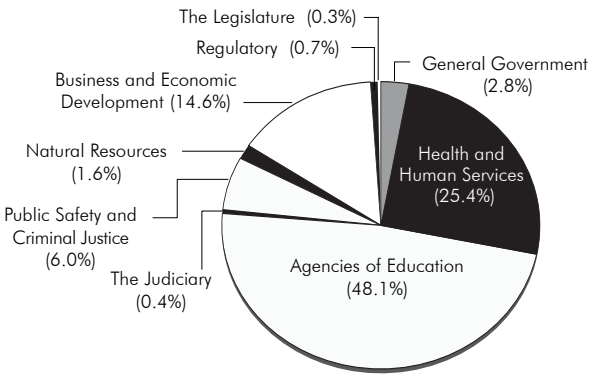
FISCAL YEAR 1985

TOTAL = $14,669.1



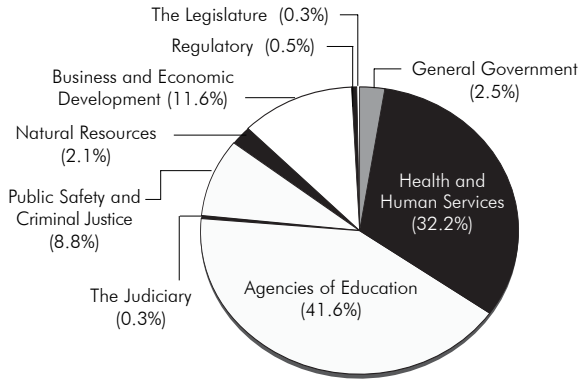
FISCAL YEAR 1990

TOTAL = $16,433.9



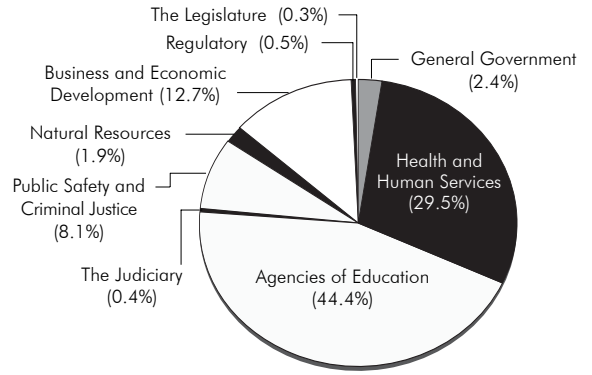
FISCAL YEAR 1995

TOTAL = $20,313.8



FISCAL YEAR 2000

TOTAL = $21,682.9

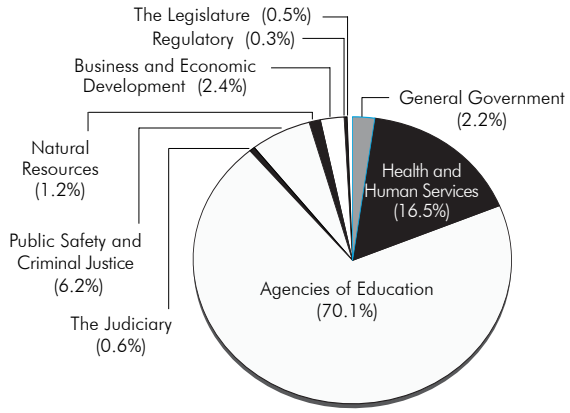


SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

FIGURE 3
GENERAL REVENUE FUNDS EXPENDITURES, BY FUNCTION
ADJUSTED FOR POPULATION GROWTH AND INFLATION

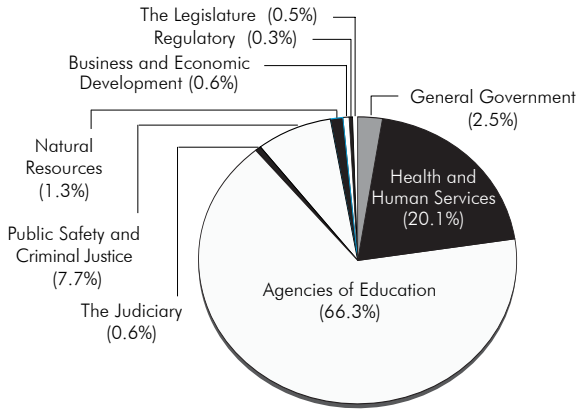
FISCAL YEAR 1985

TOTAL = $10,080.3



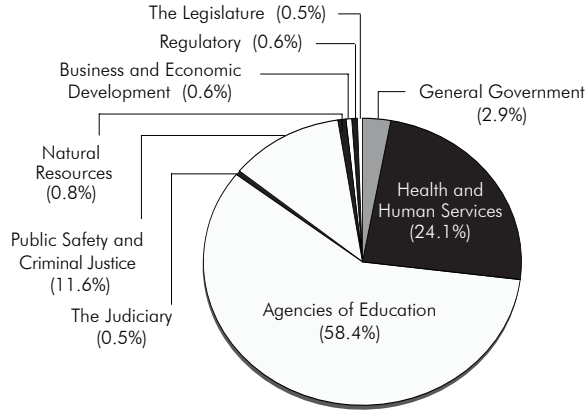
FISCAL YEAR 1990

TOTAL = $9,745.5



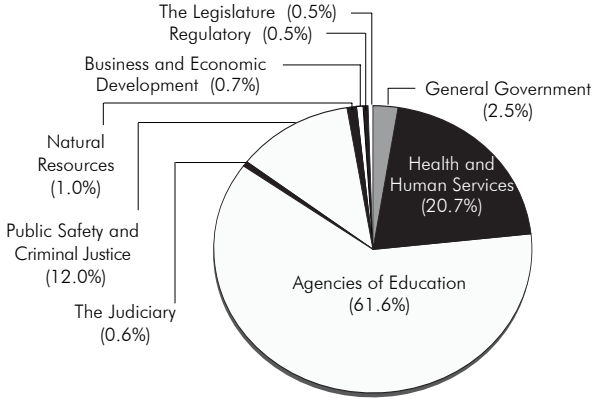
FISCAL YEAR 1995

TOTAL = $11,349.3



FISCAL YEAR 2000

TOTAL = $11,979.3



SOURCE: Legislative Budget Board *(Legislative Budget Estimates, Fiscal Size-up)*.

Benefit and Coverage Options under Medicaid and the Children's Health Insurance Program

Through state plan amendment or federal waivers, states can seek flexibility to reduce benefits, increase cost sharing, expand coverage, and use employer-sponsored insurance in both Medicaid and the Children's Health Insurance Program. Facing a biennium of potential shortfalls throughout health and human services programs, the State of Texas may examine these options for potential cost savings.

Significant Findings

- Texas spent an estimated $1.8 billion (All Funds) including $728.3 million in General Revenue Funds in fiscal year 2002 to provide Medicaid benefits considered optional by the federal government. Prescription drugs and intermediate care facilities for persons with mental retardation accounted for 83 percent of these expenditures.
- When cost effective, the Health Insurance Premium Payment Program pays for employer-based health coverage for Medicaid recipients. On average, the program can save the state $2 for every $1 expended.
- A federal Health Insurance Flexibility and Accountability waiver can provide flexibility in restructuring benefits and utilizing employer-sponsored insurance in Medicaid and the Children's Health Insurance Program.

Significant Concerns

- Dental benefits are optional under the Children's Health Insurance Program and accounted for an estimated $142.0 million in All Funds expenditures in the 2002–03 biennium.
- Prescription drugs are optional under the Children's Health Insurance Program and accounted for an estimated $71.0 million in All Funds expenditures in the 2002–03 biennium.
- The cost-sharing requirements in the Texas Children's Health Insurance Program are less than the amounts allowed under federal law.
- The Health Insurance Premium Payment program had only 2,900 participants as of September 2002. A 2 percent enrollment of Medicaid and Children's Health Insurance Program recipients could result in an estimated cost-avoidance of $34.7 million in General Revenue Funds.
- Medicaid savings related to expansion of the Health Insurance Premium Payment Program were projected to be $3.2 million in General Revenue Funds for the 2002–03 biennium. Actual savings total $0.5 million in General Revenue Funds as of December 2002.
- An employer-sponsored insurance program within the Children's Health Insurance Program, authorized by the Seventy-seventh Legislature, 2001, has not been implemented.

Recommendations

- **Recommendation 1:** The Legislature should examine optional benefits and the scope of benefits in Medicaid and the Children's Health Insurance Program, as well as cost sharing in the Children's Health Insurance Program when making budget decisions.

- **Recommendation 2:** The Health and Human Services Commission should consider the use of a federal waiver to restructure healthcare packages for appropriate groups and use employer-sponsored insurance to avoid costs in Medicaid and the Children's Health Insurance Program.
- **Recommendation 3:** The Health and Human Services Commission should expand the Health Insurance Premium Payment Program in Medicaid and the Children's Health Insurance Program by establishing a less stringent, uniform cost-effectiveness test.

COMMENTS

Texas delivers healthcare to the needy through Medicaid and the Children's Health Care Insurance Program (CHIP). Medicaid and CHIP are partnerships between the federal government and the states, with the amount of state match determined by the Federal Medical Assistance Percentage (FMAP) for Medicaid or Enhanced Federal Medical Assistance Percentage (EFMAP) for CHIP. The FMAP and EFMAP fluctuate slightly each year. In fiscal year 2002, the FMAP was 60.17 percent and the state share was 39.83 percent, and the EFMAP was 72.12 percent and the state share was 27.88 percent. Medicaid is an entitlement program, but CHIP is not. In an entitlement program, a state must provide coverage to any person who meets the eligibility requirements. For the 2002–03 biennium, appropriations to Medicaid totaled approximately $25.2 billion in All Funds and $10.0 billion in General Revenue Funds. For CHIP, appropriations totaled $942.2 million in All Funds and $283.1 million in General Revenue Funds.

MEDICAID

If a state elects to offer Medicaid services, certain groups must be provided health insurance coverage (the mandatory population) that covers certain basic services (mandatory benefits). States may also receive federal funding for optional populations and optional services. Extending coverage to more individuals through waivers (expansion populations) can also be proposed. Table 1 summarizes the mandatory and optional groups.

TABLE 1
MEDICAID MANDATORY AND OPTIONAL GROUPS IN TEXAS

MEDICAID MANDATORY POPULATIONS

- Children under 6 years old and Pregnant Women (up to 133% Federal Poverty Level (FPL))
- Children ages 6 –18 (up to 100% FPL)
- Aged, Blind, and Disabled (Supplemental Security Income (SSI))
- Temporary Assistance for Needy Families (TANF) Recipients
- Those losing TANF due to increased Child Support (4 months of coverage)
- Those losing TANF due to increased earnings (12 months of coverage)
- Eligible Children in Foster Care and Adoption Assistance

MEDICAID OPTIONAL POPULATIONS

CATEGORICALLY NEEDY

- Pregnant Women and Infants (between 133 and 185% FPL)
- Aged, Blind, and Disabled (between SSI limit and 300% of SSI benefit rate)
- Low Income, Uninsured Women Diagnosed with Cancer
- Disabled Returning to Work
- Persons Ages 18 – 24 Transitioning from Foster Care

MEDICALLY NEEDY

- Pregnant women and children with medical expenses that spend down income to below 300% of TANF maximum grant

WAIVER CLIENTS

SOURCE: Legislative Budget Board.

BENEFITS

Federal Medicaid law gives a state many options in terms of restructuring the optional benefit package. The mandatory population's optional benefits may be changed by state plan amendment. Such a restructuring cannot apply to children since the state must provide all medically necessary services to children. If a state provides an optional service, it must provide the service to all "categorically needy groups." The "categorically needy" group shares characteristics of the mandatory group but has less restrictive eligibility criteria. The "medically needy" group's income excludes them from eligibility; however, they are allowed to "spend down" to eligibility limits by deducting medical expenses from their income. The "medically needy" group may be provided a more limited benefit package than the categorically needy group.

The state expended $1.8 billion (All Funds) including $728.3 million in General Revenue Funds for optional services in fiscal year 2002. Table 2 shows a breakout of the costs associated with these optional benefits. As shown in Figure 1, prescription drugs and intermediate care facilities for persons with mental retardation account for 83 percent of these costs.

States may limit the scope of any service except medically necessary services delivered to children. Limits on hospital stays and prescription drugs are common state strategies. Texas limits inpatient hospital stays to a 30-day annual limit per episode of illness. Medicaid will cover more than one 30-day hospital visit per year if the stays are separated by 60 or more consecutive days.

In Texas, fee-for-service participants (those who receive healthcare outside of a managed care arrangement) have a three-prescription limit on drugs per month. Children, nursing facility residents, pregnant women, managed care participants, and waiver clients have unlimited prescriptions. Prescription drugs accounted for 44 percent of the spending for optional services in fiscal year 2002 (see Figure 1). The state is allowed to cap managed-care participants' access to prescriptions, to further reduce the monthly cap for fee-for-service participants or to expand managed care.

COST SHARING

Federal law allows nominal cost sharing for all Medicaid groups except children, pregnant women, and persons receiving hospice care. Per federal law, emergency services and family planning services are not subject to cost sharing. On October 11, 2002, the Health and Human Services Commission (HHSC) published a rule in the *Texas Register* which increased cost sharing for all groups except children, pregnant women, individuals living in institutions, and individuals receiving hospice services. The new copayments will include a $3 copayment for non-emergency visits to the emergency room, a $0.50 copayment on generic medications, and a $3 copayment for brand-name medicines. The copayment collected cannot exceed $8 per month per person, and providers cannot refuse service to those who are unable to pay. As of December 2002, litigation has delayed the effective date.

For fiscal year 2003, HHSC estimates a $200,000 General Revenue Fund reduction for each 1 percent reduction in emergency room use; the estimated savings doubled for the 2004–05 biennium. For medication copayments in fiscal year 2003, HHSC estimates a $1.4 million General Revenue Fund reduction for each 1 percent redirection away from brand-name drugs and a $3.3 million General Revenue Fund reduction in provider reimbursements. For the 2004–05 biennium, the reductions are $3.6 million and $8.9 million, respectively.

CHILDREN'S HEALTH INSURANCE PROGRAM (CHIP)

CHIP (Title XXI of the Social Security Act) was authorized in the Balanced Budget Reconciliation Act of 1997, and is the largest expansion of health insurance coverage for children since the Medicaid program. CHIP serves children with family income below 200 percent of the federal poverty level (FPL),

TABLE 2
ESTIMATED EXPENDITURES OF MEDICAID OPTIONAL SERVICES

IN MILLIONS OPTIONAL SERVICE	FISCAL YEAR 2002 GENERAL REVENUE EXPENDITURE
Intermediate Care Facilities for the Mentally Retarded Services	$310.9
Prescription Drugs	291.5
Day Activity and Health Services	31.3
Hospice Services	31.1
Mental Health Rehabilitative Services	16.1
Licensed Medical Social Worker Advanced Clinical Practitioner Services	12.4
Ambulatory Surgical Centers	11.0
Institutions for Mental Disease (over 65)	4.2
Vision Care (optometrist, eyeglasses, etc.)	4.0
Targeted Case Management for Mental Health/Mental Retardation Clients	3.2
Licensed Professional Counselors	2.9
Certified Nurse Anesthetist Services	2.9
Psychologist Services	1.9
Podiatrist Services	1.7
Advanced Practice Nurse	1.2
Targeted Case Management for Pregnant Woman and Infants	0.7
In-home Total Parenteral Hyperalimentation	0.7
Hearing Aids	0.6
Chiropractic Services	0.3
Physical Therapist Services	0.3
Maternity Clinics	0.1
Birthing Centers/Maternity Clinics	<0.1
Respiratory Therapists	<0.1
Tuberculosis Clinic Services	<0.1
TOTAL	**$728.3**

NOTE: Does not include expenditures related to children.
SOURCE: Health and Human Services Commission.

which equated to $36,200 gross annual income for a family of four in calendar year 2002.

BENEFITS

A state has a great deal of flexibility in designing its CHIP benefit package. Health coverage must include four basic services: inpatient/outpatient hospital services, laboratory and x-rays, physician services, and well-baby/well-child care. The package can offer additional services such as prescription drugs, vision services, and mental health. The Texas CHIP program offers many additional services.

States may seek federal approval using one of three benchmarks (see Figure 2). Texas selected a benefits package that was the actuarial equivalent to the health maintenance organization (HMO) plan offered to state employees, which is also the HMO with the largest enrollment in Texas. According to the actuarial study required as a supplement to the state plan, the actuarial value of the CHIP benefit package exceeds that of the state HMO.

Under the actuarial equivalent option, if the HMO plan offers prescription drugs, vision services, or mental health benefits, the CHIP package must cover 75 percent of the value of these benefits under the HMO. Prescription drugs are available to CHIP participants without a cap and account for an estimated 10 percent of the total benefit package. The drug benefit is carved out of the HMO capitation rate. Within the actuarial equivalent option, this benefit could be limited. Dental benefits are not offered through the state HMO and account for approximately 20 percent of CHIP expenditures. Expenditures for dental benefits are estimated to be $142.0 million (All Funds) for the 2002–03 biennium.

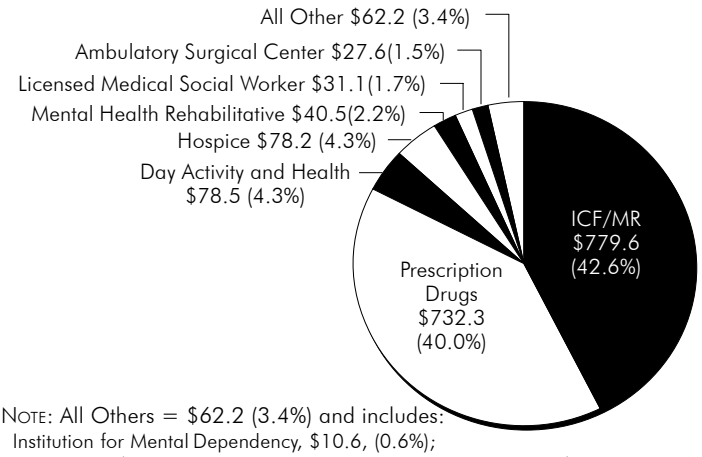
COST SHARING

CHIP allows an enrollment fee and cost sharing for both premiums and copayments based on family income (Table 3). Funds collected from cost sharing are deposited in the state treasury. Federal law caps the amount of premiums and copayments for families with incomes at or below 150 percent FPL at the same level as the Medicaid "medically needy." The

FIGURE 1
ESTIMATED ALL FUNDS EXPENDITURES OF MEDICAID OPTIONAL SERVICES
FISCAL YEAR 2002

IN MILLIONS

TOTAL ALL FUNDS = $1.8 BILLION



NOTE: All Others = $62.2 (3.4%) and includes: Institution for Mental Dependency, $10.6, (0.6%); Vision Care $10.0 (0.5%); Targeted Case Management–MHMR $8.0 (0.4%); Licensed Professional Counselors $7.3 (0.4%); Certified Nurse Anesthetists' Services $7.2 (0.4%); Psychologists $4.7 (0.3%); Podiatrists $4.2 (0.2%); Advanced Practice Nurse $3.0 (0.2%); Targeted Case Management–PWI $1.8 (0.1%); In Home Total Parenteral Hyperalimentation $1.8 (0.1%); Hearing Aids $1.6 (0.1%); Chiropractic $0.8 <(0.1%); Physical Therapists $0.8 <(0.1%); Maternity Clinics $0.3 <(0.1%); Birthing Center/Maternity Clinic <$0.1 <(0.1%); Respiratory Therapists <$0.1 <(0.1%); TB Clinic <$0.1 <(0.1%).

SOURCE: Legislative Budget Board.

state may not require this group to pay premiums exceeding $19 for a family of one or two persons, $16 for a family of three or four persons, and $15 for larger families. Nominal copayments may be charged. For families with incomes above 150 percent FPL, premiums, deductibles, and copayments must not exceed 5 percent of the family's annual income. As shown in Table 3, Texas would have some flexibility in adjusting its cost-sharing requirements.

In making budget decisions, the Legislature has options in addition to eligibility reductions in Medicaid and CHIP. Changes in optional benefits, the scope of benefits, and cost sharing could be accomplished through state plan amendments (Recommendation 1).

HEALTH INSURANCE FLEXIBILITY AND ACCOUNTABILITY DEMONSTRATION INITIATIVE

Sections 1115 and 1915(b) and (c) of the Social Security Act provide a mechanism for states to significantly restructure Medicaid and CHIP programs. 1115 waivers allow states to test new policy. Federal 1915(b) waivers allow states to waive certain requirements of federal law such as freedom of choice in selecting a medical provider or the requirement to provide medical services statewide. Such waivers provide states with opportunities to test innovative approaches to delivering health services. Waivers must be budget neutral to the federal government.

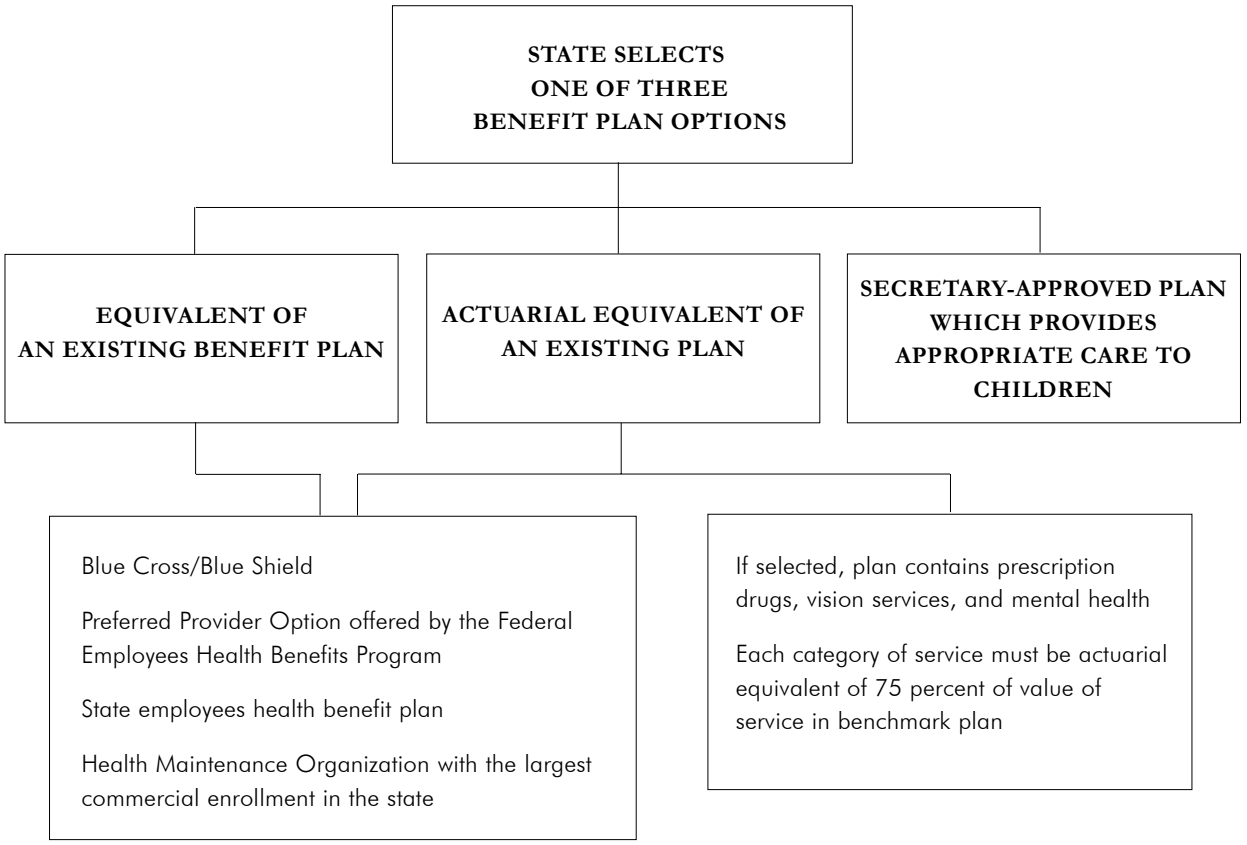
On August 4, 2001, the Centers for Medicare and Medicaid Services (CMS) unveiled the Health Insurance Flexibility and Accountability (HIFA) Demonstration Initiative, which is a new 1115 waiver for the Medicaid program and CHIP. This waiver appears to be the most flexible of the 1115 waivers. The purpose of the initiative is to reduce the number of uninsured persons by expanding health insurance coverage through these programs. While not offering additional federal funds, HIFA provides states with the option to finance healthcare coverage to additional low income populations with savings from providing a more limited benefit package to existing client groups or with savings from increased client cost sharing.

BENEFITS

The degree to which a state may modify benefit packages depends on whether federal law mandates coverage. Table 4 summarizes the benefits under the various programs.

Under HIFA, a state may provide a more limited package than currently provided to CHIP clients or optional

FIGURE 2
BENEFIT PLAN OPTIONS FOR THE CHILDREN'S HEALTH INSURANCE PROGRAM



Source: Legislative Budget Board.

populations. States may also provide a basic primary care package (e.g., services provided by a general practitioner) to expansion populations. Figure 3 summarizes the options available in terms of benefits and cost sharing. A limited benefit package may be appropriate for some optional populations such as CHIP, the "medically needy," and TANF transitional. States may also design packages tailored to the needs of the group at issue. States must weigh the benefits from using the savings to expand health coverage to more individuals against the disadvantages of reducing benefit packages to others. HHSC should examine waivers as a means to save costs by restructuring benefits (Recommendation 2).

For example, through an 1115 waiver, Utah extended Medicaid coverage to persons age 19 and above with incomes up to 150 percent FPL and high risk pregnant women who have assets exceeding state limits. CMS approved Utah's waiver in February 2002. Utah achieves budget neutrality through the reduction in benefits to current mandatory and optional Medicaid recipients. Specifically, the expansion group receives a benefit package that includes primary and preventive care, but excludes inpatient hospital or long-term care services. TANF parents transitioning to employment and optional adults in the "medically needy" category receive fewer benefits comparable to benefits under Utah's CHIP. Benefit reductions include limits on the

TABLE 3
COST SHARING IN THE
CHILDREN'S HEALTH INSURANCE PROGRAM

BENEFIT	FEDERAL POVERTY LEVEL: AT OR BELOW 100 PERCENT	101–150 PERCENT	151–185 PERCENT	186–200 PERCENT
TEXAS PRACTICE				
Annual enrollment fee per family	$0	$15	$15	$18
Monthly premium per family	0	0	15	18
Office visit	0	2	5	10
Emergency room	3	5	50	50
Generic drug	0	0	5	5
Brand drug	3	5	20	20
State copayment cap	100	100	5 percent of annual income	5 percent of annual income
Deductible, noninstitutional	0	0	0	0
Deductible, institutional	0	0	0	0
Facility copayment, inpatient	0	25	50	100
Facility copayment, outpatient	0	0	0	0
FEDERAL MAXIMUM COST SHARING	Premium $15–$19 depending on family size nominal copayments	Premium $15–$19 depending on family size nominal copayments	5 percent of annual income	5 percent of annual income

SOURCE: Legislative Budget Board.

number of visits to physical therapists, chiropractors, and psychiatrists and dental, vision, and speech benefits. Non-emergency medical transportation is no longer covered, and the "medically needy" group pays a $50 annual enrollment fee.

COST SHARING

A state also has more flexibility in cost sharing. While the nominal levels remain in place for the mandatory populations, optional Medicaid recipients and CHIP children are limited to 5 percent of annual income. There is no cap for other expansion groups, such as parents of CHIP children.

Other factors to consider in the development of a HIFA waiver include the following:

- Waivers must have statewide application.
- Benefits should be integrated with private insurance.
- Waivers must be budget neutral in terms of federal expenditures over the five-year life of the demonstration.
- States must not supplant existing state-only financed health service expenditures.
- The number of persons at or below 200 percent of the FPL with health insurance must increase. Waivers affecting high-income populations will still be considered.
- More comprehensive waivers that include both Medicaid and CHIP populations within the waiver request will be given priority.

TABLE 4
COMPARISON OF BENEFIT PACKAGES OF VARIOUS PROGRAMS

MEDICAID MANDATORY BENEFITS	SELECTED TEXAS MEDICAID OPTIONAL BENEFITS	TEXAS CHIP BENEFITS	SECRETARY-APPROVED PLAN FOR OPTIONAL GROUPS
Inpatient/outpatient hospital services		Inpatient/outpatient hospital services	Inpatient/outpatient hospital services
Laboratory and x-rays	Emergency care	Laboratory and x-rays Emergency care	Laboratory and x-rays
Physician services		Physician services	Physician services
Rural health clinic services	Surgery	Surgery	
Early and Periodic Screening, Diagnosis, and Treatment (EPSDT includes all "medically necessary" services to those under age 21)		Well-baby/well-child care	Well-baby /well-child care
Pediatric and family nurse Practitioners service			
Prenatal care Nurse-midwife services	Prescription drugs	Prescription drugs	
Family planning services	Vision services/glasses	Vision screening/glasses Dental services	
	Psychology (limited)	Mental health and substance abuse treatment	
	Rehabilitation for chronic medical conditions	Habilitation/rehabilitation services	
	Intermediate care facilities for mentally retarded		
Nursing facility services	Home/community-based services		
Home healthcare for eligible persons (includes durable medical equipment)		Home healthcare Durable medical equipment	
Certain Federally-qualified Ambulatory and Health Center services			

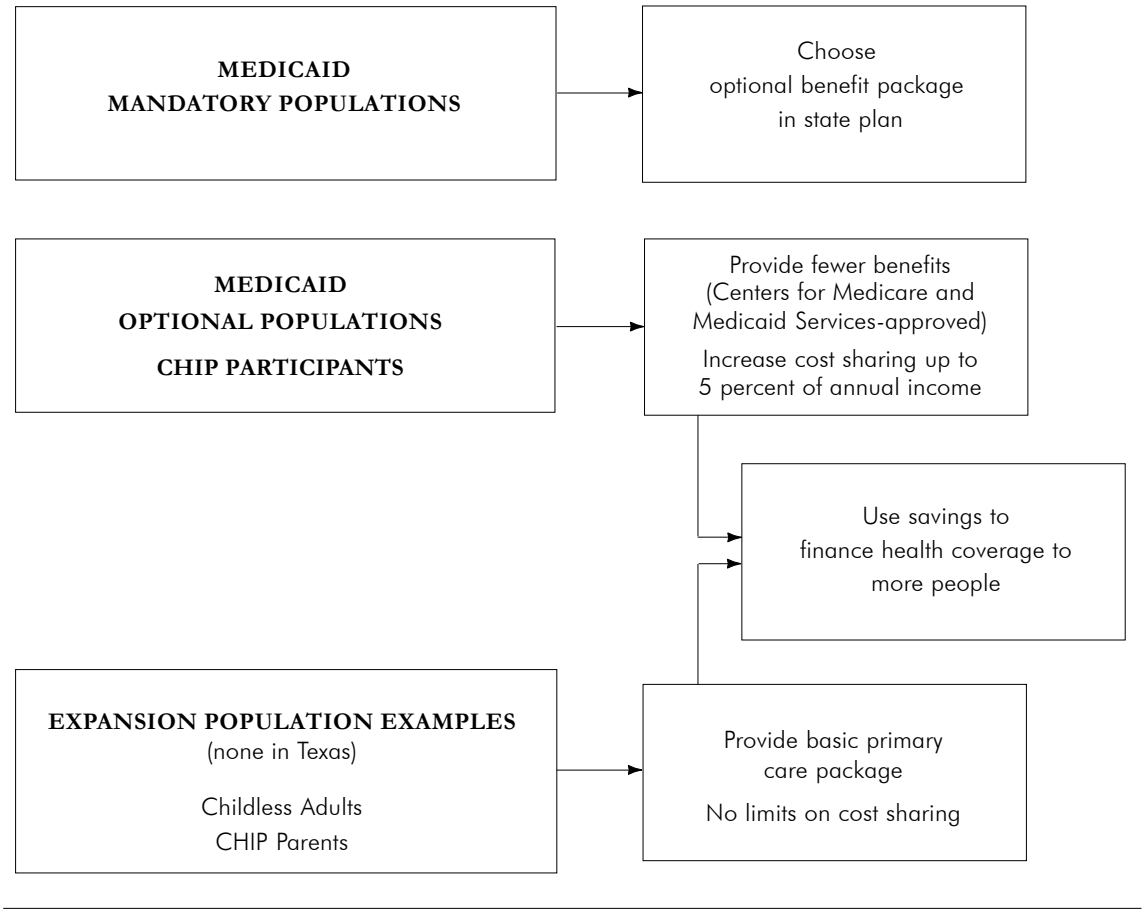
SOURCE: Legislative Budget Board.

INTEGRATION WITH PRIVATE INSURANCE

Medicaid and CHIP funds can be used to subsidize employer-based insurance for children and their families. Under this approach, a family would have private insurance with comparable benefits to CHIP or Medicaid, and the employer's contribution would reduce the state's cost. The employer would gain a healthier and more productive workforce. This integration with private insurance is weighed in the HIFA approval process.

Subsidizing employer-based insurance appears to be particularly promising as a means to save costs. Texas has experience in such a program. The Health Insurance Premium Payment (HIPP) program pays the premium for private insurance for Medicaid clients if

FIGURE 3
ALLOWABLE PROGRAMMATIC OPTIONS FOR
HEALTH INSURANCE FLEXIBILITY AND ACCOUNTABILITY DEMONSTRATION



SOURCE: Legislative Budget Board.

such action is determined to be cost effective. The state test for cost effectiveness is shown is Figure 4.

Though in operation since September 1, 1994, HIPP's current enrollment is minimal. House Bill 3038 of the Seventy-seventh Legislature, 2001, enacted two changes to facilitate enrollment. Upon a determination of cost effectiveness, a child's eligibility for CHIP or Medicaid benefits is contingent upon his or her enrollment in the respective premium assistance program. Secondly, the issuer of a group health insurance plan may enroll a HIPP participant in the group plan without regard to enrollment period restrictions.

As of October 2002, current enrollment is approximately 2,900, compared to a Medicaid population of 2.1 million participants. There were 1,133 employers participating in HIPP including several state agencies. The average premium cost per family is $134, and administrative costs are $30 per family. On average, for every dollar that the state pays, $2 in costs are avoided through HIPP. According to HHSC, an estimated $3,668 per family per year, on average, are

FIGURE 4
STATE TEST FOR COST-EFFECTIVENESS FOR MEDICAID HEALTH INSURANCE PREMIUM PAYMENT PROGRAM

IF
Cost for services under the private plan (adjusted for percentage of services covered by Medicaid)

+
Administrative costs

<
Medicaid cost for these services

Then
Employer-based insurance is cost-effective.

SOURCE: Legislative Budget Board.

avoided. Assuming similar levels of cost avoidance, a 2 percent enrollment of the Medicaid and CHIP caseloads into a premium payment program would result in an estimated cost avoidance of $28.9 million (General Revenue) in Medicaid and $5.8 million (General Revenue) in CHIP.

HIPP appears to offer an opportunity for cost savings, but it is underutilized. Iowa, for example, saved $19 million in 2000. Iowa has 8,000 participants in its HIPP program out of 650,000 clients enrolled in the Iowa Medicaid program. HHSC should expand enrollment in premium assistance programs under Medicaid and CHIP (Recommendation 3). Medicaid or CHIP cases that involve a court order or private medical support and TANF recipients transitioning to work appear to be likely targets for HIPP enrollment.

The Seventy-seventh Legislature, 2001, authorized expansion of HIPP; Medicaid savings for the strategy were projected to be $3.2 million in General Revenue Funds for the 2002–03 biennium. The actual savings have been $0.5 million in General Revenue Funds.

House Bill 3038 also authorized a similar health insurance premium payment reimbursement program within CHIP. HHSC has not yet implemented such a program within CHIP, but it has begun researching the use of HIFA waivers to accomplish this.

Two aspects of HIFA waiver proposal merit further discussion: a cost-effectiveness test and insuring additional populations.

COST EFFECTIVENESS

Under federal CHIP law, the cost-effectiveness test weighs the cost of insuring one child under employer-sponsored insurance against the cost of insuring one child under CHIP. If the private plan has the same premium for large and small families, it is unlikely small families could satisfy the cost-effectiveness test.

Under HIFA, a state is not required to meet a specific cost-effectiveness test. The aggregate cost of the premium assistance program must not be more than the cost under Medicaid or CHIP. States may use one simplified cost-effectiveness test in Medicaid and CHIP premium assistance.

INCREASING THE NUMBER OF PERSONS WITH HEALTH INSURANCE

CMS has approved waivers extending coverage to as few as 27,000 parents. The minimum number of people to receive new coverage is not defined. There does not seem to be a floor on the number of new persons extended health insurance coverage. The avoidance of a waiting list appears to be an expansion of coverage to those who would not have had health coverage but for the waiver. Further, the dollars saved from the waiver do not appear to have to equal expenditures for the expansion.

CONCLUSION

Both the Medicaid and CHIP benefit packages offer optional benefits that could be capped or removed. Federal waivers offer states more options including

a restructuring of benefit packages and increased cost sharing.

The Texas Legislature has directed the HHSC to expand HIPP, Texas' version of an employer-sponsored insurance subsidy program. The current enrollment in Medicaid HIPP is only 0.1 percent of the Medicaid population, and a similar program for CHIP has not been implemented. A HIFA waiver could be a mechanism to expand this program through use of a simplified cost-effectiveness test. The savings could be used to address growth in the number of applications for Medicaid and CHIP benefits.

BEST PRACTICES: THE TEXAS BEGINNING EDUCATOR SUPPORT SYSTEM

This report was first issued in February 2002. It reviews the Texas Beginning Educator Support System's performance for the program's first two years. The University of Texas at Austin Dana Center and the State Board for Educator Certification have addressed the first concern and recommendation related to how the program is to be evaluated. The remaining concerns and recommendations have not been fully addressed as of December 2002.

A 1997 study by the National Center for Education Statistics showed that about 20 percent of new teachers leave the profession within their first three years. A Texas Center for Educational Research report noted a more significant pattern among teachers in this state: a 19 percent attrition rate for first-year teachers, and an overall 43 percent attrition rate for teachers in their first three years. This study also pointed out that the current annual turnover rate of 15 percent for all teachers costs Texas school districts several hundred million dollars a year in hiring and training resources (Texas Center for Education Research, 2000).

The Texas Beginning Educator Support System (TxBESS) tries to address the issue by working with school districts, regional education service centers, and institutions of higher education to provide new teachers with a support system for their first and second years. Using a $10 million, three-year federal grant, the State Board for Educator Certification (SBEC) has developed program standards for TxBESS mentoring activities; allocated funds to regional education service centers for the training and support of beginning teachers, mentors, and university faculty; and created an evaluation instrument that mentors and new teachers can use to identify areas for classroom teaching improvement.

SIGNIFICANT FINDINGS

- TxBESS has had a beneficial impact on beginning teacher retention. First-year participating teachers returned to Texas classrooms in school year 2001 at a rate of 88 percent, compared to the statewide average of 81 percent for the year prior to implementation. The program served 2,057 beginning teachers statewide in school year 2001, with 1,789 experienced teachers acting as mentors.
- Beginning teacher retention rates for the 20 regional service centers ranged from 98 percent for Region 14 (Abilene) to 69 percent in Region 19 (El Paso). Participation among first-year teachers was quite high in Region 20 (San Antonio), which served 313 beginning teachers (23 percent of all new Region 20 teachers), compared to Region 8 (Texarkana), which served 20 new teachers (9 percent of all new Region 8 teachers).

SIGNIFICANT CONCERNS

- The methodology used by the UT Dana Center to gauge TxBESS program success for the program's first two years does not provide for a clear determination of successful practices that could be used to develop model strategies for future new teacher induction programs. The impact of regional programs cannot be fully assessed because the retention rates of first-year

teachers are compared between TxBESS and non-TxBESS first-year teachers only for participating school districts.

- Several service centers have had difficulty creating an attractive program to promote enthusiasm for their mentor programs. Five service centers were unable to generate sufficient interest in their regions to utilize more than 20 to 40 percent of the original funding allocations awarded in the first fiscal year.
- Although the Texas Education Agency (TEA) has allocated a small portion of its fiscal year 2002 federal Eisenhower funding to the TxBESS program ($200,000), more work could be done to secure state-level federal funds or coordinate and assist school districts in obtaining Title II, Part A, Teacher Quality state grants.
- A new initiative, the Teacher Recruitment and Retention project, involving SBEC, TEA, and the Higher Education Coordinating Board, and aimed at addressing the shortage issue could serve as a platform for more extensive collaboration between school districts and higher education and strengthen the impact of regional teacher mentor programs.

RECOMMENDATIONS

To address these concerns, the review identified these recommendations.

- **Recommendation 1:** The final evaluation of the TxBESS program should include an analysis of different regional approaches to compare TxBESS teachers to all non-TxBESS teachers. This will help identify the most effective strategies for reducing the attrition of new educators. The Texas Education Agency should assist the State Board for Educator Certification by providing it the technical guidance and data necessary to complete this assessment.
- **Recommendation 2:** The State Board for Educator Certification should identify multiple models for successful teacher mentor programs based on a thorough effort to locate the best practices emerging from the TxBESS pilot. Information on these models should be available on the agency's website to ensure that school districts and service centers can easily access the information.
- **Recommendation 3:** The Texas Teacher Recruitment and Retention project should include in its plan a strategy for assisting school districts with establishing or improving teacher mentor programs utilizing best practices found in the TxBESS program as well as a strategy for continuing the current TxBESS program. New sources of federal funding should be obtained to continue and expand TxBESS, such as Title II, Part A, Teacher Quality State Grants under the No Child Left Behind Act.

COMMENTS

In July 1999, the State Board for Educator Certification (SBEC) was awarded a $10 million federal Teacher Quality Enhancement grant to fund a three-year effort to establish pilot induction, or mentor, programs for new teachers. The Texas Beginning Educator Support System (TxBESS), now in its third year, has involved educator preparation programs, regional education service centers, and school districts in the implementation of small-scale induction programs. Federal law requires a 50 percent state match, which can be met by recognizing in-kind administrative costs. The goals of the program are to reduce the turnover of new teachers, improve the quality of teaching, and develop effective models of beginning-teacher support. Program administration is shared among SBEC, the 20 regional education service centers, and participating school districts. Educator preparation programs, primarily institutions

of higher education, complement this partnership by providing faculty resources.

The State Board for Educator Certification has contracted with the UT Dana Center to conduct an evaluation of the program. The UT Dana Center's final evaluation report on TxBESS, in August 2002, provides information and analysis of the program's impact on teacher quality and retention. This review is intended to serve as an interim assessment of the program, now in its third year.

PROGRAM HISTORY

Upon receiving the initial grant award for school year 1999–2000, SBEC contracted with Education Testing Service Inc. to develop performance standards. After program standards were created and a funding allocation process established, SBEC requested grant applications from all of the 20 regional education service centers. For the first year, the agency distributed $2.8 million to service centers through competitive grants that were based on the number of new teachers the center agreed to support and the quality of the proposal. Grants for the second and third years, $5.4 million and $3.6 million respectively, were allocated based on a combination of actual performance measured in terms of teachers retained as well as first-year teachers served.

Education service centers have considerable latitude to design their own regional programs with this funding, as long as TxBESS program standards are followed. Some service centers have retained virtually all of their funding and administered most aspects of the program themselves. Other centers have provided sub-grants to local school districts, which in turn have operated their induction programs in different ways. This flexibility allows for local control so that regions and school districts can tailor their mentor programs to meet specific needs.

The process of establishing regional induction programs began when service centers recruited participating school districts, which identified and paired experienced mentor teachers with beginning teachers. In some cases, mentors have assisted more than one beginning teacher. Mentors, campus principals, new teachers, administrators, and university faculty received program training from their service centers, or from others trained at the service centers. After this initial training, mentors observed and counseled their assigned beginning teachers. Local higher education faculty and school district administrators, along with mentors, formed support teams that coordinated professional development activities and other services for each beginning teacher.

The TxBESS new teacher review process calls for either the mentor or an outside observer to conduct a formative assessment during the first school year, which gives new teachers feedback on their performance. The assessment, referred to as the TxBESS Activity Profile (TAP) results in a final evaluation which serves as a platform for future professional development and an early diagnostic measure of classroom performance.

Districts have followed a variety of strategies to give experienced teachers an incentive for being a TxBESS mentor. Virtually all districts pay stipends to mentors ranging from $100 to $800 per school year. Some districts provide mentors credit to purchase supplies and materials for their classrooms. To allow mentors and their proteges the opportunity to observe each other's teaching techniques and discuss their observations, school districts give them classroom release time by providing substitutes. In most cases, districts use federal TxBESS grant funding to finance these costs, although some districts have paid for stipends out of local funds.

To conclude, federal funding for TxBESS in the second year of the pilot program was the highest of the three year allocations. This review analyzes performance among the 20 education service centers for the second year of the program, school year

2000–2001. Three service center regions have been selected to highlight the variety of outcomes and strategies used to implement local induction programs. Table 1 identifies the 20 service center regions.

TABLE 1
LOCATION OF
EDUCATION SERVICE CENTERS

REGION	CITY	REGION	CITY
Region 1	Edinburg	Region 11	Fort Worth
Region 2	Corpus Christi	Region 12	Waco
Region 3	Victoria	Region 13	Austin
Region 4	Houston	Region 14	Abilene
Region 5	Beaumont	Region 15	San Angelo
Region 6	Huntsville	Region 16	Amarillo
Region 7	Kilgore	Region 17	Lubbock
Region 8	Mt. Pleasant	Region 18	Midland
Region 9	Wichita Falls	Region 19	El Paso
Region 10	Richardson	Region 20	San Antonio

SOURCE: Texas Education Agency.

SCHOOL YEAR 2000–01 PERFORMANCE

Table 2 displays the performance levels that service centers achieved in recruiting school district and higher education faculty participation in the TxBESS program. The San Antonio-based Region 20 service center shows significantly higher first-year teacher and mentor participation levels than the other regions. Region 20 took an aggressive approach to building the capacity of local school districts to continue mentoring programs after 2002.

Region 20 has established a self-sustaining program by training a group of mentors in each district who can then pass on their skills to other mentors. Also, each of the eight participating school districts has designated a coordinator for TxBESS who works with campus and district staff so that beginning teachers receive help from a trained mentor teacher. The impact of these initiatives is reflected in Region 20's low cost for mentoring and its retention rate among new teachers (which reflects fiscal year 2000 performance).

Two regions at the mid to low range of recruiting success followed different approaches in implementing regional programs. Region 7, based in Kilgore, and Region 4, based in Houston, both developed more extensive programs in the second and third years of the grant. To some extent, this late start accounts for the low number of second-year teachers served in 2001. Region 4 began with six school districts and expanded to 12 districts in fiscal year 2002. School districts in this region were provided mini-grants that allowed them to allocate their resources to meet local needs. For example, Alvin Independent School District (ISD) focused its resources for beginning teachers on content-based training that included math instruction methods. Pasadena ISD, on the other hand, used its funding to give beginning teachers more generous release time so they could attend professional development workshops. Overall, Region 4 has relied on a system of training district staff who can then train mentors at school campuses.

Region 7 combines regular professional development opportunities with a support and assessment network that seeks to address the gaps in knowledge or skills among beginning teachers. The region uses a needs identification questionnaire to identify specific training needs and then tailors its workshops around those needs. In spite of efforts to customize training and meet specific needs, Region 7's district administrators have shown only moderate interest in sending its beginning teachers to professional development. One conference held during the summer of 2001 had to be scaled back because of low registration.

PROGRAM CONCERNS AND RECOMMENDATIONS

EVALUATION METHODOLOGY

A complete assessment of the 20 service centers' performance cannot be conducted until beginning teacher retention rates can be compared between TxBESS participants and nonparticipants. This entails determining the percentage of TxBESS beginning

TABLE 2
TxBESS PARTICIPATION BY EDUCATION SERVICE CENTER REGION

		REGION					
CATEGORY	**STATEWIDE**	**1**	**2**	**3**	**4**	**5**	**6**
Total number of first-year teachers	**21,497**	1,578	360	229	4,919	410	702
TxBESS first-year teachers	**1,604**	111	81	62	51	21	73
Percent of total	**7%**	7%	23%	27%	1%	5%	10%
TxBESS second-year teachers	**453**	75	20	32	0	7	0
Funding per teacher served	**3,367**	4,059	5,243	2,011	5,875	5,069	1,963
SY 2000 TxBESS teachers retained	**88%**	81%	70%	89%	98%	90%	88%
TxBESS mentors	**1,789**	183	87	75	68	26	25
Higher education faculty on TxBESS Support Team	**107**	7	2	2	9	2	2
TxBESS ISDs	**233**	7	5	18	6	5	19
Campuses	**896**	54	16	58	NA	12	48

	REGION						
CATEGORY	**7**	**8**	**9**	**10**	**11**	**12**	**13**
Total number of first-year teachers	644	218	174	4,172	2,585	736	1,311
TxBESS first-year teachers	35	20	34	100	42	100	141
Percent of total	5%	9%	20%	2%	2%	14%	11%
TxBESS second-year teachers	0	25	24	25	0	0	0
Funding per teacher served	4,244	5,000	4,945	4,186	6,167	2,326	2,998
SY 2000 TxBESS teachers retained	91%	95%	94%	85%	83%	79%	81%
TxBESS mentors	35	42	26	103	39	46	143
Higher education faculty on TxBESS Support Team	7	5	2	8	NA	6	NA
TxBESS ISDs	11	16	5	8	3	3	14
Campuses	20	34	33	66	20	44	46

	REGION						
CATEGORY	**14**	**15**	**16**	**17**	**18**	**19**	**20**
Total number of first-year teachers	152	190	354	364	343	675	1,381
TxBESS first-year teachers	56	96	39	70	107	52	313
Percent of total	37%	51%	11%	19%	31%	8%	23%
TxBESS second-year teachers	20	48	0	4	37	0	136
Funding per teacher served	6,298	2,371	2,791	4,556	3,926	5,245	1,280
SY 2000 TxBESS teachers retained	98%	94%	79%	94%	82%	69%	88%
TxBESS mentors	80	129	29	75	105	23	450
Higher education faculty on TxBESS Support Team	8	14	2	9	2	20	16
TxBESS ISDs	27	27	17	9	2	3	8
Campuses	60	76	26	30	69	20	164

SOURCES: University of Texas Dana Center; State Board for Educator Certification; Texas Education Agency.

teachers served by a region in one year and then returning the following school year, and comparing that to a similar calculation for all of the region's beginning teachers who did not participate in the program. According to the statewide program evaluator, the UT Dana Center, comparison calculations for the first two years of the program have been limited to school districts participating in the TxBESS program. This makes a clear comparison impossible because in many school districts almost all of the beginning teachers participated in TxBESS. As a result, some districts show an insufficient number of nonparticipating beginning teachers for comparison purposes.

Recommendation 1 would address this concern by suggesting that the State Board for Educator Certification and the UT Dana Center to work with the Texas Education Agency (TEA) to build an evaluation process that includes a thorough assessment of the impact of each service center's TxBESS program. TEA should provide the UT Dana Center with data on teacher retention rates and any other data necessary for a complete evaluation of the TxBESS program. This assessment should identify those regional programs that have had the most significant impact on new teacher retention rates, as well as teacher quality measured in academic achievement scores.

In light of the potential for an effective teacher mentor program to address the teacher shortage, the experience and knowledge gained from a complete evaluation of the TxBESS pilot should be used to develop effective models that school districts can use to expand their current efforts. This information should be presented in a way that assists service centers and school districts towards improving and expanding their current mentor programs, regardless of whether they chose to participate in a future TxBESS program.

INTEGRATING TXBESS WITH P-16 INITIATIVES

While higher education entities such as the Higher Education Coordinating Board and several of the state universities have engaged in efforts to improve the supply of qualified teachers in Texas public schools, the TxBESS program has promoted such collaboration at the regional and local levels. School districts participating in TxBESS have benefitted from this cooperation, as education school faculty have assisted new teachers with learning to adjust to real-world problems. However, the extent of this cooperation has not fully reached the statewide level. An opportunity exists to accelerate interagency collaboration in managing a statewide teacher mentor program and to incorporate it into the framework of P-16 (Pre-K - 4 years of college) initiatives that integrate higher education and public education objectives.

The Higher Education Coordinating Board, under Rider 46 of the 2002–03 General Appropriations Act, is charged with developing a strategic plan for teacher recruitment and retention with assistance from the Texas Education Agency and the State Board for Educator Certification (SBEC). Under Recommendation 2, the Coordinating Board's plan should include a strategy designed to show school districts how to create mentor programs based on the best practices gleaned from the TxBESS program to ensure a coordinated approach to teacher retention. This collaboration should also extend to a multi-agency goal of acquiring more significant federal funding for teacher induction programs in Texas.

Additional federal funds for TxBESS might be obtained from sources other than the one-time Teacher Quality Enhancement grant. Under federal guidelines, school districts and institutions of higher education may use Eisenhower Professional Development State Grants for teacher mentoring programs. Texas Education Agency Rider 84, contained in the 2002–03 General Appropriations Act, directs the agency to transfer no more than $350,000 to SBEC for the TxBESS program in each year of the 2002–2003 biennium. To date, TEA has allocated $200,000, primarily from federal Eisenhower grant money, for the fiscal year 2002 transfer.

The federal No Child Left Behind Act provides a mechanism to channel money to teacher quality and retention efforts such as TxBESS. The teacher quality section of the bill consolidates the Eisenhower Professional Development and the Class Size Reduction grants, giving states more flexibility on how to allocate resources targeted to educators. State fiscal year 2003 federal appropriations are estimated to provide Texas $232 million under the Improving Teacher quality grant.

According to preliminary information, teacher mentor programs can be funded with money from this grant. Texas would be required to distribute 95 percent of teacher quality funds to school districts, but may use 2.5 percent for state activities, while 2.5 percent must be allocated to the Higher Education Coordinating Board (THECB) for competitive grants to partnerships. As stated in Recommendation 3, the three agencies involved in the recruitment project mentioned previously (TEA, THECB, SBEC) should explore the feasibility of tapping these existing alternative and new federal fund sources, to continue and expand Texas' statewide mentor program.

CLASS-SIZE WAIVERS

In 1984, the Texas Legislature required that class size be limited to 22 students per teacher in kindergarten through fourth grade (Texas Education Code § 25.112). The legislature authorized the commissioner of education to grant exceptions, or waivers, to the class-size limitations if the commissioner found that the limits created an undue hardship on a school district. Exceptions to class-size limitations are valid for only one semester at a time, and the commissioner is prohibited from granting exceptions for more than one semester at a time. The class-size limitations do not apply to the last 12 weeks of a school year for most districts.[1] This review examines the administration of class-size waivers by the Texas Education Agency (TEA) State Waiver Unit (Waiver Unit).

SIGNIFICANT CONCERNS

- TEA approves a class-size waiver for an entire district, not at the campus or class level; one district receives one waiver. Due to this method of granting waivers, class-size waiver data does not accurately reflect the number of classrooms that exceed size limitations.
- The Waiver Unit does not maintain data at the classroom level. TEA only knows about excess in class size if a district applies for a class-size waiver, and the application for the waiver accurately identifies all classrooms (grade and section) that exceed 22:1. This also makes it impossible to detect the "overflow" (the number in excess of 22 students) in any classroom requiring a waiver.
- The Public Education Information Management System (PEIMS) database containing the class-size data is not linked to the Waiver Unit's class-size waiver data. This results in the Waiver Unit having inconsistent, incorrect, and sometimes missing data.
- TEA evaluators may make note of excessive class size while on a site visit or the media alerts TEA to violations.[2] There is no formal mechanism to identify excess in class size within the PEIMS database or the Waiver Unit database.
- Commissioner's rules stipulate that low-performing campuses are not to be granted waivers.[3] However, there is no evidence to indicate that academic performance is considered before the granting of a waiver. The Waiver Unit relies only on the data submitted by the districts when applying for a waiver.
- The Waiver Unit's waiver data system does not flag districts that apply for a waiver for multiple consecutive semesters as needing to submit a compliance plan per commissioner's rule.[4]

[1]Districts whose average daily attendance is adjusted under § 42.005(c) may use any 12-week period of the school year selected by the district.

[2]June 5, 2002 meeting with Waiver Unit management.
[3]Texas Education Agency Correspondence, August 20, 2002; Compliance with Class-size Requirements, Fall 2002 Texas Education Code § 25.112.
[4]Id.

RECOMMENDATIONS

- **Recommendation 1:** The Waiver Unit should collect class-size data from the district and report waiver data at the class level rather than using only campus and district-level data. The Waiver Unit should also implement a method to detect districts in violation of the class-size waiver law that have failed to apply for a waiver. Furthermore, the Waiver Unit should consider implementing a web-based submission process to reduce data errors and improve accountability as recommended by TEA Internal Audit Number 01-09 issued in October 2001.
- **Recommendation 2:** Currently, class-size waiver data is manually inputted into the State Waiver Unit database. Class-size waiver data should be linked to PEIMS data that are already collected and maintained by other divisions in TEA. This would reduce duplication of work and would ensure that the data maintained and used by the Waiver Unit are the most accurate and current data available. The Waiver Unit should be able to validate the data submitted by the school district.
- **Recommendation 3:** The Waiver Unit should develop a system to flag campuses that have submitted waiver applications for two or more consecutive semesters and require that a compliance plan be submitted before a waiver is approved.
- **Recommendation 4:** The Waiver Unit should implement routine tests for verifying accuracy of waiver applications and database input prior to granting waivers. This system should undergo a periodic internal audit.

COMMENTS

The purpose of the class-size provision of House Bill 72, Sixty-eight Legislature, 1983, was to promote a higher level of student achievement. The supporters of the original bill were particularly concerned with numerous educational studies demonstrating the importance of smaller class sizes for students in the first few grades.[5] Opponents of the original bill were concerned that the ratio set was not low enough.[6] However, both supporters and opponents agreed that Texas classrooms needed to be smaller.

Currently, the Waiver Unit grants class-size waivers at a broad, school district level. By granting waivers at the district level and by maintaining data at the district and campus level, rather than at the class level, there is no practical way of knowing how many classrooms are in excess of the 22:1 student-to-teacher ratio. As a result, it is difficult to evaluate compliance with a law designed to have an impact at the class level when the Waiver Unit collects and maintains data at the district level. This also restricts the Waiver Unit's ability to ensure that districts applying for several consecutive semesters are actually alerting the parents and the community of the increased class sizes, which is required by House Bill 72.[7] Further, because waivers are granted at a district level, legislators do not have an accurate account of how the Class-size Law is impacting the size of classrooms in Texas.

In 2001, a TEA internal audit of the State Waivers Unit found numerous data-entry errors and waiver applications that were never processed. The auditor's recommendations include the following:

- Implement routine crosschecks for verifying accuracy of database input prior to filing the waiver; and
- Provide web-based data entry by the school districts to improve processing turnaround. This structure would include drop-down boxes to reduce data-entry errors and would require districts to provide a history of waivers specific

[5]House Study Group Daily Floor Report, 68th Legislative Session, June 21, 1984 Re: HB 72.
[6]The research cited by legislators reveals that a teacher-student ratio of 15 to 1 is ideal.
[7]Texas Education Code § 25.113 Notice of Class-size.

to the school district. The TEA Information Systems Department has indicated that the waivers system would not require a major redesign or additional hardware to add web-enabled data entry.

The manager of the Waiver Unit provided a written response to the TEA audit recommendations by stating that procedures for processing the waivers would now include routine data verification to improve database quality to a 95 percent level of accuracy. The manager also stated that the Waiver Unit would submit a proposal to the deputy commissioner regarding the feasibility of web-based data entry. However, the Legislative Budget Board analysis reveals the most recent Waiver Unit data still contains a considerable number of data-entry errors.

CLASS-SIZE WAIVER APPLICATION PROCEDURE

To determine compliance with the class-size requirements, districts are required to conduct a class enrollment survey no later than a date specified by the commissioner each semester. For fall 2002, that date is September 6, 2002 for most districts. Districts having classes exceeding the set limit must submit a class-size waiver request to the Waiver Unit no later than a date specified by the commissioner each semester. For fall 2002, that date is October 8, 2002.

For the request to be granted, the district must show that the 22 student limit presents an undue hardship on the district. The commissioner of education then uses the following criteria to determine undue hardship:

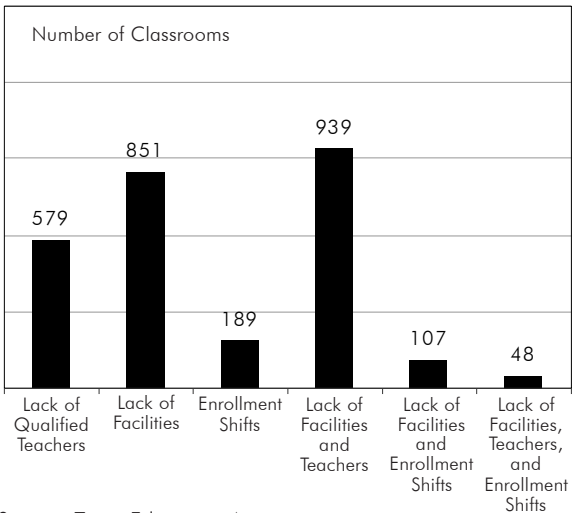
- The district is unable to employ qualified teachers;
- The district is unable to provide educational facilities;
- The district has budgeted for a class-size ratio of 22:1 in kindergarten through grade 4, but one or more campuses experience enrollment shifts that result in no more than one section per grade level increasing to a maximum of 24:1; or
- A combination of the above reasons describes the situation[8] (Figure 1).

Regardless of the reason cited by the district, it must document its effort to alleviate the existing hardship and must submit a compliance plan, including a schedule for completion, approved by the local board of trustees.[9]

REPORTING

The Waiver Unit does not maintain class-level data, which means that it has no information regarding any excess in class size after an application for a waiver is approved. This review analyzed PEIMS data in order to determine the actual number of classes in excess of size requirements in Texas for the 2000–01 school year. Figure 2 indicates the number of classrooms with 23 or more students. Figure 3 identifies the

FIGURE 1
REASONS DISTRICTS REQUEST WAIVERS
FALL 2002



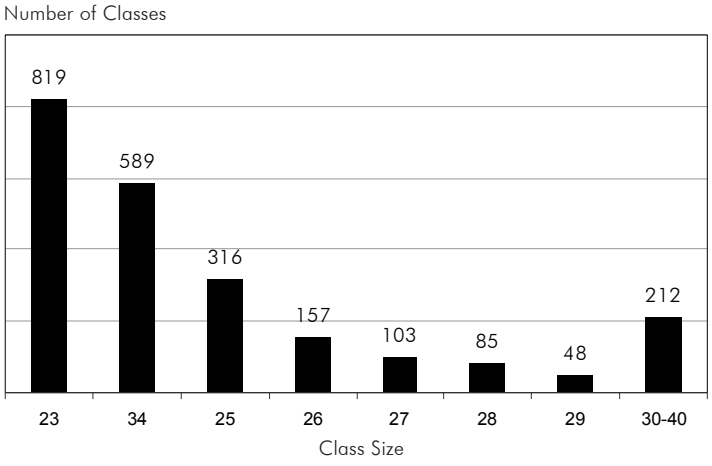
SOURCE: Texas Education Agency.

[8]TEA Committee on Instruction: Update on Class-size Waivers, Bilingual Education Exceptions, and Waivers for English as a Second Language. Issued January 15, 1998.
[9]Texas Education Agency Correspondence, August 20, 2002; Compliance with Class-size Requirements, Fall 2002 Texas Education Code § 25.112.

number of classrooms with 23 or more students by grade level over a 10-year period.

According to 2000–01 PEIMS data, Texas had 4,666 classrooms with more than 22 students. However, because the Waiver Unit grants class-size waivers to districts, not classrooms, the data are reported as "145 waivers," rather than 4,666 classrooms that are in excess of the 22:1 ratio and requiring waivers (see Table 1 and Figure 2). The Waiver Unit data methodology does not accurately report the number of children actually affected. For example, a comparison of the Waiver Unit's 1997–98 and 1998–99 data for "number of waivers approved" shows an 11 percent reduction in the number of waivers granted in the latter year. However, the actual number of campuses covered by waivers compared between the same two years shows an increase of 32 percent. The 2000–01 PEIMS data reveals that 116,647 students spent the 2000–01 school year in classrooms that exceeded the size requirement.[10]

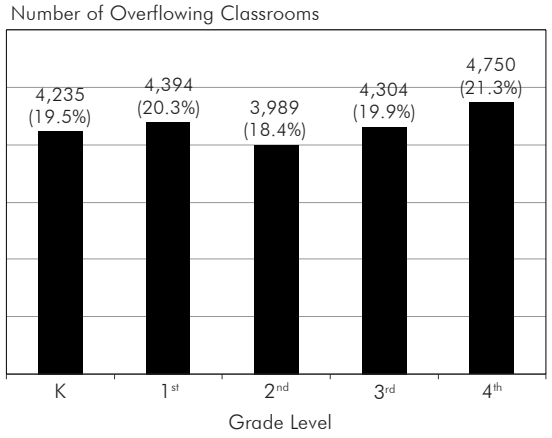
FIGURE 2
TEXAS OVERFLOW CLASSROOMS
FISCAL YEAR 2001



SOURCE: Texas Education Agency PEIMS data.

Therefore, if a school district applies for and is granted a class-size waiver, there is no need for it to report any subsequent classrooms that exceed the class-size limit after the district has submitted its application. A single class-size waiver granted to a district covers every classroom in that district, and is only reported as one waiver.

FIGURE 3
WAIVERS GRANTED
OVER 10-YEAR PERIOD
BY GRADE, BY CLASSROOM
1993–2002



SOURCE: Texas Education Agency PEIMS data.

NOTICE OF SECTION SIZE

Under Texas Education Code 25.113, a district that is granted an exception from class-size limits must provide written notice of the exception to the parent or guardian of each student affected by the exception. The notice must be in conspicuous bold or underlined print and:

- specify the class for which a class-size waiver was granted;
- state the number of students in that class;
- must be included in a regular mailing or other means of communication from the campus or

[10]Data determined by teacher identification.

TABLE 1
DISTRICT CLASS-SIZE WAIVERS APPROVED

SCHOOL YEAR	DISTRICT WAIVERS APPROVED BY STATE WAIVER UNIT	CAMPUSES COVERED BY WAIVERS BY SEMESTER		CLASSROOMS IN EXCESS OF 22:1	
		FALL	SPRING	AVERAGE NUMBER PER CAMPUS PER YEAR	TOTAL
1993–94	115	—	—	—	—
1994–95	114	591	621	5.3	1,326
1995–96	105	447	466	4.3	1,963
1996–97	202	430	461	2.2	1,960
1997–98	207	577	696	3.0	1,910
1998–99	185	702	742	3.9	2,816
1999–2000	169	511	507	3.0	1,527
2000–01	145	512	522	3.6	1,861

NOTES: Total number of districts statewide = 1,038.
Total number of elementary campuses statewide = 4,030.
SOURCES: Texas Education Agency State Waiver Unit.

district, such as information sent home with students; and

- must not be delivered later than the 31st day of the school year or the 31st day from the date the waiver was granted, if it was granted after the beginning of the school year.

The Waiver Unit does not have a method in place to ensure that these notices are delivered to the parents of the students affected by the granting of the class-size waiver. Underscoring the problem is the Waiver Unit's current reliance on media coverage to alert it to any problems in the class waiver system.[11] If the parents of the affected children are not given proper notice of their children's classroom conditions, it is less likely that the media, and subsequently TEA, will know of any problems needing to be resolved (see Table 2, and Figure 3).

[11]June 5, 2002 meeting with Waiver Unit management.

CONSECUTIVE WAIVERS

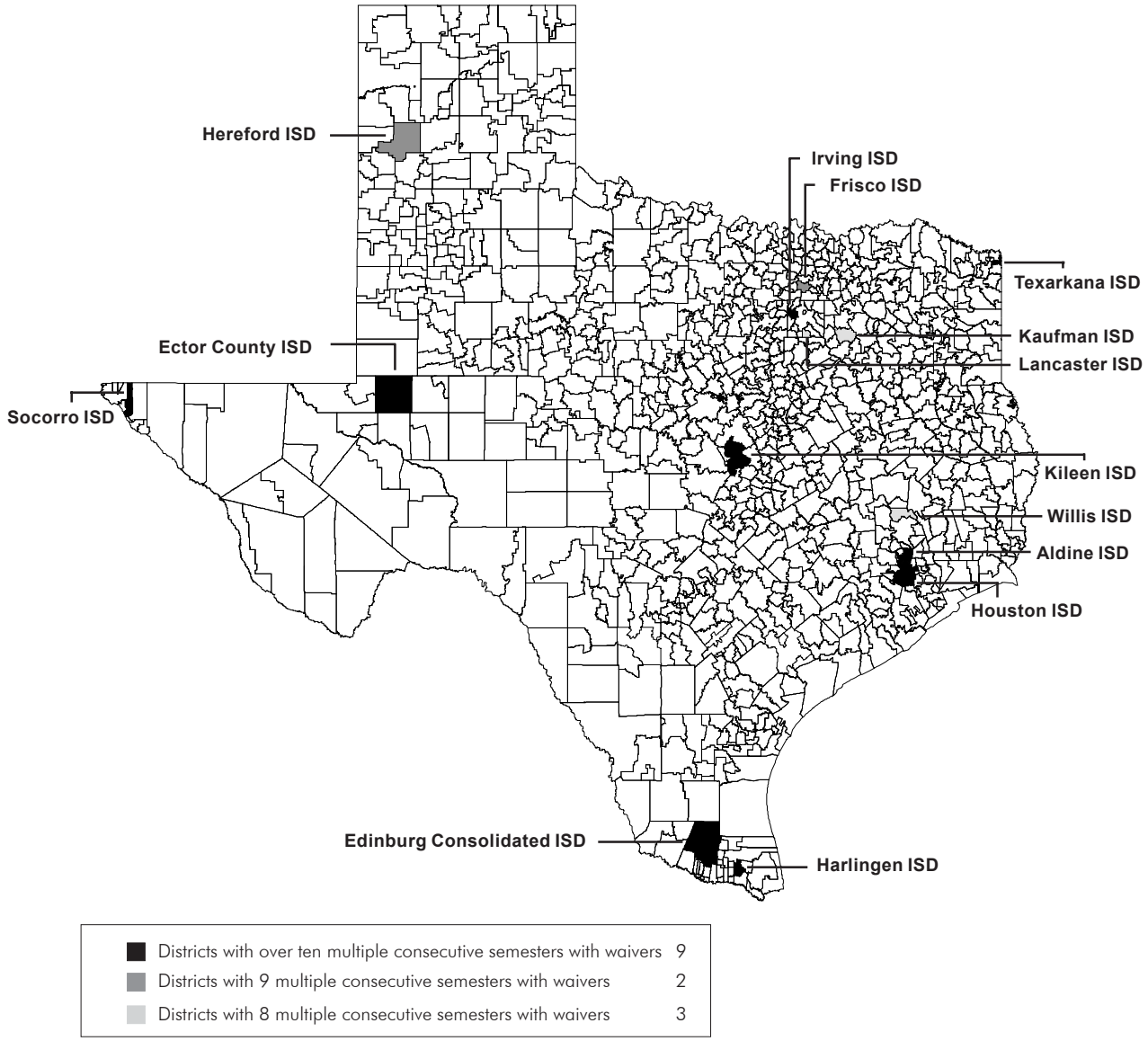
According to TEA correspondence with school administrators, when a district requests a class-size waiver for two consecutive semesters, the district must "initiate a public notification" to ensure that the community is aware of the requests. This notice must describe the steps the district is taking to reduce the need for continued class-size waivers. A district requesting a class-size waiver for a third or subsequent semester is required to hold a meeting for parents and community members at each campus covered by the waiver request to discuss the continued need for the waiver and the specific steps that will be taken to bring the district into compliance. For districts that request a class-size waiver for more than four consecutive semesters, commissioner's rules require that student performance be considered in the decision to grant a waiver.[12] A district requesting a waiver for the fifth or subsequent consecutive semester must show that all campuses covered by the waiver achieved annual gains in performance for all students, and for each student group on each state assessment administered, unless the student group is performing at the "recognized" or "exemplary" level on each assessment. For a district requesting a class-size waiver for the seventh or subsequent semester at any campus, the local school board of trustees must hold a public hearing addressing the continued need for a class-size waiver at one or more campuses.[13]

It is unclear how TEA is enforcing these rules. Several districts have been granted class-size waivers for more than 10 consecutive semesters, even while these districts' accountability ratings either remained the

[12]TEA Correspondence 12/04/01.
[13]Id. Effective for 2001–2002.

same or declined. The data provided by the Waiver Unit contains a list of nine districts granted waivers for "10+" consecutive semesters. Figure 4 demonstrates the locations of districts granted waivers for eight to 10 plus consecutive semesters, and Table 2 lists the 10 districts with the largest number of classrooms requiring waivers over the past 10 years in Texas.

Figure 4
Independent School Districts with Multiple Consecutive Semesters with Waivers



Sources: Legislative Budget Board; Texas Education Agency.

TABLE 2
TOP 10 DISTRICTS
IN NUMBER OF CLASSROOMS
REQUIRING WAIVERS
OVER PAST TEN YEARS

RANKING	SCHOOL DISTRICT	CUMULATIVE NUMBER OF CLASSROOMS REQUIRING WAIVERS OVER PAST TEN YEARS
1	Houston ISD	18,999
2	Dallas ISD	4,339
3	Killeen ISD	1,358
4	Edinburg ISD	937
5	Aldine ISD	927
6	Brownsville ISD	894
7	North Forest ISD	721
8	Socorro ISD	671
9	Mesquite ISD	588
10	Hector County ISD	497

SOURCE: Texas Education Agency PEIMS data.

CONCLUSION

The procedures and policies currently in place within the Waiver Unit hinder the proper reporting, enforcement, and original purpose of the class-size provision of House Bill 72. The data collection procedures and methodologies provide no accountability for actual class sizes, which was the original purpose of the law. Because of this, the Waiver Unit is unable to enforce the law or detect existing problems in the application of the law.

With the implementation of stricter quality controls on data collection and maintenance, the Waiver Unit can provide more useful information to parents, legislators, and policy makers. By implementing the Legislative Budget Board recommendations along with TEA Internal Audit recommendations, there would be a reduction in the duplication of data entry, a possible reduction in Waiver Unit administrative costs, and the assurance of more accurate and useful data. Once these improvements are implemented, the Waiver Unit can better monitor the application of the class-size law that is intended to improve the achievement of all Texas school children.

Distribution of Public School Grants by the Telecommunications Infrastructure Fund Board

The Telecommunications Infrastructure Fund (TIF) was created by the Public Utility Regulatory Act of 1995 (PURA '95), which was passed by the Seventy-fourth Legislature, 1995. It was established to collect $1.5 billion in assessments on telecommunications services over a ten-year period. That legislation also created an appointed, nine-member Board to direct the expenditure of these funds. The TIF Board's mission is to help Texas develop an "advanced and sustainable telecommunications infrastructure that stimulates equitable access and universal connectivity" through grant awards to public schools, institutions of higher education, libraries, and not-for-profit healthcare facilities.[1]

The legislation required the TIF Board to prioritize the funding of projects based on a set of criteria. For example, the Board is required to prioritize groups not previously served, especially in rural or remote areas, and distance learning projects in school districts with a disproportionate number of at-risk students. Additionally, the Board, in distributing grants to public schools, must consider the relative property wealth per student of the recipient school districts and recognize the unique needs of rural communities.

This review analyzes the distribution of public school (PS) grants awarded by the TIF Board from its first cycle, PS1, in fiscal year 1997, through the last cycle for which there is available data, PS9, awarded in fiscal year 2001, to determine whether the agency is prioritizing grants based on (1) rural status, (2) district property wealth per student, and (3) percentage of students designated as at-risk.

[1]Telecommunications Infrastructure Fund Board Strategic Plan for Fiscal Years 2003–07.

Significant Findings

- The TIF Board distributed $405 million to public schools between 1997 and 2001 in nine separate grant cycles. All but 16 of the 1,040 eligible districts in the state have received TIF Board grant funding in one or more of the grant cycles.
- In these grant cycles, the agency has successfully targeted rural school districts in its public school grant awards. Rural districts on average received $622 per student in average daily attendance (ADA) in TIF Board grants, whereas non-rural districts on average received $88 per ADA.
- In the first nine grant cycles, the distribution of grant dollars does not reflect a consideration of districts' relative property wealth. Cumulatively from PS1 in 1997 to PS9 in 2001, the average TIF Board grant dollars per ADA for the richest 20 percent of school districts is approximately $260 more than that for the poorest 20 percent of districts ($620 to $359, respectively). The agency's requests for proposals (RFPs) for these grant cycles confirm that property wealth per ADA was not a factor in determining grant eligibility or award amount.
- Based on TIF Board grant dollars per ADA, the agency has not prioritized projects, distance learning or otherwise, in school districts with disproportionate numbers of at-risk students. Districts with the highest percentages of at-risk students have received, on average, approximately $70 fewer grant dollars per ADA than districts with the lowest percentages of at-risk

students. The RFPs for these grant cycles also reveal that a district's percentage of at-risk students was not considered when grant eligibility or award amounts were set.

SIGNIFICANT CONCERNS

- By aggressively targeting rural districts, the Board has likely fulfilled the needs of underserved rural areas. However, its grant distribution policies make it unlikely that projects in underserved, non-rural areas of the state have received funding prioritization.
- For its first nine grant cycles (1997–2001), the agency failed to catalog the Texas Education Agency's (TEA's) identification number for the districts applying for its grants and ultimately receiving TIF Board grant funds. This failure rendered the agency unable to pull TEA data on district property wealth and at-risk populations, making it impossible to factor these considerations into grantee selection and award amount decisions. This lack of uniform identifiers for recipient districts has also delayed post-grant analysis of the distribution of TIF Board grant funds, such as the kind detailed in this review.

RECOMMENDATIONS

- **Recommendation 1:** If the Seventy-eighth Legislature, 2003, appropriates the remaining public school grant funds—approximately $300 million—the Board should prioritize campuses and districts with high at-risk populations and/or low property wealth per student. The agency could accomplish this by creating a funding formula to weight districts or campuses based on these characteristics to ensure a grant funding distribution more in line with districts' needs.
- **Recommendation 2:** The Board should create a specific, detailed plan to demonstrate how it will fulfill each of the statutory requirements for grant prioritization. This should be done not only for public school grants but for grants to other eligible entities as well. This plan should be included in the agency's Strategic Plan and distributed to the members of the Legislature and the Governor for review and comment.
- **Recommendation 3:** The Board should incorporate into its grants database the TEA identification numbers for each recipient campus and district in order to analyze whether its public school grant distribution is conforming to statutory requirements. The Board should perform this analysis annually. The analysis should cover agency performance on the three prioritization requirements covered by this review (rural status, property wealth per student, and percentage of at-risk students), as well as other relevant statutory requirements, including project sustainability and inter-entity collaboration.

COMMENTS

Of the $1.5 billion in revenue collected by the TIF over its 10-year lifespan, approximately half is dedicated to funding grants to public schools. Provisions of PURA '95, codified into the Texas Utilities Code, Chapter 57, Subchapter C, establish a set of criteria by which the TIF Board must prioritize these grants (see Figure 1). Several of these criteria describe types of projects that shall be given priority; for example, those that are collaborative, come with matching funds, and will be self-sustaining. However, some provisions establish particular types of schools and school districts that shall be prioritized. Statute states that in awarding grants to public schools the Board shall:

- consider the relative property wealth per student of the school districts that receive the money (§ 57.047(d)(1)); and

FIGURE 1
TEXAS UTILITIES CODE, CHAPTER 57

§ 57.047. Grant and Loan Program

(c) In awarding a grant or loan under this subchapter, the board shall give priority to a project or proposal that:

(1) represents collaborative efforts involving more than one school, university, or library;

(2) contributes matching funds from another source;

(3) shows promise of becoming self-sustaining;

(4) helps users of information learn new ways to acquire and use information through telecommunications;

(5) extends specific educational information and knowledge services to a group not previously served, especially a group in a rural or remote area;

(6) results in more efficient or effective learning than through conventional teaching;

(7) improves the effectiveness and efficiency of healthcare delivery; or

(8) takes advantage of distance learning opportunities in a rural or urban school district with a

(A) disproportionate number of at-risk youths; or

(B) high dropout rate.

(d) In distributing money to public schools, the board shall:

(1) consider the relative property wealth per student of the school districts that receive the money; and

(2) recognize the unique needs of rural communities.

- recognize the unique needs of rural communities (§ 57.047(d)(2)).

Also, the Board shall give priority to a project or proposal that:

- extends specific educational information and knowledge services to a group not previously served, especially a group in a rural or remote area (§ 57.047(c)(5)); and
- takes advantage of distance learning opportunities in a rural or urban school district with a disproportionate number of at-risk youths or high dropout rate (§ 57.047(c)(8)).

This review analyzes whether the Board has prioritized grants based on the three school district characteristics identified in the above statutes: rural status, district property wealth per student, and percentage of students designated as at-risk.

OVERVIEW OF TIF BOARD PUBLIC SCHOOL GRANT PROCESS

The TIF Board awarded its first cycle of public school (PS) grants in fiscal year 1997. This grant cycle (PS1), and the next (PS2), were announced as competitive grants with the expectation that applying districts would be ranked, and that not all applicants were guaranteed to receive a grant. However, the Board discovered that, given the grant award amounts they had established, every district that applied could be given a grant. Beginning with PS3 in fiscal year 1998, every subsequent public school grant cycle has been non-competitive, so that as long as the applicant met a set of minimum qualification requirements described in the grant RFP, the applying district's project will be awarded a grant. These requirements have included commitments by the district to match the TIF Board grant with local funds, create a "technology task force" and participate in a technology training program.

For its first two grants, the TIF Board targeted certain types of school districts. PS1 was for districts in which over 70 percent of students were economically disadvantaged. PS2 was dedicated to rural districts only. PS3 through PS9 were available to all districts.

If a school district received a PS grant in one cycle, the Board placed restrictions on whether it could apply for subsequent grants based on the district's

ADA. For example, districts with less than 10,000 ADA that received a PS4 or PS5 grant were not eligible to receive a PS6 grant. These restrictions were intended to recognize that larger districts have more campuses in need of technology aid, and therefore should have more access to TIF funds than smaller districts. However, some grant cycles had broader eligibility restrictions; for example, all districts that received a PS6 grant, regardless of ADA, were not eligible to receive a PS7 grant.

For each grant cycle, the Board also established minimum and maximum grant awards that school districts may receive. The minimum grant amount, generally awarded to districts with very few ADA, ranged between $40,000 and $50,000 for PS1 through PS9. The maximum grant amount, received by only the very largest districts, ranged between $480,000 and $1,000,000.

TABLE 1
NUMBER AND AMOUNTS OF GRANTS
PS 1 (1997) — PS 9 (2001)

GRANT CYCLE	YEAR AWARDED	NUMBER OF GRANTS AWARDED	AMOUNT AWARDED
PS1	1997	78	$23,870,654
PS2	1997	82	$28,568,058
PS3	1998	489	$58,356,332
PS4	1998	213	$27,844,875
PS5	1998	33	$6,599,892
PS6	1999	613	$56,270,012
PS7	2000	123	$9,022,221
PS8	2000	360	$103,206,809
PS9	2001	783	$91,654,392
TOTALS		**2,774**	**$405,393,245**

SOURCE: Telecommunications Infrastructure Fund Board.

ANALYSIS OF TIF BOARD PUBLIC SCHOOL GRANT DISTRIBUTION

This review examines all TIF Board public school grants from the first cycle in 1997 (PS1) through the last cycle for which there is available data (PS9), awarded in 2001, to determine whether the agency is prioritizing grants based on (1) rural status, (2) district property wealth per student, and (3) percentage of at-risk students.

Table 1 summarizes the nine grant cycles analyzed in this review. The TIF Board releases an average of two public school grant cycles per year, awarding an average of $45 million per cycle. The two largest grant cycles have been the two most recent, PS8 and PS9; the Board carried large unexpended balances into fiscal year 2000 and 2001, making larger grant cycles possible in these years.

For the analysis, district-level grant award data from the TIF Board was merged with TEA data on ADA, district type, property wealth, and at-risk students for each of these grant cycles. Also, each district's cumulative TIF Board grant awards from PS1 to PS9 were calculated.[2]

The distribution of TIF dollars across school districts is assessed by calculating the grant dollars per ADA for each district. Because school districts in Texas vary greatly in size, grant dollars per ADA is the method used to allow comparison between districts as to the relative impact of TIF dollars on their students. Districts are grouped by type for the rural analysis or divided into quintiles for the property wealth and at-risk students analysis. The grant dollars per ADA figures for the districts in each type or quintile are

[2]For PS2, the TIF Board awarded funds to consortia comprising a group of collaborating rural districts. For purposes of analysis, the grant dollars were divided evenly between the consortia member districts.

then averaged to compute an overall figure for comparison.[3]

RURAL/NON-RURAL STATUS

There are two definitions of a rural school district that are relevant to this analysis. The first is part of TEA's widely used "community type" categories, which divides districts into nine discrete types, including "rural."[4] The second definition, used by the TIF Board since 1998, defines rural districts as those with fewer than 1,000 students in ADA.

Table 2 shows the nine community types and number of districts of each type receiving TIF Board grant dollars. Also shown are the cumulative TIF Board grant dollars from PS1 through PS9, 2001 ADA and overall dollars per ADA for each of the community district types.

TABLE 2
TIF BOARD GRANTS
BY COMMUNITY TYPE

COMMUNITY TYPE	NUMBER OF DISTRICTS	TOTAL GRANT DOLLARS	2001 ADA	OVERALL DOLLARS PER ADA
Major Urban	10	$25,685,401	796,751	$32
Major Suburban	63	64,907,566	1,051,537	62
Other Central City	38	47,871,871	625,130	77
Other CC Suburban	91	45,578,179	344,154	132
Independent Town	75	38,323,881	303,103	126
Non-Metro Fast Grow	61	15,631,300	69,380	225
Non-Metro Stable	275	79,646,535	404,066	197
Rural	411	79,791,887	128,311	622
Charter	102	7,946,624	33,700	236
TOTALS	**1,126**	**$405,393,245**	**3,756,132**	**$108**

SOURCES: Telecommunications Infrastructure Fund Board; Texas Education Agency.

As the table illustrates, rural districts have received the greatest benefit by far from TIF Board grants in terms of grant dollars per ADA. Rural districts as a group have received $622 per ADA over the last five years of TIF Board grants; non-rural districts (excluding charter schools) have received $88 per ADA. Rural districts have been awarded nearly 20 times the amount per ADA that major urban districts have received.

Figure 2, which categorizes districts based on ADA, shows a pattern similar to the community types. The average grant amount per ADA among districts with fewer than 1,000 ADA (the Board's definition of a rural district) far exceeds that of districts with over 1,000 ADA.

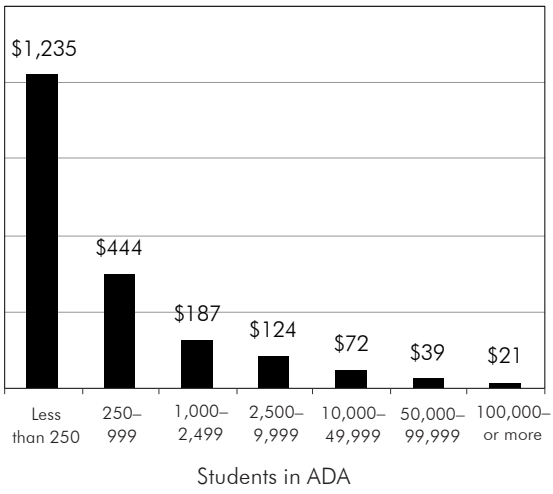
Based on this analysis, the TIF Board has certainly recognized the unique needs of rural communities and has likely benefitted underserved rural areas, as mandated by its statute. Indeed, the TIF Board has on occasion specifically targeted rural districts in its grant awards; for example, the PS2 grant cycle was dedicated exclusively to rural districts and associated consortia.

It should be noted, however, that this targeting is not the primary driver behind the very large difference in total grant dollars per ADA between rural

[3] There are two different methods of computing an average dollars-per-ADA. For the community types in Table 1, grant dollars and ADA were summed for each type, and the total dollars was divided by the total ADA. However, in the remaining figures of this report, grant dollars per ADA was computed for each district, then simply averaged for each quintile.

[4] Community type is a component of TEA's *Snapshot: School District Profiles* publications. Rural districts are defined as those that do not meet the criteria for placement into any of the above categories. These districts either have a growth rate less than 20 percent and the number of students in membership is between 300 and the state median, or the number of students in membership is less than 300.

FIGURE 2
TIF BOARD GRANTS PER ADA BY DISTRICT
PS1 (1997) — PS 9 (2001)



SOURCES: Telecommunications Infrastructure Fund Board; Texas Education Agency.

and non-rural districts. Rather, it is the Board's policy of establishing a minimum and maximum grant amount for its grant cycles that is mainly responsible for this distribution pattern, because it fails to account for the fact that Texas has very large and very small school districts.

In general, the minimum grant award for PS cycles was $50,000 while the maximum was $600,000, or 12 times larger than the minimum award. Houston Independent School District (ISD), for example, has 1,000 times as many students in average daily attendance than 130 school districts. Nevertheless, Houston ISD could only receive 12 times the amount of grant dollars as these very small districts. This resulted in a depressed grant award per ADA figure for large districts like Houston ISD ($14 per 189,216 students in ADA) and an elevated grant award per ADA figure for small districts like Divide ISD ($4,949 per 16.3 students in ADA).

PROPERTY WEALTH PER STUDENT

For this analysis, districts were divided into quintiles based on their 2001 property wealth per ADA, and an average grant dollars per ADA figure was computed for each quintile.

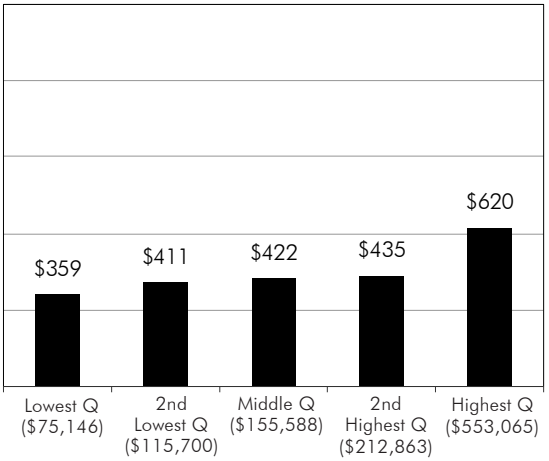
Figure 3 shows the results for all districts. For the TIF Board's first nine grant cycles, the average grant dollars per ADA awarded to the poorest 20 percent of districts was $359. The average grant dollars per ADA for the middle three quintiles were roughly the same, slightly over $400. However, the average grant dollars per ADA for the richest 20 percent of districts was $620.[5] This is $261 more than that of the poorest 20 percent of districts.

Statistical analysis of the data confirms that there is a significant positive correlation between property wealth per ADA and total TIF Board grant dollars received; in general, the higher a district's property wealth, the more TIF funds per ADA it will have received over the last five years. This pattern also holds true for each individual grant cycle, including PS1, in which funding priority was given to campuses with high percentages of economically disadvantaged students.

It is possible that the goal of serving low-property-wealth districts may have conflicted with the goal of serving rural districts which, on average, have slightly higher property wealth per ADA than non-rural districts. As a test of this possibility, Figure 4 repeats the quintile analysis, but only rural districts are examined. As the chart shows, a similar pattern emerges: the richest 20 percent of rural districts have, on average, received more TIF dollars per ADA than any other rural districts.

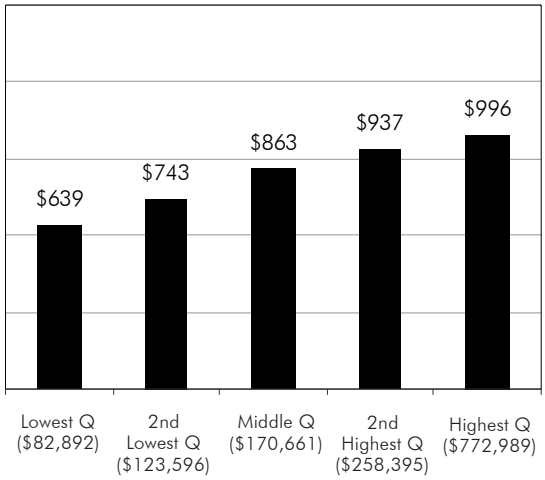
[5]Calculating a quintile's average grant dollars per ADA by averaging the dollars per ADA of all districts within that quintile leaves the result open to the effects of outliers. To control for these effects, the seven districts with the highest grant dollar per ADA amounts—above $4,000—were eliminated from the quintile analyses in Tables 2 through 5. All seven districts were rural with ADA under 100.

FIGURE 3
TIF BOARD GRANT AWARDS
BY PROPERTY WEALTH
PS1 (1997) — PS 9 (2001)



SOURCES: Legislative Budget Board; Telecommunications Infrastructure Fund Board; Texas Education Agency.

FIGURE 4
TIF BOARD GRANT AWARDS
BY PROPERTY WEALTH, RURAL DISTRICT ONLY
PS1 (1997) — PS 9 (2001)



SOURCES: Legislative Budget Board; Telecommunications Infrastructure Fund Board; Texas Education Agency.

These results indicate a distribution of TIF Board grant funds that appears contrary to legislative intent. The statute requires the Board to consider property wealth per student in distributing grants to districts. The presumption is that lower-wealth districts would receive more consideration than higher-wealth districts, and that such consideration would result in a distribution of funds in which more dollars went to districts that lacked the local resources to adequately fund their telecommunications and technology needs.

In awarding its public school grants, the TIF Board did not intentionally favor districts with high property wealth per student. Rather, they simply failed to consider the property wealth per student of the applying districts in any of its first nine grant cycles. This review could find no reference to property wealth per student in the sections of the Board's RFPs which described eligibility or award amount determination. And, unlike rural districts, there was no grant cycle in which districts with low property wealth were prioritized.

PERCENTAGE OF AT-RISK STUDENTS

The final analysis divides districts into quintiles based on the percentage of students classified as at-risk. As with the previous analysis, an average grant dollars per ADA figure was computed for each quintile.

It should be noted that the statutory requirement mandating the prioritization of projects in districts with disproportionately high numbers of at-risk students refers only to distance learning projects. For several grant cycles, the TIF Board awarded separate grants for distance learning projects and for "technology advancement" or telecommunications and technology purchases that did not necessarily relate to distance learning. Because the grant data does not distinguish between these two types of grants, this analysis includes all grant dollars from PS1 to PS9.

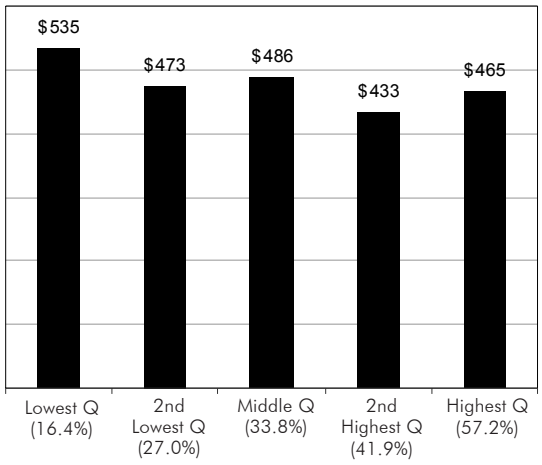
Figure 5 shows the results of this analysis. From PS1 through PS9, the 20 percent of districts with the most at-risk students received on average $465 per ADA. The 20 percent of districts with the fewest at-risk

students received an average of $535, or $70 more. However, this slight negative correlation is not statistically significant, meaning that districts' percentages of at-risk students have had no impact on the distribution of TIF Board grant funds.

These results suggest that the TIF Board did not prioritize districts with disproportionate numbers of at-risk students, at least with regard to grant dollars per ADA. Furthermore, a review of the Board's RFPs indicates that in no grant cycle, including those explicitly for distance learning, were districts' percentages of at-risk students a factor in determining eligibility or award amounts.

One may argue that because the TIF had enough money so that anyone who applied could receive a grant, the statutory prioritization of districts with high at-risk populations was no longer relevant. However, it is reasonable to suggest that the legislative desire to favor certain districts through prioritization, as expressed in statute, should be reflected not only in a project's place "in line" for funds but also to the amount of grant dollars the favored districts are awarded relative to other districts.

FIGURE 5
TIF BOARD GRANT AWARDS
BY PERCENT OF AT-RISK STUDENTS
PS1 (1997) — PS 9 (2001)



SOURCES: Telecommunications Infrastructure Fund Board; Texas Education Agency.

RECOMMENDATIONS AND CONCLUSIONS

As mandated by statute, the TIF Board has been successful in delivering more grant dollars per ADA to rural districts than non-rural districts. However, the statute is silent to the magnitude of the prioritization of rural districts. Therefore, the appropriateness of the large difference between dollars per ADA in rural versus non-rural districts ($622 versus $88, respectively) is beyond the scope of this review.

With regard to distributing funds to school districts with low property wealth and high numbers of at-risk students, the Board has not fulfilled its statutory requirements. Indeed, districts with the highest property wealth were, on average, awarded substantially more TIF grant dollars per ADA than less prosperous districts.

Two procedural problems appear most responsible for this maldistribution of TIF Board funds. First and most obviously, the TIF Board simply has failed to consider property wealth per student and percentage of at-risk students when determining eligibility and award amounts in any of its grant cycles. Second, the Board established a set of minimum and maximum grant amounts which did not account for the fact that Texas has very large and very small school districts. The Board's attempts to recognize this disparity by limiting small districts' eligibility on consecutive grant cycles was not enough to overcome the significant gap in grant dollars per ADA between large and small districts.

To attempt to correct for this past maldistribution, the TIF Board should do the following:

- **Recommendation 1:** If the Seventy-eighth Legislature, 2003, appropriates the remaining

public school grant funds (approximately $300 million) the Board should distribute them in a manner that directly addresses the statutory requirements for prioritization. In future grant cycles, the agency should emphasize the two criteria that it has failed to adequately consider when distributing its first nine grant cycles: property wealth per student and at-risk populations. The agency may wish to create a funding formula to weight districts and/or campuses based on these criteria.

- **Recommendation 2:** The Board should create a specific, detailed plan describing how it will fulfill each of the statutory requirements for grant prioritization. This should be done not only for public school grants but for grants to other eligible entities as well. This plan should be included in the agency's Strategic Plan and distributed to the members of the Legislature and the Governor for review and comment.

At the end of 2001, the TIF Board had not included TEA district and campus identification numbers in its grants database, making it impossible to incorporate relevant data on property wealth and at-risk students. This made it impossible for the Board to assess applying districts based on these factors, or to analyze the distribution of grant dollars already distributed. For this review, the relevant data were able to be synthesized at the district level but not at the campus level, and therefore analysis was limited to district comparisons. However, campus-level analysis would be preferable for certain prioritization criteria; for example, because percentages of at-risk students can vary widely between campuses within a district, grant awards should be tracked down to the campus level to ensure that districts are directing TIF dollars to their neediest campuses. To enable these levels of review, the Board should do the following:

- **Recommendation 3:** Incorporate into its grants database the TEA identification numbers for each recipient campus and district in order to analyze whether its public school grant distribution is conforming to statutory requirements. The Board should perform this analysis annually. The analysis should cover agency performance on the three prioritization requirements covered by this review (rural status, property wealth per student, and percentage of at-risk students). Other relevant statutory requirements, including project sustainability and inter-entity collaboration should be considered as well. The review should be at the campus level for appropriate criteria.

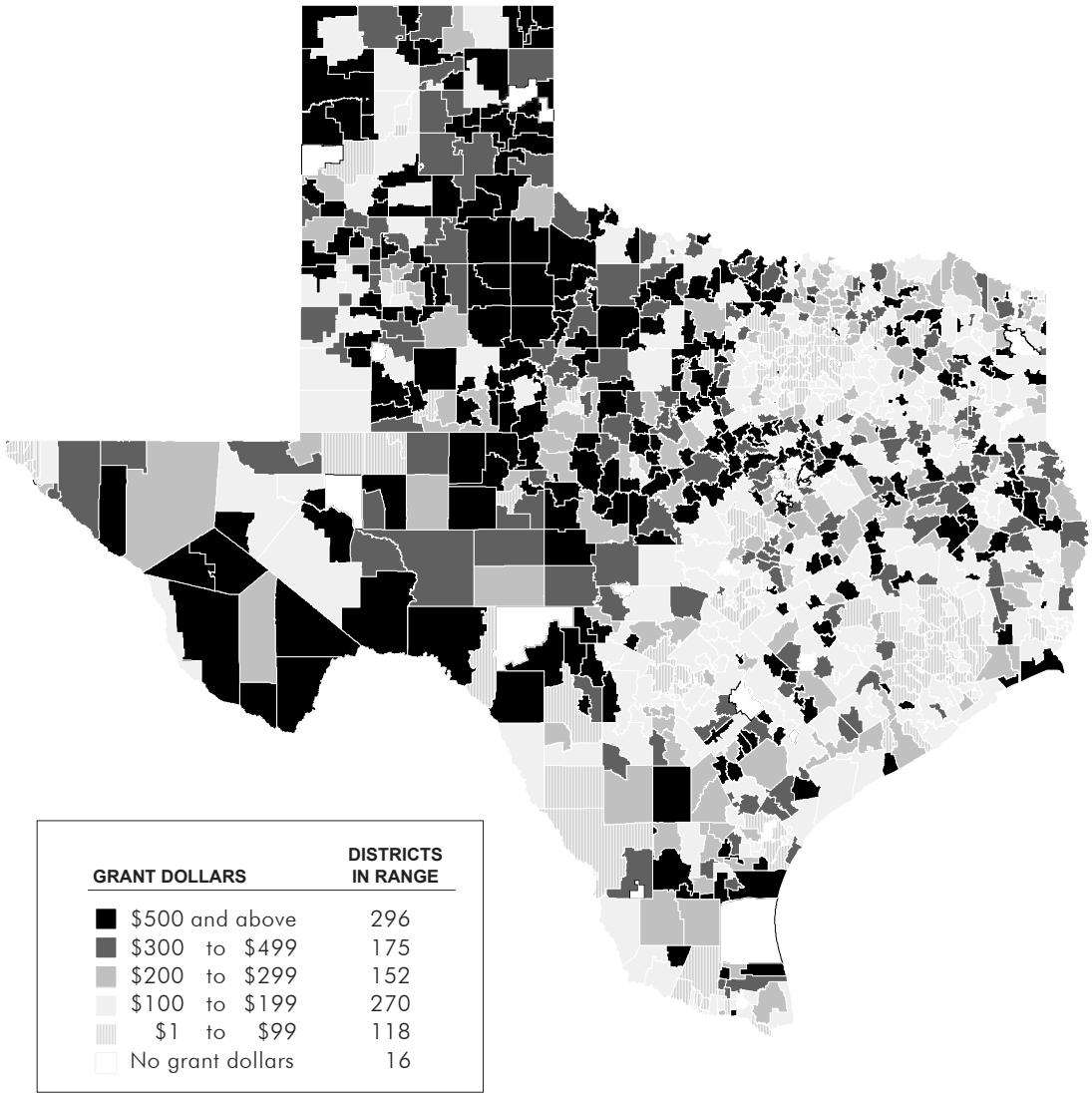
According to its statute, the TIF Board shall give priority to projects that will provide "specific educational information and knowledge services to groups not previously served, especially in a rural or remote area" (§ 57.047(c)(5)). However, because no comprehensive data exists on what areas and specifically school districts in the state have been underserved by telecommunications services, nor any information on the degree to which they may be underserved, it is difficult to design a grant program that fulfills this prioritization requirement. By distributing more grant dollars per ADA to rural districts than non-rural districts, it is likely that many underserved rural areas have benefited from TIF Board grant decisions. However, the agency's grant distribution policies for PS1 through PS9 make it unlikely that projects in underserved non-rural areas of the state, such as poorer, urban areas, have received funding prioritization. Figure 6 gives the geographical distribution of TIF public school dollars per ADA and suggests that adequate and equitable levels of TIF funding may not be reaching some underserved urban areas of Texas, especially those along the U.S.-Mexican border.

Although this analysis is at the school district level, the TIF Board generally has awarded its grants to specific campuses within districts. Late in fiscal year 2001, the TIF Board announced a grant cycle (PS Spec) of $87 million for the approximately 1,979

school campus identified as having never received a TIF Board grant; each campus is eligible to receive between $40,000 and $45,000. This grant cycle may ultimately serve to correct past problems in public school grant distribution by channeling funds to districts with relatively high numbers of at-risk students and/or low property wealth that have been underrepresented in past grant cycles.

However, using the sole eligibility criterion of having never received a TIF Board grant and awarding a flat amount regardless of campus ADA are not systematic methods of identifying campuses most in need. By not specifically identifying campuses and districts most deserving of prioritization and scaling grant awards to their needs, the Board is not making the most efficient use of the $87 million. Finally, even if this grant cycle does result in a large benefit to districts with low property wealth and high numbers of at-risk students, the Board still will have run afoul of its statutory requirements by failing to actively consider these factors in its decision-making process.

Figure 6
Geographic Distribution of TIF Board Public School Grants per ADA



Sources: Legislative Budget Board; U.S. Census Bureau.

Dropout Reporting by School Districts: Unusual Uses of Leaver Reason Codes

The Texas Education Agency (TEA) has received criticism in recent years for its dropout rate and the methodology by which it is calculated. For the 1999–2000 school year, according to the TEA, 1.3 percent of students (23,457 students) in grades 7–12 were reported to have dropped out. Significantly higher dropout estimates from other sources, as well as anecdotal evidence from schools, have prompted critics to argue that the TEA calculation severely understates the dropout problem in the state of Texas.[1]

One criticism centers on district reporting of dropouts and other school "leavers." Independent school districts (ISDs) in Texas annually report to the TEA those students that have left school and the reasons for their departures using a set of "leaver reason codes." Leavers assigned certain codes, such as withdrew to pursue a job, are considered dropouts and included in both the districts' and the state's official dropout count. Leavers given other codes, such as withdrew for home schooling, are not considered dropouts and are left out of the dropout count.

The accuracy of the TEA's dropout rate statistic, therefore, relies on districts assigning the correct codes to their student leavers. Any intentional or unintentional misuse of leaver codes by school districts, especially by reporting dropouts as those school leavers who are not included in the dropout calculation, could artificially deflate the TEA's dropout rate.

[1]For example, the Intercultural Development Research Association (IDRA) publishes annual analysis of dropout and attrition rates in Texas (www.idra.org). See also, "Written Off: Texas' Dropout Problem," *Dallas Morning News*, May 20, 2001.

The first step in identifying possible misreporting of dropouts and other leavers through the leaver reason code system is to examine individual districts for unusually high uses of particular leaver codes. This report analyzes district dropout and leaver reporting from the 1999–2000 school year for unusual uses of two leaver reason codes that may be particularly vulnerable to misuse: code 28, *withdrew with intent to enroll in a public school in Texas*, and code 60, *withdrew for home schooling*.

Significant Concerns

- In the 1999–2000 school year, districts reported 132,596 students as having withdrawn with the declared intent to transfer to another public school in Texas. However, 29,041 of these students, or 21.9 percent, could not be found enrolled in another school district. The TEA does not count these "missing in-state transfers" as dropouts. In fact, the number of missing in-state transfers exceeded the number of official dropouts (23,457). Counting them as dropouts would have more than doubled the statewide dropout rate of 1.3 percent.
- In 11 districts, the percentage of in-state transfers that subsequently could not be found enrolled in another district was over 40 percent; in two of these districts it was over 50 percent. If these missing in-state transfers had been counted as dropouts, the dropout rates of these districts would have tripled on average, and four of these districts would have received a lower accountability system rating as a result. One would have earned an *academically unacceptable* rating.

- In 13 districts, usage of the leaver code *withdrew for home schooling* was in excess of five times the statewide average. In one district, home school leavers as a percentage of grades 7–12 enrollment was 6.6 percent, or 11 times the statewide average of 0.6 percent.
- These two leaver codes, *withdrew with intent to enroll in a public school in Texas* and *withdrew for home schooling*, have weak documentation standards that may leave them especially vulnerable to misuse. These weaknesses, combined with the leniency the TEA affords districts with respect to underreported students (those students for whom the TEA expects a district to file a leaver code but does not receive one), represent potential flaws in the dropout reporting system which may allow actual dropouts to go unreported.
- In the case of charter schools, 41.9 percent of reported in-state transfers could not be found enrolled in another district. Unusual patterns in leaver and dropout reporting by charter schools suggest that these schools may be having difficulty using the leaver reason code reporting system properly, and that official dropout rates for some charter schools may be unreliable.
- None of the districts or charter schools identified in this report as reporting unusual leaver code usage in 1999–2000 were targeted for leaver code audits or reviews by the TEA. Although the TEA has since made improvements to its leaver data review process, it still may not be identifying districts with the highest potential for data misuse.

RECOMMENDATIONS

- **Recommendation 1:** The TEA should revise its dropout calculation to count missing in-state transfers as dropouts.
- **Recommendation 2:** The TEA should tighten the documentation standards for leaver code 28, *withdrew with intent to enroll in a public school in Texas* and code 60, *withdrew for home schooling*, by eliminating the acceptability of an "oral statement" of intent to withdraw, signed only by a district representative.
- **Recommendation 3:** Missing in-state transfer rates exceeding a predetermined threshold should automatically trigger a TEA leaver code review of that district. Districts reporting unusual percentages of students withdrawing for home schooling should also be targeted for review.
- **Recommendation 4:** Dropout audit guidelines and training provided by the TEA to independent auditors should direct auditors to examine the documentation of those specific leaver codes that are most vulnerable to misuse: code 28, *withdrew with intent to enroll in a public school in Texas*, code 29, *withdrew with intent to transfer to a private school in Texas*, code 60, *withdrew for home schooling*, code 07, *withdrew with intent to enroll in a school out-of-state*, and code 16, *returned to home county*.
- **Recommendation 5:** Charter schools and the Texas Education Agency should take appropriate steps to ensure that charter school administrators understand the leaver reason code system and properly report student data through it.
- **Recommendation 6:** The threshold for percentage of underreported students, beyond which school districts are penalized in the accountability system, should be set lower than the current mark of 10 percent.

COMMENTS

Since the 1997–98 school year, school districts have reported the status of every student who was enrolled in grades 7–12. In the fall following the completion

of a school year, previously enrolled students who did not return to school are reported to the TEA with a "leaver record." In the annual reporting through the Public Education Information Management System (PEIMS), districts assign up to three of 43 leaver reason codes to describe the circumstances of a student's departure.

Depending on the primary leaver reason code assigned, school leavers are categorized as graduates, dropouts, or other leavers. Table 1 shows a selection of commonly used reason codes for each category.[2]

After the TEA receives the final PEIMS submission containing this leaver reporting, staff initiates an automated statewide search of other data files for those school leavers coded as dropouts. This includes, among other situations, students who are found enrolled in public school somewhere else in the state and students appearing on the GED information file as having received GED certificates. Any students found by this process are removed from districts' dropout counts. For the 1999–2000 school year, the TEA found 4,041 students originally reported by districts as dropouts enrolled in another district in the state and removed them from the dropout count.

Through the same process, the agency examines whether those students reported by districts with code 28, *withdrew with intent to enroll in a public school in Texas*, actually enrolled in another district. In the same school year the TEA found that, of the 132,596 students reported as these in-state transfers, 29,041 or 21.9 percent could not be found in another school district. These students are not added to the dropout count because, according to the agency, they may in fact be enrolled but under different identifying information, or their true statuses are not known.

However, when examining ways in which the leaver code reporting system could possibly understate the actual number of dropouts in Texas, missing in-state transfers are a logical place to begin. First, they represent a very large number of students for whom the TEA cannot account. The total of 29,041 missing in-state transfers is larger than the number of official dropouts, 23,457 in 1999–2000. If a significant majority of them are dropouts, the state's dropout rate would double.

TABLE 1
SELECTED LEAVER REASONS REPORTED
1999–2000

CODE	LEAVER REASON	NUMBER OF RECORDS 1999–2000
GRADUATES/COMPLETERS (5 TOTAL CODES)		
01	Graduated	212,925
19	Completed graduation requirements except exit-level TAAS	1,809
31	Completed GED	7,338
OTHER LEAVERS (19 TOTAL CODES)		
07	Intent to enroll in school out-of-state	35,039
16	Returned to home country	10,676
22	Alternative program working toward GED or diploma	21,011
28	Intent to enroll in a public school in Texas	132,596
29	Intent to enroll in a private school in Texas	8,501
60	Withdrew for home schooling	12,721
DROPOUTS (19 TOTAL CODES)		
02	Withdrew/left school to pursue a job	2,012
12	Withdrew/left school because of poor attendance	7,389
99	Withdrew/left school – reason unknown	15,256

Source: Texas Education Agency.

[2]A complete list of leaver reason codes can be found in the TEA publication entitled *Secondary School Completion and Dropout in Texas Public Schools 2000–01*.

Secondly, the agency's requirements regarding acceptable documentation for this code appear to leave it fairly vulnerable to misuse. There are two types of acceptable documentation: (1) a withdrawal form or letter signed by the parent/guardian or adult student, or (2) written documentation of an oral statement made by the parent/guardian or adult student made at the time the student quits attending school in the district, signed and dated by an authorized representative of the district. The latter type of documentation produces no verifiable evidence of intent, and therefore makes the use of this code more susceptible to manipulation than, for example, a student transfer for which there was a records request.

TEA Leaver Data Review Processes

The TEA, aware that the leaver code reporting system presents opportunities for dropout misclassification and underreporting, has established procedures to investigate districts' leaver code use. However, the agency has not yet conducted a review that focuses exclusively on districts identified as having unusually high rates of missing in-state transfers.

Two divisions within the agency review district reporting of leaver codes. The Research and Evaluation division conducts an analysis of leaver code use on a statewide level after the annual district leaver reporting in January. The division checks for dramatic increases or declines in the use of particular leaver codes from year to year; its findings contribute to efforts to improve the leaver code system by adding, deleting, or consolidating leaver codes.

The TEA's Special Data Inquiry Unit (SDIU) has conducted "data quality" investigations of districts based on high percentages of underreported students since 1999, when the first year of leaver data was reported (reflecting dropouts during the 1997–98 school year). Underreported students are those students for whom the agency was expecting a leaver record from a district but did not receive one.

The following year, SDIU began analyzing districts' usages of particular leaver codes. For the first two years of this review (submissions reflecting dropouts in the 1998–99 and 1999–2000 school years), staff randomly selected four leaver codes for analysis, isolated the regions of the state that the agency had not visited in prior investigations into underreported students, and then randomly selected districts and charter schools in these regions for review.

For the review of submissions reflecting dropouts in the 2000–01 school year, the TEA improved its process by selecting for analysis the two most used leaver codes: code 28, *withdrew with intent to enroll in a public school in Texas*, and code 07, *withdrew with intent to enroll in a school out-of-state*. Districts were flagged for review if they reported over 100 leavers with code 28 and if the number of code 28 leavers represented 80 percent or more of total leavers reported.

This represents a substantial improvement over the previous policy of random selection of leaver codes and districts. However, it is not the best method at the TEA's disposal for identifying districts with potential leaver code misuse.

For example, a district may have a highly mobile student population, and thus heavy usage of the in-state transfer code 28, even exceeding 80 percent of its total leavers. Currently, the agency would flag this district for review. However, the TEA has the ability to verify whether these reported transfers in fact re-enrolled in another district in the state. If most of them did, this district should not be considered high-risk. On the other hand, a district with a high percentage of reported in-state transfers that the TEA cannot find enrolled in another Texas public school would be a good candidate for further analysis. Thus, the total and percentage of missing in-state transfers represent superior criteria by which to identify districts with potential leaver code misuse.

OTHER LEAVER DATA INVESTIGATIONS

In its March 2002 audit report, *The Quality of the State's Public Education Accountability Information*, the State Auditor's Office (SAO) tested the validity of leaver codes reported by 12 secondary campuses in its statistical sample of 45 Title I, Part A schools. SAO staff randomly selected 70 leavers and found that 19 records did not support the leaver reason the districts reported, resulting in a 27 percent error rate. However, 14 of the 19 errors came from a single campus, calling into question the generalizability of these results to other campuses, districts and the state as a whole. Nevertheless, the SAO findings underscore the need for district-level analysis of unusual leaver code use by district and subsequent data quality investigations by the TEA based on its findings.

Also, concern over the validity of the dropout rate and the leaver code system from which it is calculated led the Seventy-seventh Legislature, 2001, to include in House Bill 1144 a provision requiring every school district to have an annual independent audit of its leaver records. District leaver records for the 2001–02 school year, reported to the TEA in January 2003, will be the first reviewed by independent auditors. The completed audits are due to the agency by mid-April 2003, which will then summarize and report its findings in Summer 2003.

In 2002, the TEA drafted a set of dropout audit guidelines, and currently is providing training and certification on the guidelines to public accountants. In order to test the adequacy of its audit guidelines and training, the agency also conducted a pilot audit of a randomly selected school district in the summer of 2002. Of the 61 leaver records tested, the auditor found 15 files, or 24.6 percent, in which the documentation either did not support the leaver code assigned to the student or did not meet the TEA requirements for acceptability. Also, of the 35 underreported student files tested, the auditor found that 22 files, or 62.9 percent, did not contain any documentation regarding leaver status or attendance and should have been reported as dropouts.

The findings of this pilot, while certainly not generalizable to all districts, suggest that concern over the reliability of leaver reason code reporting by school districts may be well founded. Given that the results of the dropout record audits will not be available until after the Seventy-eighth Legislative Session has ended, an analysis of unusual leaver code use by districts may provide a useful glimpse of what to expect from these independent audits. The following section summarizes the methodology and findings of such an analysis.

METHODOLOGY

This report takes the first step in examining the validity of school leavers reported under code 28, *withdrew with intent to enroll in a public school in Texas*, by analyzing the percent of missing in-state transfers on a district-by-district basis. The analysis seeks to identify districts with unusually high percentages of in-state transfers that are not found enrolled in another Texas school. This report then examines unusually high usage of leaver code 60, *withdrew for home schooling*.

What constitutes an unusually high percentage of missing in-state transfers is not obvious, although some logical benchmarks can serve as starting points. For example, each district's missing in-state transfer rate can be compared to the statewide average which, for the 1999–2000 school year, was 21.9 percent, or to the average of the districts in its immediate vicinity. Ultimately, any reasonable threshold is defensible if the goal of the analysis is simply to "red flag" a handful of districts that deserve closer examination.

It is important to note that districts that are identified as having unusual leaver code use should not be presumed automatically to have misused that code. One reason this code was selected for analysis is that there are no immediately obvious or intuitive reasons why a district's missing in-state transfer rate should

vary significantly from the statewide average. In contrast, for other codes that rely on a leaver's "intent," such as the intent to enroll in a school out of state or in his or her home country, it is logical to expect certain districts to report markedly higher use of these codes—for example, districts that share a border with another state or with Mexico.

Nevertheless, there still may exist legitimate demographic, geographic or idiosyncratic circumstances that cause a certain district's missing in-state transfer rate to be unusually high. This is why the analysis in this report represents only what should be the first step in a more thorough examination of certain districts' leaver code use and related documentation.

ANALYSIS OF LEAVER CODE USE

The following tables show leaver records for students from the 1999–2000 school year, as reported by school districts to TEA in 2001. The analysis focuses on three types of student records: (1) in-state transfers—school leavers reported under code 28, *withdrew with intent to enroll in a public school in Texas*, (2) leavers under code 60, *withdrew for home schooling*, and (3) underreported students, those students for whom the TEA expected a leaver record but did not receive one from the district.

Table 2 identifies the districts with the highest numbers of missing in-state transfers as a percentage of the total number of in-state transfers reported by the district. Reported in-state transfers are considered missing if the TEA cannot subsequently find them enrolled in another public school in Texas.

For this analysis, districts are identified as having unusual code 28 usage if their missing in-state transfers, as a percentage of reported in-state transfers, were 40 percent or higher. In order to account for districts in which this percentage can be driven by just a handful of students, small districts with fewer than 100 students in grades 7–12 enrollment and fewer than 20 leavers reported under code 28 are excluded from analysis. These parameters yield a list of 11 districts.

In 1999–2000, Socorro ISD had the highest number of missing in-state transfers as a percentage of its reported in-state transfers, at 55.2 percent. It was joined by Hitchcock ISD as the only two districts in which half of their in-state transfers could not be found enrolled elsewhere. A total of five districts had missing in-state transfer rates that at least doubled the statewide rate of 21.9 percent.

For six of the 11 selected districts, the number of missing in-state transfers exceeded the number of official dropouts. Indeed, in Huntington ISD, missing in-state transfers outnumbered official dropouts by a factor of 15 (46 to 3, respectively).

To test for regional or geographic circumstances that may be contributing to these high numbers of missing in-state transfers, the average percentage of missing in-state transfers for the districts that share the same county was calculated from each selected district. As Table 2 shows, the missing in-state transfer rates for all 11 districts significantly exceed those of their neighboring districts, suggesting that regional factors did not contribute to the very high numbers of missing in-state transfers.

Table 3 displays the same dropout and missing in-state transfer information as Table 2, but also illustrates what would happen to these districts' dropout rates and accountability ratings if missing in-state transfers were included in the official dropout count.

As the table illustrates, if missing in-state transfers in all districts were counted as dropouts, the statewide dropout rate for the 1999–2000 school year would more than double, from 1.3 percent to 2.9 percent. However, the dropout rate increases for several of the selected districts would be even more dramatic. For example, the dropout rate for Corsicana ISD would rise by nearly 3.5 percentage points, from 1.4 percent to 4.8 percent. Huntington ISD's dropout rate would

TABLE 2
DISTRICTS WITH HIGHEST PERCENTAGES OF MISSING IN-STATE TRANSFERS
1999–2000

DISTRICT[1]	7–12 ENROLLMENT	NUMBER OF OFFICIAL DROPOUTS	DROPOUT RATE	MISSING IN-STATE TRANSFERS		SURROUNDING DISTRICTS' AVERAGE[2]
				NUMBER	AS PERCENTAGE OF IN-STATE TRANSFERS REPORTED	
STATEWIDE AVERAGE			**1.3%**			**21.9%**
Socorro ISD	11,666	117	1.0	96	55.2%	19.9
Hitchcock ISD	658	9	1.4	20	52.6	21.4
Roma ISD	2,647	46	1.7	45	47.9	21.2
Corsicana ISD	2,369	34	1.4	80	45.2	25.6
Cotulla ISD[3]	744	14	1.9	35	44.3	26.5
San Diego ISD	736	7	1.0	26	43.3	27.0
Rio Grande ISD	3,645	171	4.7	22	42.3	23.9
Huntington ISD	930	3	0.3	46	42.2	17.7
Robstown ISD	1,850	49	2.6	45	41.7	20.5
Cedar Hill ISD	3,266	37	1.1	25	40.3	22.3
Los Fresnos CISD	3,090	12	0.4	40	40.0	25.9

[1]Only districts with 100 or more students in grades 7-12 enrollment, and 20 or more code 28 leavers were selected for analysis. This yields a universe of 205 districts.
[2]Surrounding district average includes the average missing in-state transfer percentage from the districts that share the same county.
[3]Cotulla ISD occupies the entire county of La Salle, so an average of the surrounding counties was used for comparison.
SOURCES: Legislative Budget Board; Texas Education Agency.

increase by 5 percentage points, and Cotulla ISD's rate would be pushed from 1.9 percent to 6.6 percent. In contrast, Rio Grande ISD, which already posted a relatively high dropout rate of 4.7 percent, would see this rate rise only slightly, to 5.3 percent.

For four of the 11 districts, this revised dropout rate would precipitate the downgrading of their 2001 accountability rating. Los Fresnos Consolidated ISD would lose its exemplary status as its revised dropout rate would exceed the exemplary standard of 1.0 percent or less. Huntington and Robstown ISDs would no longer qualify for recognized status, which requires a dropout rate of 3.0 percent or less, and Cotulla ISD would be rendered academically unacceptable for exceeding a dropout rate of 5.5 percent.

The unusual rates of missing in-state transfers by the districts listed in Tables 2 and 3, and their potential consequences on dropout rates and accountability ratings, make these districts fairly obvious, high-risk targets for subsequent investigations into leaver data reporting. However, because the TEA randomly selected both the districts to audit and the leaver code records to analyze at these districts, none of the districts identified above were selected for review by the agency.

LARGE URBAN DISTRICTS

Table 4 illustrates the rates of missing in-state transfers in the state's eight largest school districts. The missing in-state transfer percentages generally are higher for the largest urban districts in Texas, and the

TABLE 3
MISSING IN-STATE TRANSFERS
HYPOTHETICAL EFFECTS ON DROPOUT RATES AND ACCOUNTABILITY RATINGS
1999–2000

DISTRICT	NUMBER OF OFFICIAL DROPOUTS	DROPOUT RATE	2001 ACCOUNTABILITY RATING	MISSING IN-STATE TRANSFERS		MITS COUNTED AS DROPOUTS	
				NUMBER	AS PERCENTAGE OF IN-STATE TRANSFERS REPORTED	DROPOUT RATE	ACCOUNTABILITY RATING
STATEWIDE AVERAGE		**1.3%**			**21.9%**	**2.9%**	
Socorro ISD	117	1.0	Recognized	96	55.2	1.8	Recognized
Hitchcock ISD	9	1.4	Acceptable	20	52.6	4.4	Acceptable
Roma ISD	46	1.7	Acceptable	45	47.9	3.4	Acceptable
Corsicana ISD	34	1.4	Acceptable	80	45.2	4.8	Acceptable
Cotulla ISD	14	1.9	Acceptable	35	44.3	6.6	**UNACCEPTABLE**
San Diego ISD	7	1.0	Acceptable	26	43.3	4.5	Acceptable
Rio Grande ISD	171	4.7	Acceptable	22	42.3	5.3	Acceptable
Huntington ISD	3	0.3	Recognized	46	42.2	5.3	**ACCEPTABLE**
Robstown ISD	49	2.6	Recognized	45	41.7	5.1	**ACCEPTABLE**
Cedar Hill ISD	37	1.1	Acceptable	25	40.3	1.9	Acceptable
Los Fresnos CISD	12	0.4	Exemplary	40	40.0	1.7	**RECOGNIZED**

SOURCES: Legislative Budget Board; Texas Education Agency.

TABLE 4
MISSING IN-STATE TRANSFERS
FROM THE EIGHT LARGEST DISTRICTS
1999–2000

DISTRICT[1]	7–12 ENROLLMENT	NUMBER OF OFFICIAL DROPOUTS	DROPOUT RATE	MISSING IN-STATE TRANSFERS		DROPOUT RATE IF MITS ARE COUNTED AS DROPOUTS
				NUMBER	AS PERCENTAGE OF IN-STATE TRANSFERS REPORTED	
STATEWIDE AVERAGE			**1.3%**		**21.9%**	**2.9%**
Houston ISD	84,679	2,690	3.2	1,600	31.3	5.1
Dallas ISD	63,580	765	1.2	614	37.7	2.2
Fort Worth ISD	34,697	921	2.7	332	25.0	3.6
Austin ISD	33,592	792	2.4	552	32.8	4.0
El Paso ISD	29,273	469	1.6	569	31.1	3.5
Cypress-Fairbanks ISD	28,053	62	0.2	144	12.9	0.7
San Antonio ISD	27,674	493	1.8	523	20.5	3.7
Arlington ISD	25,788	335	1.3	283	19.4	2.4

[1]Northside ISD was excluded from analysis; the district reported no in-state transfers in 1999–2000; the validity of this submission could not be confirmed.
SOURCES: Legislative Budget Board; Texas Education Agency.

sheer numbers of missing in-state transfers from these districts—Houston ISD with 1,600, for example—are notable.

One may suspect that the elevated missing in-state transfer rates for large, urban districts may result from students transferring out of these districts more frequently than other districts. However, this is true only of Houston ISD, in which reported in-state transfers as a percentage of grades 7–12 enrollment are slightly higher than the statewide average.

Underreported Students

As mentioned earlier, one reason the TEA does not count missing in-state transfers—29,041 statewide in 1999–2000—as dropouts is the possibility that some of these leaver records are simply data errors caused by mismatching student identification information. However, underreported students represent another large group of "missing" student records—19,718 in 1999–2000—that the TEA does not consider when calculating dropouts. As such, both missing in-state transfers and underreported students present major opportunities to not report dropouts through intentional or unintentional misuse by districts.

Table 5 presents five districts with high numbers of both missing in-state transfers and underreported students, relative to their grades 7–12 enrollment. For all districts listed, both missing in-state transfers and underreported students significantly outnumber the official dropout counts. If even a slight majority of these underreported students were actually dropouts, the revised dropout rate for all of the selected districts would exceed 5.5 percent, reducing their accountability rating to *academically unacceptable*.

Home School Leavers

Another leaver code identified as high-risk for inaccurate reporting by both the TEA and SAO is code 60, *withdrew for home schooling*. The use of this code has risen dramatically over the last four years. The number of students reported by districts to have withdrawn for home schooling has grown from 8,632 for the 1997–98 school year to 13,676 for the 2000–01 school year, an average yearly increase of 16.8 percent over this time period.

This leaver code also suffers from the same weaknesses in documentation standards as code 28, *withdrew with intent to enroll in another public school in Texas*. Acceptable documentation as established by the

TABLE 5
DISTRICTS WITH DISPROPORTIONATELY HIGH NUMBERS OF MISSING IN-STATE TRANSFERS AND UNDERREPORTED STUDENTS
1999–2000

DISTRICT	7–12 ENROLLMENT	NUMBER OF OFFICIAL DROPOUTS	DROPOUT RATE	NUMBER OF MISSING IN-STATE TRANSFERS	DROPOUT RATE IF MITS ARE COUNTED AS DROPOUTS	NUMBER OF UNDERREPORTED STUDENTS
STATEWIDE AVERAGE			**1.3%**		**21.9%**	
Hitchcock ISD	658	9	1.4	20	4.3	11
Corsicana ISD	2,369	34	1.4	80	3.4	51
San Diego ISD	736	7	1.0	26	3.5	19
Manor ISD	1,187	16	1.3	55	6.0	64
Axtell ISD	584	2	1.2	29	5.3	29

Sources: Legislative Budget Board; Texas Education Agency.

TEA includes a record of an "oral statement" from the parent/guardian or adult student of intent to withdraw, and signed only by a district representative.

Table 6 lists nine districts identified as exhibiting unusually high numbers of home school leavers for the 1999–2000 school year. As with missing in-state transfers, defining "unusually high" is ultimately an arbitrary process. In this analysis, only those districts in which the home school leaver percentages, as both a percentage of total leavers reported by the district and as a percentage of enrollment in grades 7–12, were five times the statewide average or higher are examined.

As Table 6 shows, 6.6 percent of Ore City ISD's student population in grades 7–12 left the district for home schooling during the 1999–2000 school year, according to district leaver records. This was the highest percentage of reported home school leavers relative to grades 7–12 enrollment in the state by a substantial margin. In fact, this percentage was 11 times greater than the statewide average of 0.6 percent.

Other unusual usage patterns for code 60 include Eagle Pass ISD, in which 10 times as many students were reported as having left the district for home schooling as dropped out (171 to 17, respectively), and El Campo ISD, which did not report any dropouts for the 1999–2000 school year, but reported 57 home school leavers, or 3.1 percent of its grades 7–12 enrollment.

Table 6 also shows the district that reported the largest number of home school leavers in the 1999–2000 school year: Garland ISD, with 402. This

TABLE 6
DISTRICTS WITH UNUSUALLY HIGH NUMBERS OF HOME SCHOOL LEAVERS
1999–2000

DISTRICT[1]	7–12 ENROLLMENT	NUMBER OF OFFICIAL DROPOUTS	DROPOUT RATE	HOME SCHOOL LEAVERS		
				NUMBER	AS PERCENTAGE OF ALL LEAVERS REPORTED	AS PERCENTAGE OF 7–12 ENROLLMENT
STATEWIDE AVERAGE			**1.3%**		**3.0%**	**0.6%**
Ore City ISD	409	5	1.2	27	21.4	6.6
Boyd ISD	554	4	0.7	25	16.5	4.5
Kemp ISD	845	10	1.2	37	21.6	4.4
Big Spring ISD	2,091	15	0.7	80	18.6	3.8
Yoakum ISD	835	8	1.0	28	15.0	3.4
Mabank ISD	1,512	15	1.0	50	16.4	3.3
Eagle Pass ISD	5,467	17	0.3	171	15.8	3.1
Marble Falls ISD	1,691	25	1.5	52	15.5	3.1
El Campo ISD	1,845	0	0.0	57	17.0	3.1
DISTRICT WITH THE MOST HOME SCHOOL LEAVERS IN 1999–2000, AS COMPARED TO THE THREE LARGEST DISTRICTS						
Garland ISD	22,674	84	0.4%	402	9.2%	1.8%
Houston, Dallas Fort Worth ISDs	182,956	4,646	2.5	366	1.1	0.02

[1]Only districts with 100 or more students in grades 7-12 enrollment and with 25 or more reported leavers with code 60 were selected for analysis.
SOURCES: Legislative Budget Board; Texas Education Agency.

rate exceeds the statewide average by a factor of three. To judge the relative size of Garland ISD's usage of this code, the enrollment, dropout, and home school leaver data from the three largest districts in the state—Houston, Dallas, and Fort Worth ISDs—were aggregated. For 1999–2000, Garland ISD reported more home school leavers than these districts combined (402 to 366, respectively). This is remarkable given that Houston, Dallas, and Fort Worth ISDs have over eight times as many students as Garland ISD, and reported 55 times as many dropouts.

It is easier to imagine legitimate explanations for why some districts' uses of this code would be significantly higher than the statewide average than it is for missing in-state transfers. In some districts there may be a strong and well-established network of families who home school, thus making home schooling a more feasible choice. Districts with a relatively high proportion of two-parent families in which only one works may see more of their students leave for home schooling. Finally, districts with poorly performing schools may witness parents respond by withdrawing their children and seeking other education settings, including home schooling.

As a partial test of this last hypothesis, one can look to the 1999 accountability ratings—the most recent ratings available during the 1999–2000 school year—for all the high schools in the districts listed in Table 6. Of these districts, only the high schools in Big Spring and Eagle Pass ISDs were low performing. This may partially explain these districts' unusually high home school leaver rates. However, the Ore City, Yoakum, Mabank and El Campo ISD high schools all received a recognized rating, providing little support for this explanation. The high schools in the remaining districts were academically acceptable.[3]

[3]In the 2000 accountability ratings, which reflect district performance during the 1999–2000 school year, these districts' high schools were all rated recognized or above, except for Eagle Pass and Marble Falls ISDs, which were acceptable.

Charter Schools

Since they first opened their doors in 1997, charter schools in Texas generally have had more difficulties complying with the TEA's student data reporting requirements than regular public schools. The newness of charter schools and the lack of administrative experience among their personnel have resulted in significant error rates in charter data reporting.

For example, for reporting on the 1999–2000 school year, the agency's Special Data Inquiry Unit identified 26 of the 142 operating charter schools as being in need of review for their percentages of underreported students. Two schools, which subsequently closed, underreported 100 percent of their students; that is, no leaver record was submitted for any of their 2,700 students. The remaining schools had an average underreported rate of 28.8 percent. The state average for all schools in that year was 1.1 percent.

Table 7 lists the charter schools with the highest numbers of missing in-state transfers in the 1999–2000 school year. The average missing in-state transfer rate for charter schools was 41.9 percent, nearly double the statewide average for regular public schools. As the table shows, the South Plains Academy, located in San Antonio, had the most reported transfers that could not be found enrolled in another school in Texas: 63 of 81 transfers, or 77.8 percent, were missing. This number far exceeds the charter school's official dropout count of one student. Indeed, 63 missing in-state transfers represent nearly 29 percent of the school's enrollment in grades 7–12.

Other charter schools with unusual rates of missing in-state transfers include the Dallas Can! and Houston Can! Academies, both of which received an acceptable rating in the TEA's alternative education accountability system for the 1999–2000 school year. Notably, in addition to its 163 missing in-state transfers, the Dallas Can! Academy also reported 126 home school leavers, or nearly 8 percent of its enrollment in grades 7–12.

TABLE 7
CHARTER SCHOOLS WITH HIGHEST NUMBERS OF MISSING IN-STATE TRANSFERS
1999–2000

CHARTER SCHOOL[1]	7–12 ENROLLMENT	NUMBER OF OFFICIAL DROPOUTS	DROPOUT RATE	MISSING IN-STATE TRANSFERS		2001 ACCOUNTABILITY RATING[2]
				NUMBER	AS PERCENTAGE OF IN-STATE TRANSFERS REPORTED	
STATEWIDE AVERAGE			**1.3%**		**21.9%**	
CHARTER AVERAGE					**41.9%**	
South Plains Academy	219	1	0.5	63	77.8	AE: Needs Peer Review
Sentry Technology Prep	648	188	29.0	58	70.7	AE: Needs Peer Review
Mid-Valley Academy	127	25	19.7	9	69.2	AE: Needs Peer Review
Raven School	522	0	0.0	153	68.6	AE: Needs Peer Review
Dallas Can! Academy	1,595	225	14.1	163	66.5	AE: Acceptable
Houston Can! Academy	735	43	6.1	146	64.9	AE: Acceptable
Eagle Project (Del Rio)	120	10	8.3	13	61.9	AE: Needs Peer Review

[1]Only charter schools with five or more missing in-state transfers were selected for analysis.
[2]AE indicates the school qualified to be rated in the TEA's alternative education accountability system.
SOURCES: Legislative Budget Board; Texas Education Agency.

For leaver data submitted for the 1999–2000 school year, the TEA randomly selected 14 regular districts and two charter schools for an investigation into leaver code use. None of the charter schools listed in Table 7 were investigated.

CONCERNS AND RECOMMENDATIONS

This report describes opportunities within the TEA's leaver code reporting system for districts and charter schools to misreport and underreport school dropouts. However, none of the districts and charter schools listed above should be presumed to have intentionally misused these leaver codes to artificially lower their dropout rate simply based on this analysis.

Rather, this report simply identifies unusual patterns of leaver code use that warrant systematic examination by the TEA to ensure the accuracy and reliability of its leaver reporting system and the district and state dropout rates it produces. Also, these findings suggest several recommendations that the agency can adopt to strengthen this system.

COUNT MISSING IN-STATE TRANSFERS AS DROPOUTS (RECOMMENDATION 1)

One of every five students that left a Texas public school in the 1999–2000 school year with the reported intent to enroll in another public school in the state could not be found enrolled anywhere else. The TEA determines this rate through a "dropout data recovery" process it uses to search for reported dropouts and remove them from districts' dropout counts if found. However, when TEA finds that an in-state transfer did not in fact re-enroll, the agency does not add them to the dropout roll.

The agency's stated rationale is that some of these missing in-state transfers may be the result of personal identification errors. The school leaver in fact may have enrolled in another district, but discrepancies in identifying information between the two districts prevent the TEA from finding these students in its recovery process and confirming them as transfers.

However, in 2000–01 the agency began implementing a person identification database (PID) error rate policy that requires submitted student identification information meet a standard for accuracy, thus greatly reducing student data discrepancies across districts. As a result, as PID rates continue to improve, the less likely it has become that missing in-state transfers are the result of student identification errors.

In fact, many of these missing in-state transfers may well be dropouts. The TEA, through its dropout data recovery process, has shown that whatever documentation districts possess regarding the intent of these school leavers is inaccurate. The TEA's leaver system policy holds each district responsible for reporting the status of every one of its students. Therefore, leavers for which a district cannot account and for which the district has no reliable documentation—in this case, missing in-state transfers—should be counted as dropouts.

Additionally, counting missing in-state transfers as dropouts can serve as a strong incentive for districts to improve the quality of their student identification data, as any transfer who is not found due to mismatched identifying information is counted as a dropout regardless. For example, it is likely that districts would make more of an effort to coordinate student records requests whenever there are in-state transfers, thus reducing potential data mismatches. This data quality is especially important given the importance of matching student records across years to track progress and calculate longitudinal dropout and graduation rates.

This recommendation is not new to the TEA. In April 2000, the agency assembled a panel of nine Education Service Center representatives, who were asked to review and suggest improvements to the leaver reason code system. One of the panel's recommendations was to count missing in-state transfers as dropouts. The TEA ultimately declined to adopt this recommendation.

Tighten Leaver Documentation Standards (Recommendation 2)

The TEA should tighten the documentation standards for leaver code 28, *withdrew with intent to enroll in a public school in Texas* and code 60, *withdrew for home schooling*, by eliminating the acceptability of an "oral statement" of intent to withdraw, signed only by a district representative. The only acceptable documentation should be a withdrawal form signed by the parent/guardian or adult student, a signed letter or fax, or a dated email.

Acceptable documentation for these codes currently includes a withdrawal form or letter signed by the parent/guardian or adult student, but also written documentation of an oral statement made by the parent/guardian or adult student made at the time the student quits attending school in the district, signed and dated by an authorized representative of the district. The latter form of documentation produces no verifiable evidence of intent, and therefore makes the use of this code susceptible to manipulation.

Tightening these documentation standards by eliminating the acceptability of an "oral statement" would not be onerous to districts. If districts had received oral information about where a student was transferring but no signature, that district could still follow up with the destination district to ensure that a records request was made once the student enrolled in that district. The student would then be reported as leaver code 73, *withdrew with no intent but documented enrollment in a public school in Texas*. Even if no records request is made and the original district is forced to classify that student as a dropout, the TEA's dropout data recovery system automatically removes a student from a

district's dropout count if that student is found enrolled by another district. Thus, the district would not be adversely affected by the more stringent documentation standard if those students do in fact enroll in another public school in the state.

For code 60, *withdrew for home schooling*, the sheer number of home school leavers suggests the need for stronger assurances of the quality of leaver data than the current documentation standards provide. Over the past four years, an average of 11,500 students have left school for home schooling just in grades 7–12. If one assumes that departures from grades kindergarten through 6 to be equal in number,[4] the TEA leaver data suggests that Texas public schools are losing 23,000 students to home schooling every year.

Even considering the possibility that some may re-enroll and leave more than once, the cumulative effect of such an exodus would produce a staggering estimate of the number of home-schooled Texans, one far in excess of any other estimate ever produced. For example, in 1999 the National Center for Education Statistics estimated that approximately 850,000 or 1.7 percent of the student-age population across the country was home schooled. For Texas, that would produce an estimate of 68,000 home-schooled students. By contrast, extrapolating from the TEA's leaver data, the total number of home-schooled students in Texas would be nearly 150,000.[5]

[4]The U.S. Department of Education's National Center for Education Statistics (NCES) estimates that, in fact, the home schooling rate is slightly higher for grades K–5 (1.80 percent) than for grades 6–12 (1.64 percent).

[5]This estimate was produced by first calculating the number of annual home school leavers per grade cohort (23,000/12 grades = 1,770). Assuming that the state's 12th grade cohort has experienced 13 years of these annual leavers (13 X 1,770), the state's 11th grade cohort has experienced 12 years of these annual leavers (12 X 1,770), etc., the sum of the home school leavers for all grade cohorts was calculated to be 149,565. This number serves as an estimate of the number of children in Texas of school age that have left public school for home schooling.

Establish Audit Trigger for High Numbers of Missing In-state Transfers and Home School Leavers (Recommendation 3)

Rates of missing in-state transfers and home school leavers higher than a certain threshold should automatically trigger a TEA leaver code examination of the reporting district. The thresholds established for this report—a missing in-state transfer percentage of twice the statewide average, and a home-school leaver rate of five times the statewide average—were hypothetical but effective in producing a workable number of districts for review. The agency also could employ other thresholds, such as a comparison to surrounding districts and a comparison to a district's code use from prior years, to further identify districts with the highest risk of leaver code misuse. Lastly, exemptions can be made for small districts whose missing in-state transfer rates can vary dramatically based on only a few students.

Focus Independent Dropout Audit Guidelines on High-risk Leaver Codes (Recommendation 4)

Dropout audit guidelines and training provided by the TEA to independent auditors should direct those auditors to examine the documentation of those specific leaver codes that are most vulnerable to misuse: code 28, *withdrew with intent to transfer to a public school in Texas*, code 29, *withdrew with intent to transfer to a private school in Texas*, code 60, *withdrew for home schooling*, code 07, *withdrew with intent to enroll in a school out-of-state*, and code 16, *returned to home county*.

Auditors also should be directed to assess the reliability of documentation standards for the in-state transfer and home-schooling codes. Auditors should be instructed to tally the number of documents signed by a student or parent (strong documentation) and the number of documents signed by the district representative (weak documentation). A finding should be reported for districts with excessive numbers of the latter.

PROVIDE ADDITIONAL REPORTING TRAINING TO CHARTER SCHOOLS (RECOMMENDATION 5)

Because charter schools appear to be especially vulnerable to data misreporting, the agency should provide additional resources to charter schools to facilitate the understanding and proper reporting of the leaver reason code reporting system. These resources can be provided both at the agency and education service center level, with special attention paid to those charter schools identified as high-risk, based on analysis similar to the kind performed in this report.

LOWER ACCEPTABLE THRESHOLDS FOR UNDERREPORTED STUDENTS (RECOMMENDATION 6)

The underreporting of students is another area where potential misuse by districts can artificially deflate the dropout count. Districts that exceed the threshold for either the number or percentage of underreported students in grades 7–12 cannot be rated higher than academically acceptable in the accountability system. The TEA's current thresholds are 1,000 or more, or 10 percent or more, underreported students.

For the 1999–2000 school year, the statewide underreported student rate was 1.0 percent. Thus, districts could have an underreported rate up to 10 times higher than the state average and suffer no immediate consequences in the accountability system. And although the underreported rate has dropped to 1.0 percent from 3.6 percent in 1997–98, there has been no change to these thresholds.

Furthermore, TEA has found an unusual pattern in statewide underrerported student reporting. For the 2000-01 school year, African-American students were greatly overrepresented in the underreported student count; they represented only 14.5 percent of enrolled students, but accounted for 24.9 percent of the underreported student records. This finding may provide further support for the idea that districts' underreported students are less the product of random data error and more the result of leaver system misuse and the possible undercounting of dropouts.

The agency could alleviate concerns like this by lowering its thresholds for acceptable levels of underreported students. Additionally, the underreported student records of districts that exceed the threshold should be analyzed to see if students of particular ethnic status are overrepresented.

CONCLUSION

Five years after the leaver code reporting system was deployed, the TEA is struggling to win the confidence of educators, legislators and the public in the accuracy of the annual dropout rate produced by the system.[6] Shortly after being named to the post, Commissioner of Education Felipe Alanis pledged to revisit the agency's dropout calculation in order to improve it.

This report suggests a logical starting point to this undertaking: improve the agency process by which district use and reporting of leaver codes are evaluated for validity and reliability. By refining and focusing leaver data review processes on the leaver codes most vulnerable to misuse, the agency could better identify and correct data for those districts which may be significantly undercounting their dropouts. The end result would be a dropout rate, for districts and the state as a whole, that more accurately reflects the true dropout problem in Texas public schools.

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[6]State Senator Gonzalo Barrientos, Dallas ISD superintendent Mike Moses, and State Board of Education member Joe Bernal, among others, have expressed concern that the official dropout rate published by TEA may understate the true dropout problem in the state (see "Written Off: Texas' Dropout Problem," *Dallas Morning News*, May 20, 2001, and Minutes of the State Board of Education meeting, September 13, 2002).

FOUNDATION SCHOOL PROGRAM: FISCAL AND POLICY STUDIES

The Legislative Budget Board conducts biennial studies on the funding elements of the Foundation School Program and reports its findings and recommendations to the Legislature. Statutory requirements and interest in specific fiscal issues determine which school finance topics are addressed by the studies. The studies this interim focus on basic allotment and regular program funding, fiscal neutrality, the state bilingual education program, and the tax rate hold harmless study required under Texas Education Code Section 42.007(d). These four studies produced the following recommendations:

- The current basic allotment of $2,537 should be maintained. Although the analysis shows an annual regular program cost that exceeds Foundation School Program revenue per student, the variance is less than 5 percent and therefore is not great enough to justify an adjustment in the basic allotment.
- Raise the Tier 2 guaranteed yield from $27.14 to $27.61 for fiscal year 2004, and to $28.48 for fiscal year 2005 in order to maintain equity standards. The General Revenue Fund cost associated with increasing the Tier 2 yield is estimated to be $500 million for the 2004–05 biennium.
- Legislative Budget Board and Texas Education Agency staff should conduct a thorough review of bilingual education costs with a twofold purpose. First, the review should identify specific ways to modify Public Education Information Management System (PEIMS) reporting so the statutory allowable uses for the bilingual education allotment have matching expenditure codes in PEIMS. Second, the review should collect bilingual education program cost data, from school districts representing a variety of student populations with limited English proficiency, in order to clearly assess the adequacy of the bilingual education allotment.

Each of the four studies is summarized below.

BASIC ALLOTMENT AND REGULAR PROGRAM

The purpose of this study was to determine whether funding from the current law generates sufficient revenue to fund the regular education program in school districts meeting the standard of accreditation set by the Commissioner of Education.

A regular education program student is one who does not have special educational needs. The current standard for accreditation requires that 50 percent of students in the district pass the reading and mathematics portions of the Texas Assessment of Academic Skills. The analysis in the study is based on fiscal year 2001 test data. The average cost of providing the regular program in districts meeting the 50 percent passing accreditation standard in fiscal year 2001 was $4,422 per student.

To estimate the cost of providing the regular program in districts meeting this accreditation standard in 2004–05, the fiscal year 2001 cost was adjusted using the State and Local Government Deflator. The State and Local Government Deflator is a price index that specifically measures the cost of providing state and local government services. As shown in Table 1, the regular program cost for districts with at least an accredited rating is calculated to be $4,820 in fiscal year 2004 and $4,974 in fiscal year 2005.

TABLE 1
COMPARISON OF REGULAR PROGRAM COSTS TO CURRENT LAW REVENUE

FISCAL YEAR	STATE AND LOCAL DEFLATOR	REVENUE PER ADA	REGULAR PROGRAM COST PER ADA	DIFFERENCE
2004	1.090	$4,818	$4,820	($3)
2005	1.124	$4,830	$4,974	($144)

SOURCE: Legislative Budget Board.

The study then compared the regular program cost to the state and local revenue per student generated through the Foundation School Program. This revenue was calculated using the Tier 1 and Tier 2 amounts in the Legislative Budget Board's (LBB) current school finance model. Tier 1 costs were calculated using regular program students only. Tier 2 costs were based on the ratio of regular average daily attendance (ADA) to total ADA, multiplied by the total Tier 2 revenue.

For the 2004–05 biennium, a maintenance and operations tax rate of $1.50 generates sufficient total state and local revenue under the Foundation School Program to fund the average cost of a student in the regular program in accredited districts or in the top-rated districts. Although fiscal year 2005 shows a greater disparity between revenue and cost per student, the variance is less than 5 percent and therefore not large enough to justify recommending an adjustment in the basic allotment.

FISCAL NEUTRALITY

To evaluate the fiscal neutrality of the school funding system, this study applied three separate measures of equity. These are the same measures that the state district court in the Edgewood IV case used to determine whether the school finance system achieved a constitutional standard of efficiency, an approach later accepted by the Texas Supreme Court.[1] Under current law,[2] the funding elements are projected to meet the "variation in revenue" and "percent of equalized revenue" equity standards used by the court (see Table 2).

To meet the target for the "percent of students in the equalized system" measure, however, the Tier 2 guaranteed yield would have to be raised to $27.61 for fiscal year 2004 and $28.48 for fiscal year 2005. Keeping all other factors constant, the 2004–05 biennial General Revenue Fund cost of increasing the guaranteed yield to these levels is estimated to be $500 million, as projected by the LBB school finance model. Because of its large student population and property wealth, Dallas ISD again affected the projected performance for this measure. Current estimates indicate a wealth per weighted student for Dallas ISD in fiscal year 2004 of $276,102 and in fiscal year 2005 of $284,760.

TABLE 2
PROJECTED EQUITY MEASURES
2004–05 BIENNIUM

EQUITY MEASURE	TARGET	PROJECTED FISCAL YEAR 2004	PROJECTED FISCAL YEAR 2005
Percent of students falling within the equalized system	85%	82%	77%
Variation in revenue between the highest and lowest wealth districts with tax rates limited to $1.50 or less	<$600	$301	$310
Percent equalized revenue	98%	98%	98%

SOURCE: Legislative Budget Board, Model 777.

[1]Edgewood ISD v. Meno et al., Supreme Court of Texas, No. 94-0152, Austin, TX 1/30/95.

[2]LBB Model 777 includes a basic allotment of $2,537, a Tier II guaranteed yield of $27.14, and an equalized wealth level of $305,000.

STATE BILINGUAL EDUCATION PROGRAM

This study found that the state and local bilingual education allotment has shown significant growth in recent years, primarily as a function of enrollment expansion. The allotment increased by 52 percent, and bilingual education average daily attendance grew by almost 40 percent over the eight-year period ending with fiscal year 2002. On the other hand, the Tier 1 weight for bilingual education funding, 10 percent, has stayed constant since fiscal year 1986.

Attempts to analyze whether the allotment and its related 10 percent weight generate sufficient funding to cover bilingual education costs did not produce useful results. Chapter 42 of the Texas Education Code lists specific uses for the bilingual education allotment that do not have similar expenditure codes in the PEIMS. PEIMS provides a program category for bilingual education expenditures that is much broader than the list of cost areas specified for the bilingual education allotment. As a result, the reporting structure of PEIMS prevents a valid assessment of the bilingual education weight.

TAX RATE HOLD HARMLESS ESTIMATE

Texas Education Code § 42.007(d) requires the LBB to identify the "projected cost to the state in the next state fiscal biennium of ensuring the ability of each school district to maintain existing programs without increasing property tax rates." This study produced an estimate of the cost to hold all school districts harmless from tax rate increases.

To establish a range for the state cost to hold school districts harmless for tax rate increases, the study used two different methodologies. One methodology compared projected expenditures to projected revenue; the other used projected revenue on a per student basis as a proxy for projected expenditures. The goal underlying the first approach was to determine the extent to which projected school district expenditures exceed projected revenues without making any adjustments for tax rate increases. The second methodology compared each district's projected revenue, using the same statewide average tax increase assumed in the LBB school finance model for the next biennium, to what the district's revenue would be without such a tax rate increase. For the 2004–05 biennium, the two methodologies indicate that a tax rate hold harmless would cost between $1.2 billion and $1.4 billion.

BASIC ALLOTMENT AND REGULAR PROGRAM

The Legislative Budget Board (LBB) has a statutory responsibility to study Foundation School Program funding elements. The study identifies projected costs associated with providing an accredited regular education program. Accredited districts are those in which at least half of the students taking the Texas Assessment of Academic Skills, in fiscal year 2001, passed the assessment. The study compares projected regular program costs with Foundation School Program projected per student revenue, for the 2004–05 biennium, at a $1.50 tax rate.

The premise of the study is that accredited districts, as determined by the state's accountability system, have met the constitutional requirement to provide a general diffusion of knowledge.

SIGNIFICANT FINDINGS

- The Foundation School Program formulas generate sufficient revenue per student to fully fund regular program costs projected for the 2004–05 biennium. Foundation School Program revenue comes within 5 percent of matching regular program costs per student for the 2004–05 biennium.
- Regular program costs have risen significantly since fiscal year 1999, largely due to growing compensation costs experienced by school districts. Professional payroll costs per student

increased about 12 percent over the two-year period ending in fiscal year 1999, accounting for about 60 percent of the growth in total regular program cost per student during that time.

RECOMMENDATION

- Based on the comparison of projected future revenue to regular program costs, the current basic allotment of $2,537 should be maintained. Although the analysis shows projected regular program costs that exceed Foundation School Program revenue per student, the variance is less than 5 percent.

EDGEWOOD DECISION

In a series of opinions issued during the previous decade, the Texas Supreme Court has established the criteria for an equitable and efficient system of public education in Texas. In its final decision in the Edgewood case,[3] the Supreme Court found the school finance system constitutional. In approving the current system, the Court created a link between the level of funding that must be provided by the Foundation School Program and a "general diffusion of knowledge."[4]

The court found that the accountability system established by the Legislature meets the constitutional requirement to provide for a general diffusion of knowledge, provided that districts have "substantially equal access to funding up to the legislatively defined level that achieves the constitutional mandate of a general diffusion of knowledge." The Court specified that this means "each district must have substantially equal access to the funds necessary to provide an accredited education."[5]

[3]Edgewood Independent School District v. Lionel R. Meno, et al. Supreme Court of Texas, No. 94-0152. Austin, Texas. January 30, 1995.

[4]Ibid at 10-11.

[5]*supra* at pp. 12-13.

ACCOUNTABILITY STANDARDS

The accountability standards established by the Texas Education Agency (TEA) for district ratings define the threshold necessary for a district to achieve accredited status. Indicators for meeting this threshold are student performance on the Texas Assessment of Academic Skills (TAAS) and district dropout rates. Standards for these indicators must be met not only by all students, but also by each individual student group (Hispanic, African-American, white, and economically disadvantaged). This study used the rates at which all students pass TAAS as the basis for identifying accredited school districts.

The study's standards for delineating between accredited and high achievement ratings mirror those employed by TEA. Accredited districts show a 50 percent or greater TAAS passing rate. The two highest ratings, recognized and exemplary, reflect 80 percent and 90 percent passing rate thresholds, respectively. In fiscal year 2001, 1,031 school districts fall under the accredited category for this study, and of those in the accredited category, 648 districts show passing rates placing them in the two high achievement categories.

DETERMINING THE COST OF A GENERAL DIFFUSION OF KNOWLEDGE

To determine the cost associated with a general diffusion of knowledge, LBB staff examined regular program costs in districts that met the aforementioned accreditation standard based on fiscal year 2001 school district passing rates. The statewide cost of providing the regular program was calculated by adding together annual expenditures for functions directly related to the program and then dividing the result by the total number of regular program students in average daily attendance. The analysis used fiscal year 2001 actual expenditure data from the Texas Education Agency's Public Education Information Management System (PEIMS).

Functions associated with the regular program include instruction, instructional administration, instructional resources, school administration, curriculum and staff development, communications and dissemination, guidance counseling, social work services, health services, generic administration, plant maintenance, and data processing. Functions not attributable to the regular program and therefore excluded from the analysis include transportation, food services, debt service and facilities, contracted instruction, co-curricular and extracurricular activities, and community service.

The fiscal year 2001 average cost of providing the regular program among districts meeting the accreditation standard was $4,423 per student. For the same year, the average cost per student among districts in the recognized and exemplary categories was $4,434. The average cost for the highest rated districts differs only slightly from the average cost for all accredited districts.

The next step in the study involved projecting forward the average regular program costs for fiscal year 2001 for accredited districts as well as for districts in the highest-rated categories. This meant applying increase factors based on the State and Local Government Deflator. Table 3 shows the results of this analysis.

TABLE 3
ACTUAL AND PROJECTED
REGULAR PROGRAM COST PER STUDENT

FISCAL YEAR	ALL ACCREDITED DISTRICTS	HIGHEST RATED DISTRICTS
2001	**$4,423**	**$4,434**
2004*	**$4,820**	**$4,832**
State and Local Government Factor	1.090	1.090
2005*	**$4,974**	**$4,986**
State and Local Government Factor	1.124	1.124

*Projected.
SOURCE: Legislative Budget Board.

COMPARING REGULAR PROGRAM REVENUE TO AVERAGE COST

As stated previously, the goal of this study is to determine whether the Foundation School Program generates sufficient state and local revenue to cover the average cost of the regular program. Two Foundation School Program revenue streams contribute funding for the regular program—the Tier 1 basic allotment, as well as that portion of the Tier 2 guaranteed yield associated with regular program student enrollment. The basic allotment represents the primary funding allocation for the regular program. Current law specifies a basic allotment of $2,537 per student in average daily attendance (ADA).[6] To reflect total Tier 1 funding associated with the regular program, revenue from the cost-of-education index and small/medium district adjustments is also included. It is worth noting that the basic allotment has remained constant since the Seventy-sixth Legislature, 1999, which increased the allotment by $141, from $2,396.

The Tier 2 portion was determined on a district-by-district basis by calculating the ratio of regular program weighted ADA to total weighted ADA, and then multiplying the result by the revenue generated in Tier 2 for each district. The analysis assumed the maximum Tier 2 maintenance and operations (M&O) tax rate of 64 cents for all districts—which combined with the Tier 1 rate of 86 cents equals the $1.50 limit.

The study calculated regular program revenue per student by adding the statewide Tier 2 portion to the adjusted Tier 1 revenue and then dividing the result by total regular program student ADA. Regular program-related revenue is projected forward, based on assumptions regarding student enrollment, property value, and tax rate growth.

Table 4 compares Foundation School Program regular program revenue per ADA to the average per ADA cost of an accredited regular program (50 percent or more passing) increased by the State and Local Government Deflator for each year of the 2004–05 biennium.

[6] Texas Education Code (TEC), § 42.101.

Table 4 also shows the same comparison for districts in the two top-rated categories—recognized and exemplary (80 percent or more passing). Table 4 compares projected average regular program costs for the next biennium to Foundation School Program revenue per ADA, assuming a $1.50 total M&O tax rate for all districts.

TABLE 4
COMPARISON OF REGULAR PROGRAM COSTS TO CURRENT LAW REVENUE

FISCAL YEAR	STATE AND LOCAL FACTOR	FOUNDATION SCHOOL PROGRAM REVENUE PER ADA	REGULAR PROGRAM COST PER ADA	DIFFERENCE
DISTRICTS WITH AT LEAST 50 PERCENT OF STUDENTS PASSING ALL TESTS TAKEN				
2004	1.090	$4,818	$4,820	($3)
2005	1.124	$4,830	$4,974	($144)
DISTRICTS WITH AT LEAST 80 PERCENT OF STUDENTS PASSING ALL TESTS TAKEN				
2004	1.090	$4,818	$4,832	($14)
2005	1.124	$4,830	$4,986	($156)

SOURCE: Legislative Budget Board.

For the 2004–05 biennium, an M&O tax rate of $1.50 generates sufficient total state and local revenue under the Foundation School Program to fund the average cost of a student in the regular program in accredited districts. Although fiscal year 2005 shows a disparity between revenue and cost per student, the variance is less than 5 percent and therefore not great enough to justify recommending an adjustment in the basic allotment.

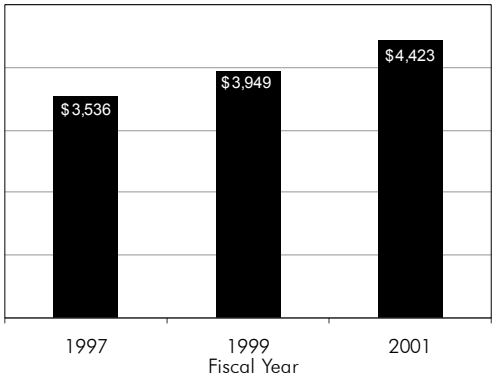
In the past, regular program costs and Foundation School Program revenue have tended to grow at about the same rate. However, in recent years the regular program cost trend has outpaced revenue growth. The next section discusses the factors contributing to this condition.

CONTRIBUTING FACTORS

Regular program costs have increased at a fairly significant pace over the period between the 1999 fiscal study and the current study. Figure 1 shows the trend in program cost per ADA from the base year for the 1999 fiscal study (fiscal year 1997) to the base year for the 2001 study (fiscal year 1999), and then the base year for the current study (fiscal year 2001). As indicated by this figure, the respective program costs have grown by 11.7 percent and 12 percent for the two biennial periods ending in fiscal years 1999 and 2001.

Table 5 illustrates how particular cost areas influenced this growth. Between the base year for the 2001 study (fiscal year 1999) and the present study (fiscal year 2001), the average cost per regular program student increased to $4,423 from $3,949. Compensation-related costs account for 86 percent of this increase, primarily a function of payroll growth. The $3,000 salary increase for teachers implemented under Senate Bill 4 (Seventy-sixth Legislature, 1999) probably had a substantial impact on payroll growth during this timeframe. Operating expenses contributed to about 14 percent of the cost expansion, almost all of this due to rising utility costs.

FIGURE 1
REGULAR PROGRAM COSTS PER ADA TREND



NOTE: 1999 = 11.7% increase over 1997; 2001 = 12% increase over 1999.
SOURCES: Legislative Budget Board.

TABLE 5
COST AREAS CONTRIBUTING TO REGULAR PROGRAM COST PER ADA INCREASE
2001 FISCAL STUDY VERSUS 2003 FISCAL STUDY

	FISCAL YEAR		CHANGE		
COST AREAS	1999	2001	DOLLAR	PERCENTAGE	IMPACT
COMPENSATION COSTS					
Professional Payroll	$2,394	$2,691	$298	12%	60%
Other Payroll	569	630	61	11	12
Group Insurance	142	175	33	23	7
Other Employee Benefits	101	120	19	18	4
SUBTOTAL, COMPENSATION	**$3,206**	**$3,616**	**$411**	**13%**	**86%**
OPERATING EXPENSES					
Utilities	$191	$248	$57	30%	12%
Other Operating Expenses	552	559	7	1	1
SUBTOTAL, OPERATING EXPENSES	**$743**	**$807**	**$64**	**9%**	**13%**
TOTAL	**$3,949**	**$4,423**	**$475**	**12%**	**100%**

SOURCE: Legislative Budget Board.

It is important to point out that focusing the analysis on Foundation School Program revenue does not capture the entire scope of state funding allocated to support fundamental education services. For example, the Seventy-sixth Legislature, 1999, appropriated $173 million for the Student Success Initiative, as well as $215 million to expand pre-kindergarten and kindergarten programs; the Seventy-seventh Legislature, 2001, appropriated $750 million to address school district employee health insurance needs. These initiatives channeled new money to school districts to help them address important educational issues; however, these funding allocations occurred outside of the Foundation School Program through direct General Revenue Fund appropriations.

Under current law, the Foundation School Program formulas generate revenue per student to sufficiently fund regular program costs projected for the 2004–05 biennium. It is worth noting, however, that regular program costs, driven largely by expanding school district payroll, have outpaced Foundation School Program revenue growth over the last two years. To some extent, rising compensation costs may reflect the impact of new public education initiatives that require additional or more expensive professional resources to implement them. State funding to support the cost of new education initiatives often occurs outside the Foundation School Program, which warrants taking note of the fiscal contributions that these non-formula-driven programs make.

FISCAL NEUTRALITY

"Fiscal neutrality" in the context of school finance defines a condition under which a district's ability to raise revenues is independent of the district's property wealth. Stated differently, in a fiscally neutral system, school districts experience similar access to revenue at similar levels of taxation. The Texas Supreme Court gave legal significance to this principle when it ruled in its 1989 rejection of the existing school funding system that there must be a "direct and close correlation between a

district's tax effort and the educational resources available to it." (Edgewood I, 777, S.W. 2nd at 397).

Since 1994, staff of the Legislative Budget Board (LBB) have used three primary measures to examine the fiscal neutrality of the school funding system. In the Edgewood IV case, the state district court applied these measures to evaluate whether the school finance system created by Senate Bill 7 (Seventy-third Legislature, 1993) achieved a constitutional standard of fiscal neutrality.

TABLE 6
MAJOR SCHOOL FINANCE FORMULAS AND EQUITY PROJECTIONS
2002–03 BIENNIUM

FISCAL YEAR	TIER 2 GUARANTEED YIELD	EQUALIZED WEALTH LEVEL	PERCENTAGE EQUALIZED REVENUE	PERCENTAGE OF STUDENTS FALLING WITHIN THE EQUALIZED SYSTEM
2001 (prior to House Bill 3343):				
	$24.99	$295,000	96%	90%
2002	$25.81	$300,000	99%	88%
2003	$27.14	$305,000	97%	88%

SOURCE: Legislative Budget Board, Models 672 and 668.

These measures and their targets are the following:

- the percentage of total Foundation School Program revenue within the equalized funding system (target of 98 percent);
- the percentage of students within the equalized funding system (target of 85 percent); and
- the gap in revenue between those districts at the top of the wealth spectrum, and those with wealth per student below the guaranteed yield level (target dollar amount less than $600).

The Seventy-seventh Legislature, 2001, made several adjustments to the school finance system, many of which were intended to supply school districts with more revenue to finance the employee health insurance benefits required by House Bill 3343. Table 6 shows the major formula adjustments mandated by the Seventy-seventh Legislature, 2001, and the associated equity projections for the 2002–03 biennium calculated by the LBB school finance model at the close of the Seventy-seventh Legislative Session. For comparison purposes, Table 6 also shows actual equity figures for fiscal year 2001.

SIGNIFICANT FINDINGS

Under current law parameters:

- It is predicted that the state will meet or exceed the 98 percent equalized revenue target in each year of the 2004–05 biennium.
- Using the same method of calculating the revenue gap measure that has been applied in previous studies, the revenue gap for fiscal years 2004 and 2005 will achieve the goal of falling under the $600 target.

SIGNIFICANT CONCERN

- Due to anticipated growth in the property wealth per student of Dallas ISD, the Legislative Budget Board school finance model indicates that the percentage of students within the system will fall to 82 percent in fiscal year 2004, and 77 percent in fiscal year 2005, which is lower than the 85 percent target.

RECOMMENDATION

- The Tier 2 guaranteed yield should be raised to $27.61 for fiscal year 2004 and $28.48 for fiscal year 2005 so that 85 percent of students will be included in the equalized funding system.

CALCULATION OF THE EQUITY MEASURES

The Texas Education Code (§ 42.007) requires the LBB to calculate equalized funding elements for the Foundation School Program each biennium. The elements must include:

- the basic allotment combined with the guaranteed yield component;
- adjustments designed to reflect resource costs and costs beyond the control of districts;
- program weights and the calculation of weighted students;
- the maximum guaranteed yield level in Tier 2;
- the maintenance and operations guaranteed yield maximum tax rate; and
- the Instructional Facilities Allotment guaranteed yield level.

These elements must be designed to achieve the state policy to "adhere to a standard of neutrality that provides for substantially equal access to similar revenue per student at similar tax effort, considering all state and local tax revenues of districts after acknowledging all legitimate student and district cost differences" (TEC, § 42.001(b)).

The fiscal neutrality of the funding elements and the current system are evaluated based on these measures.

The percent of equalized revenue within the system is based on an analysis of both state and local revenue within this system. Equalized revenue is defined as the sum of the following:

- Tier 1 Foundation School Program Entitlements (state, including the Available School Fund, and local share);
- Tier 2 Total Guaranteed Amount (state and local);
- Tier 3 Instructional Facilities Allotment Program Amount (state and local share);
- Tier 3 Existing Debt Allotment (state and local share);
- Teacher Transition Aid (Teacher Hold Harmless);
- House Bill 7 (Seventy-fifth Legislature, 1997) Total Revenue Hold Harmless;
- Senate Bill 4 (Seventy-sixth Legislature, 1999) Salary Increase Hold Harmless; and
- House Bill 3343 (Seventy-seventh Legislature, 2001) Gap District Formula Aid.

The sum of these eight items is divided by total state and local school district revenue as adjusted by Chapter 41 wealth-sharing provisions.[7]

The percent of students falling within the equalized system is calculated by dividing the number of students in districts with property wealth per weighted student less than or equal to the Tier 2 guaranteed yield threshold ($271,400 under current law) by the total number of students. Districts are ranked according to property wealth per weighted pupil. The number of students in school districts below the threshold of $271,400 are totaled and compared to the total number of weighted students to determine the percent falling within the equalized system.

The variation in revenue from districts with the highest wealth to those with the lowest compares revenue per pupil across districts generated at maintenance and operations tax rates up to $1.50.[8] Also referred to as the "revenue gap," this measure compares average revenue per weighted pupil in districts with property wealth below $271,400 per weighted student (the Tier 2 guaranteed yield wealth threshold) with average revenue per weighted pupil in districts with property wealth equal to or greater than $305,000

[7]Districts whose property wealth per weighted student exceeds the statutory equalization level ($305,000) are required to reduce their wealth to that level. This "recaptured" revenue is not counted in the equalized revenue total because it is not available to school districts.

[8]This is the standard that was accepted by the Texas Supreme Court in its 1995 approval of the school finance system. (Edgewood ISD v. Meno et al., Supreme Court of Texas, No. 94-0152, Austin, TX, 1/30/95).

per weighted student (the equalized wealth level). The calculation includes both maintenance and operations revenue as well as debt service funding for chapter 42 districts, in order to be consistent with the methodology used in prior studies.

TABLE 7
PROJECTED EQUITY MEASURES
2004–05 BIENNIUM

EQUITY MEASURE	PROJECTED FISCAL YEAR 2004	2005
Percentage equalized revenue	98%	98%
Percentage of students falling within the equalized system	82%	77%
Variation in revenue between the highest and lowest wealth districts at tax rates up to $1.50	$301	$310

SOURCE: Legislative Budget Board, Model 777.

EQUITY PERFORMANCE

As indicated in Table 7, the state will meet or exceed the 98 percent target for "equalized revenue" equity measure, as well as the $600 target for the revenue gap for fiscal years 2004 and 2005. Based on projected property wealth per student and current school finance parameters, however, the state would fall short of meeting the 85 percent target for the "percent of students" measure.

To bring the "percent of students" measure within the court-accepted standard of 85 percent will require an increase in the guaranteed yield to $27.61 for fiscal year 2004 and $28.48 for fiscal year 2005. Because of its large student population and property wealth, Dallas ISD affected the projected performance for this measure. Current estimates indicate a wealth per weighted student for Dallas ISD in fiscal year 2004 of $276,102, and in fiscal year 2005 of $284,760.

COMBINED REVENUE GAP

Traditionally, the revenue gap attempts to measure the difference in spending between the highest to lowest wealth district at tax rates up to $1.50. At the time of the Texas Supreme Court ruling on Senate Bill 7, Seventy-fourth Legislature, 1995, average total tax rates were close to $1.25. The average total rate in fiscal year 2002 was $1.4857, and there were approximately 431 districts in the state with total tax rates over $1.50.[9]

[9]Comptroller of Public Accounts, Statement, March/April 2002.

For comparison purposes only, Table 8 shows a separate revenue gap measure, which differs from the standard measure that is calculated for tax rates up to $1.50. This methodology incorporates all state and local revenue, regardless of the related tax rate.

Local property value growth continues to play a significant role in determining the projected equity of the Texas school finance system. As reflected by the "percent of students within the equalized system" equity measure, the school finance system will not meet the 85 percent target because of anticipated increases in the wealth per weighted pupil of Dallas ISD. Due to its large student population and its position in the wealth ranking, Dallas ISD is the key determinant of how high the Tier 2 guaranteed yield must be in order to achieve the court-mandated standard regarding the proportion of students included in the equalized school finance structure.

TABLE 8
PROJECTED COMBINED REVENUE GAP
2004–05 BIENNIUM

EQUITY MEASURE	PROJECTED FISCAL YEAR 2004	2005
Variation in revenue between the highest and lowest wealth districts, including all state and local revenue	$591	$592

SOURCE: Legislative Budget Board, Model 777.

STATE BILINGUAL EDUCATION PROGRAM

Enrollment in the state's special language programs for students with limited English proficiency has shown an exceptionally high growth rate in recent years. Between fiscal years 1995 and 2002, average daily attendance (ADA) in bilingual education and English as a second language programs grew by almost 40 percent. In contrast, regular program ADA grew by only 12 percent during the same period. With this enrollment expansion has come an equally significant increase in the Foundation School Program's bilingual education allotment. While the 10 percent bilingual education funding weight has remained constant since fiscal year 1986, the allotment has grown by 52 percent over the eight-year period ending with fiscal year 2002, primarily due to program enrollment growth.

This dramatic increase in both bilingual education enrollment and the related allotment underscores the need to periodically review the adequacy of the bilingual education weight. Attempts to perform this assessment, however, did not produce useful results because of the reporting guidelines governing how expenditure data are entered into the Texas Education Agency's Public Education Information Management System (PEIMS).

These reporting guidelines cluster a wide variety of cost areas under the "bilingual education program" heading, many of which are not allowable uses for the bilingual education allotment under the Texas Education Code. Furthermore, some of the cost areas that represent allowable uses of the allotment (e.g., salary supplements) are grouped together with other areas (e.g., teacher and professional staff salaries)—the result being that allowable allotment cost areas cannot be isolated. In effect, the structure of PEIMS expenditure data precludes a legitimate comparison of bilingual education costs to bilingual education allotment funding.

SIGNIFICANT CONCERN

- Because the bilingual education cost areas that the Texas Education Code identifies as allowable uses for the allotment do not have matching expenditure codes in the PEIMS, a valid assessment of the bilingual education weight cannot be performed.

RECOMMENDATION

- The Legislative Budget Board and Texas Education Agency staff should conduct a thorough review of bilingual education costs with a twofold purpose. First, the review should identify specific ways to modify PEIMS reporting so the allowable uses for the bilingual education allotment have matching expenditure codes in PEIMS. Second, the review should collect bilingual education program cost data from school districts representing a variety of limited English proficient student populations in order to clearly assess the adequacy of the bilingual education allotment.

The purpose of special language instruction is to ensure that students with limited English proficiency have access to the same educational opportunities as all other students. A wide array of terms are used to describe special language instructional services. The two most common terms employed by educators in Texas, however, are "bilingual education" and "English as a second language." Bilingual education, as defined by Texas Education Code § 29.055, is "a full-time program of dual-language instruction that provides for learning basic skills in the primary language of the students enrolled in the program and for carefully structured and sequenced mastery of English language skills." English as a second language, also defined by this statutory provision, is "a program of intensive instruction in English from teachers trained in recognizing and dealing with language differences."

Bilingual education services are typically delivered in the elementary grades in such a way that enrolled students learn the same academic content and skills as students in the regular program, except that the academic content is taught in the student's home language. During these elementary school years, bilingual education students are also taught essential English language skills. The intended outcome of this dual-language approach is a student prepared to benefit from the full range of English-based courses in the secondary grades.

The Texas Education Code requires school districts to provide a bilingual education program to limited English proficient (LEP) students in the pre-kindergarten through elementary grades if the district has 20 or more LEP students in the same grade district wide (Texas Education Code § 29.053). The district's Language Proficiency Assessment Committee (LPAC) determines whether a student meets the criteria for LEP designation by conducting a home language survey and evaluating the results of an oral English language proficiency test and a written English proficiency test. The oral and written tests are administered to students in the second and upper grades, but only the oral test is given to kindergarten and first graders. The LPACs also assess the annual progress of LEP students to determine whether they are ready to enter the English-based regular program (Texas Education Code, Subchapter B, et. seq.).

English as a second language (ESL) instruction, on the other hand, may be offered in any of the public school grades. For most school districts, ESL represents the predominant special language program in the secondary grades. A logistical advantage of ESL instruction is that it can accommodate students bringing a variety of home languages to the same classroom; also teachers do not need to be proficient in the student's home language because all of the instruction is delivered in English.

Funding for bilingual education and ESL programs comes from federal, state, and local sources. The state's Foundation School Program formulas determine the state and local bilingual education allotment allocated to a school district.

BILINGUAL EDUCATION ALLOTMENT

The bilingual education weight is intended to provide school districts with additional revenue for the higher costs associated with educating LEP students. Under current law, the funding entitlement for each bilingual education or ESL student in average daily attendance (ADA) is 10 percent higher than the basic allotment. The formula that determines a school district's entitlement can be expressed as:

ADJUSTED BASIC ALLOTMENT X 0.10 X BILINGUAL EDUCATION ADA[10]

Where the adjusted basic allotment is the basic allotment ($2,537 per ADA) modified by the cost of education index and any district size adjustments that apply.

BILINGUAL EDUCATION ALLOTMENT TREND

As indicated by Figure 2, the bilingual education state and local allotment increased substantially between fiscal years 1995 and 2002—from $90.3 million to $137.4 million. During this eight-year time frame, the bilingual education allotment has increased 52 percent for an average annual growth rate of 6 percent. The fiscal years for which the allotment shows higher-than-normal increases, 1996 and 2002, represent two years in which the basic allotment was increased (note the formula above). For all other fiscal years, the bilingual education allotment escalated as a direct result of bilingual education ADA expansion.

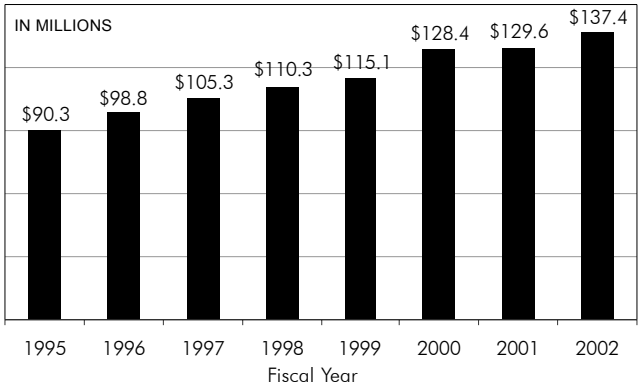
Growth in the bilingual education student average daily attendance plays a major role in determining the statewide bilingual education allotment. To bring the bilingual education ADA trend into focus, Figure 3

[10]Bilingual education ADA refers to average daily attendance in bilingual education and English as a second language programs.

compares annual percent changes in bilingual education ADA to regular program ADA, for the period from fiscal year 1995 through 2002. (Fiscal year 1995 is the base year, so the graph shows fiscal year 1996 as the first affected year.) For most of this eight-year period the bilingual education ADA growth far exceeded the regular program ADA's annual growth.[11] Overall, bilingual education ADA grew by almost 40 percent during the eight-year period for an average annual rate of 5 percent; regular program ADA increased by 12 percent during that period, for an annual average growth rate of 2 percent.

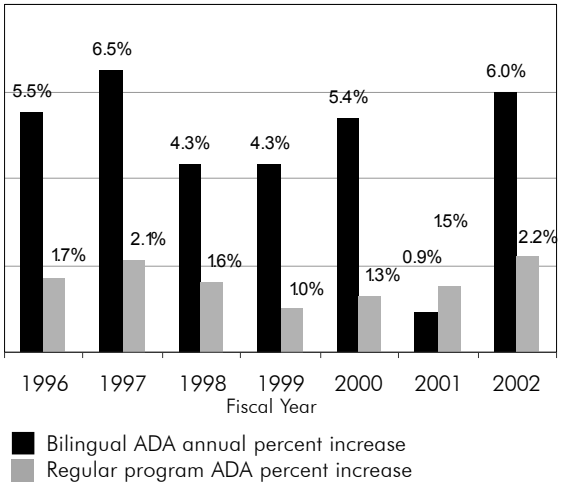
Fiscal years 1995 through 2001 represent a period of rising bilingual education allotments caused primarily by an expanding bilingual education student enrollment. The one cost factor that has remained constant during this period, the bilingual education weight, is the subject of the next section.

FIGURE 2
BILINGUAL EDUCATION ALLOTMENT



SOURCES: Legislative Budget Board.

FIGURE 3
COMPARISON OF BILINGUAL EDUCATION ADA TO REGULAR PROGRAM ADA TREND



SOURCES: Legislative Budget Board.

ORIGIN OF THE BILINGUAL EDUCATION WEIGHT

The 10 percent bilingual education weight has not changed since the enactment of House Bill 72, Sixty-ninth Legislature, 1985. Prior to the passage of House Bill 72, the bilingual education allotment represented one of the few funding allocations under which state law calculated a district's entitlement based on the number of students served: $50 per student enrolled in a bilingual education program, and $12.50 for each student in an ESL program.[12] The Sixty-seventh Legislature, 1981, through Senate Bill 477, established this allotment in order to address

[11]Bilingual Education ADA growth slowed significantly in fiscal year 2001 due to introduction of the Reading Proficiency Test for English. According to TEA staff, many formerly LEP students performed well enough to indicate that they no longer needed special language instruction. Fiscal year 2002 saw a return of normal growth, in which bilingual ADA increased 6 percent over fiscal year 2001.

[12]Before implementation of House Bill 72, state funding was allocated to school districts based on the personnel unit structure, under which the number of teachers employed by a school district was the starting point for determining state aid.

declining state aid for bilingual education and provide a basic funding level for the program. Senate Bill 477's funding mechanism existed for four years until House Bill 72 modified it.

As a result of House Bill 72, the Texas Education Code saw a new allocation scenario in which a district would be entitled to an additional 10 percent of the basic allotment per student served by the district's bilingual education or ESL program. In fiscal year 1986, the basic allotment was $1,290, so the bilingual education weight resulted in a per student program entitlement of $1,419.

According to daily floor reports covering the legislative debate of Senate Bill 477 and House Bill 72, both the $50 allotment and the 10 percent weight were deemed inadequate by some and problematic by others. Bilingual education advocates argued that the proposed funding levels should be much higher, while opponents countered that bilingual education programs in general prevent the proper assimilation of minority students into mainstream society.

Literature describing the evolution of bilingual education program funding indicates that the 10 percent weight represented a tolerable, if not fully satisfactory, funding level to program advocates. It has been noted that the combined 10 percent bilingual education and 20 percent compensatory education weights equal 30 percent, which approximates the bilingual education weight identified as adequate for certain grades by an Intercultural Development Research Association study of bilingual education costs.[13]

PROBLEMS ENCOUNTERED IN DETERMINING FUNDING ADEQUACY

An analysis of the bilingual education weight's adequacy should begin with an understanding of what the allotment is intended to finance. As noted previously, districts with more than 20 limited English proficient (LEP) students in the same grade must offer bilingual education or ESL programs (Texas Education Code § 29.053(c)). To quote the Educational Services portion (Chapter 29) of the Education Code, these school districts must provide "bilingual education classes in the kindergarten through elementary grades; bilingual education, English as a second language (ESL), or other transitional language instruction in post-elementary grades through grade 8; and ESL in grades 9 through 12" (Texas Education Code § 29.053(d)).

The Foundation School Program portion (Chapter 42) of the Education Code, however, limits the cost areas for which the allotment may be used to "program and student evaluation, instructional materials and equipment, staff development, supplemental staff expenses, salary supplements for teachers, and other supplies required for quality instruction and smaller class size" (Texas Education Code § 42.153(c)).

A comparison of statewide expenditures associated with these cost areas to the bilingual education allotment provided under Tier 1 of the Foundation School Program should result in a determination about the bilingual education weight's adequacy. Theoretically, it should be possible to total the aforementioned cost areas related to bilingual education as reported through the PEIMS and compare that to statewide bilingual education allotment generated by the 10 percent weight on a per ADA basis (see Table 9). If statewide bilingual education expenditures per ADA approximates the bilingual education allotment per ADA, then the weight produces adequate funding.

The method by which expenditure data are reported through PEIMS by school districts, however, precludes such a comparison. As defined by the Texas Education Agency's (TEA) Financial Accountability System Resource Guide, which governs how school

[13]Jose A. Cardenas, Ed.D., *Texas School Finance Reform*, (San Antonio: Intercultural Development Research Association, 1997) pp. 152-161.

districts enter data in PEIMS, expenditures reported under the bilingual education program intent code include any and all costs associated with providing bilingual education services to LEP students. This classification approach matches the broad definition of bilingual education services found in the Educational Services chapter of the Education Code cited above.

However, the TEA Resource Guide allows a much wider array of expenditures being reported than the more limited list of cost areas for which the allotment may be used. Table 10 compares the different cost areas associated with bilingual education included under the Education Services (Chapter 29), the Foundation School Program (Chapter 42), and PEIMS-related Guide referenced above. The cost areas delineated by the reporting guide do not match the Chapter 42 allotment allowable costs but do approximate the cost areas included under Chapter 29.

Table 11 illustrates the problem with using bilingual education expenditures reported in PEIMs for assessing the weight's adequacy. The table shows, for comparison purposes, bilingual education allotments and operating expenditures related to bilingual education[14] per bilingual education ADA for two large school districts with similar LEP student populations on the first two rows, and then the same type of data for two small school districts also with similar LEP populations on the last two rows. The interesting feature of this comparison is that while allotments per bilingual education ADA differ by an insignificant percentage within the two comparison groups, operating expenditures per ADA vary by more than 500 percent within each of the two groups. A variance this large cannot be attributable to program spending difference between districts. This analysis leads to the conclusion that extracting statewide bilingual education operating expenditure data from PEIMS and comparing it to the total statewide bilingual education allotment will result in an invalid test of the weight's adequacy.

TABLE 9
PUBLIC EDUCATION INFORMATION MANAGEMENT SYSTEM

"In compliance with the Texas Education Code, the Public Education Information Management System (PEIMS) contains only the data necessary for the Texas legislature and the Texas Education Agency (TEA) to perform their legally authorized functions in overseeing public education"

"According to the timelines specified in the PEIMS Data Standards, school districts submit their data to TEA via standardized computer files"

"Technical support for gathering the data from district databases is provided by one of the twenty educational service centers (ESCs) or by private vendors"

"Currently, the major categories of data collected are: organization data; budget data; actual financial data; staff data; student demographic, program participation and prior year school leaver data; student attendance, course completion and discipline data."

Source: Texas Education Agency.

An alternative way to address this expenditure identification problem would involve focusing solely on the expenditure object codes that match the allowable uses statutorily prescribed for the bilingual education allotment. However, the way in which PEIMS object codes are delineated does not permit such a calculation. Expenditures associated with salary supplements for bilingual and ESL teachers, certainly a significant cost factor for many school districts, cannot be separately identified because salary supplements are grouped together with generic wages under the object code for teacher and professional staff salaries in PEIMS.

[14]Expenditures in this analysis includes all expenditures except those associated with capital assets and non-instructional-related costs.

TABLE 10
BILINGUAL EDUCATION AND ESL PROGRAM
COST AREAS INCLUDED UNDER EDUCATION CODE OR TEA RESOURCE GUIDE SECTIONS

CHAPTER 29	CHAPTER 42	RESOURCE GUIDE/PEIMS
Bilingual education and ESL instruction	Program and student evaluation	Services intended to make students proficient in English
Bilingual education (dual language) offered in elementary grades	Staff development	Provision of a bilingual or ESL program
Bilingual education or ESL in secondary grades through grade 8	Supplemental staff expenses	Instruction in student's primary language
ESL in grades 9–12	Salary supplements for teachers	Increase in cognitive academic language proficiencies
	Supplies associated with quality instruction and small class size	Bilingual services to immigrant students

SOURCES: Texas Education Code; Fiscal Accountability System Resource Guide, Texas Education Agency.

TABLE 11
COMPARISON OF BILINGUAL ALLOTMENT AND EXPENDITURES
AMONG TWO LARGE AND SMALL SCHOOL DISTRICTS

DISTRICT	ALLOTMENT PER ADA	OPERATING EXPENDITURE PER ADA	PERCENTAGE VARIATION BETWEEN FIRST ISD AND SECOND ISD	
			ALLOTMENT PER ADA	OPERATING EXPENDITURE PER ADA
First Large ISD	$437	$467		
Second Large ISD	405	2,681	7%	474%
First Small ISD	$419	$324		
Second Small ISD	424	2,354	1%	626%

SOURCE: Legislative Budget Board.

Because PEIMS data cannot be used to determine the adequacy of the bilingual education weight, this study recommends that the Legislative Budget Board and TEA staff conduct a review of bilingual education expenditures by identifying those cost areas that represent allowable uses for the allotment. By using allotment-specific cost data from school districts, the review would better assess the adequacy of the bilingual education allotment. Also, data from a stratified sample of school districts, specifically a sample of districts grouped by enrollment size and LEP student characteristics, would help develop a clearer picture of the different resource demands associated with different LEP student populations and size of school district.

Another benefit of the review is that it would help refine the bilingual education expenditure data reported through PEIMS. The review would develop specific expenditure object codes that would allow users to identify the cost areas associated with the bilingual education allotment. This refinement would permit the legislature and the public to compare bilingual educa-

tion expenditures among different school districts and track expenditures over time, both in relation to the bilingual education allotment and to any other benchmark such as regular program expenditures.

TAX RATE HOLD HARMLESS ESTIMATE

Senate Bill 4, Seventy-sixth Legislature, 1999, amended the scope of the Legislative Budget Board's (LBB) fiscal studies by adding a requirement that the LBB identify "the projected cost to the state in the next biennium of ensuring the ability of each school district to maintain existing programs without increasing property tax rates."

The study used two different methodologies to establish a range for the state cost to hold school districts harmless for tax rate increases. One methodology compared projected expenditures to projected revenue; the other used projected revenue on a per student basis as a proxy for projected expenditures. The goal underlying the first approach was to determine the extent to which projected school district expenditures exceed projected revenues without making any adjustments for tax rate increases. The second methodology compared each district's projected revenue (using the same statewide average tax increase assumed in the LBB school finance model for the next biennium) to what the district's revenue would be without such a tax rate increase.

SIGNIFICANT FINDING

- The cost of ensuring that school districts are able to maintain current programs without increasing tax rates for the 2004–05 biennium is estimated to be between $1.2 billion and $1.4 billion based on the two methodologies described in this report.

SCHOOL DISTRICT REVENUE AND EQUALIZATION

Three main budget drivers play a central role in Texas' school finance system: student attendance, property values, and tax effort. An upward trend in any or all of these drivers may result in additional revenue for a school district. Texas' school finance formulas however, determine the extent to which these factors influence district revenue. In fact a fourth component, the equalizing effect of state aid and recapture provisions, also plays an important role in determining school district revenues.

The purpose of state equalization provisions is to ensure that districts have access to similar revenue per student at similar levels of taxation. One result of equalization is that increases in local revenue due to rising property values are substantially offset by reductions in state aid. Increases in total revenue, however, are significantly driven by increases in pupil counts. For most districts, an increased number of students is the driving force behind increased total revenue.

Wealthy districts, on the other hand, do not benefit from increases in student counts unless their property values are stagnant. Stagnant property values and rising student enrollment reduce a district's wealth per student and therefore reduce how much recapture must be paid by a property-wealthy district. In recent years, though, property values in the state have outpaced growth in student counts.

Because changes in local property values are balanced by changes in state aid, and because increases in student counts result in both increased costs and increased state aid, tax rate increases are a key mechanism through which districts may expand programs or account for inflation. The tax rate—affecting as it does both local revenue and the tax effort on which state aid is paid—is the key budget driver over which school districts may exert control. The other drivers are functionally independent of district action.

TAX RATE HOLD HARMLESS ESTIMATE

The study used two different methodologies to determine a range for the state cost to hold school districts harmless from tax rate increases. One methodology compared projected expenditures to projected funding for the 2004–05 biennium. The other methodology compared projected revenue assuming a certain average tax rate increase, as a proxy for expenditures, to projected revenue without a tax rate increase.

METHODOLOGY 1: PROJECTED EXPENDITURES

This methodology involved comparing projected expenditures for each school district to projected district revenues for the 2004–05 biennium. The goal underlying this approach was to determine the extent to which projected school district expenditures exceed projected revenues without making any adjustments for tax rate increases.

School district expenditures, as reported in the Public Education Information Management System (PEIMS), were projected forward using the same approach employed in the Basic Allotment and Regular Program study. Fiscal year 2001 per student expenditures for each district were multiplied by the state and local government deflator to determine projected fiscal year 2004 and 2005 expenditures. These projected expenditures were then compared with the total projected revenue each district could generate without making any adjustment for tax rate increases.

The analysis included expenditures associated with the following PEIMS functions: instruction, instructional resources, curriculum and staff development, instructional leadership, school leadership, guidance counseling, general administration, and plant maintenance/operations. Please note that the analysis examined only school district operating costs; it does not consider debt service.

To project current-law revenues for the 2004–05 biennium, a school finance model was run incorporating the Comptroller of Public Accounts' projection for property value increases in 2002 and 2003 and the Texas Education Agency's projection of average daily attendance for 2002–03. Tax rates were not adjusted.

The difference between the total revenue generated under this model and the projected expenditure level can be viewed as an estimate of the hold harmless cost to maintain current programs if districts did not increase their maintenance and operation tax rates.

Certain issues related to this methodology include the following:

- There is no precise way to compare school district expenditures with the state and local revenues to which districts are entitled. School district revenues need not equal expenditures. Revenue and spending anomalies may exist for any district in any given year, resulting in inappropriate projections.
- The analysis excludes debt service. While debt service is certainly an important part of district budgets and total tax rates, the problems associated with comparing PEIMS expenditure data for program costs with Foundation School Program data are exacerbated when examining debt service.
- Revenue associated with programs outside the Foundation School Program is excluded. Certain program costs are also excluded if the revenue associated with a program is not within the Foundation School Program.

METHODOLOGY 2: PROJECTED REVENUE

Two key assumptions underlie this methodology. The first assumption is that total revenue earned by districts in the current biennium (2002–03) is de facto sufficient to maintain current programs. The second assumption is that if all school districts benefited from a 2003 tax rate increase equal to the statewide average tax increase used to project state aid for the 2004–05 biennium (6 cents), then they would be able to maintain their current level of educational services.

The methodology used to produce the hold harmless estimate can be explained in the following manner. A growth factor for each year following fiscal year 2002 and ending with fiscal year 2005 was determined by comparing each year's statewide Foundation School Program total revenue (state and local) per weighted student with fiscal year 2002 total revenue per weighted student. This total revenue calculation used the LBB's current assumptions regarding student attendance, property value, and tax rate growth for the next biennium. These growth factors were then applied to each school district's fiscal year 2002 total revenue to project its revenue forward into the 2004–05 biennium. The result was a revenue projection for each school district based on a tax rate increase similar to the statewide average assumed increase.

Projected total revenue for each school district was then compared to what the school district's revenue would be without any tax rate increase (i.e., no increase above the model's tax rate for fiscal year 2002). The difference between projected revenue with and without a tax rate increase equals the hold harmless for that district. Each district's hold harmless estimate was totaled to arrive at a statewide total hold harmless.

CONCLUSION

The first methodology resulted in an estimated hold harmless cost for the 2004–05 biennium of $1.4 billion. For the second methodology, the model indicated an estimated cost of $1.2 billion.

It is reasonable to expect the second methodology to reveal a smaller hold harmless than the first. The first approach applies an inflation factor to fiscal year 2001 expenditures and then compares the result to projected school district revenue that has not been adjusted for future tax rate increases. The second approach simply compares future school district revenue with an assumed tax rate increase to revenue without a tax rate increase.

How Texas Compares: Teacher Certification Requirements and Fees

Because the issue of teacher certification standards is of interest to those concerned with the Texas teacher shortage, this report seeks to inform the reader by providing a general comparison of teacher certification testing requirements and costs found in selected states, a discussion about teacher testing issues, and information regarding State Board for Educator Certification's (SBEC) agreement with its test contractor and the new teacher certification structure (see appendices).

Significant Findings

- Texas is among a small number of states that require teachers to pass both a subject matter and a general teaching skills (pedagogy) test. Fifteen states, including Texas, assess prospective educators in both subject matter and pedagogical knowledge.
- Nine states, including Texas, require certification applicants to use tests developed for these states by National Evaluation Systems (NES) when taking subject matter or pedagogy exams. Twenty-five states use "off-the-shelf" or generic assessments sold by Educational Testing Services (ETS). The other 16 states do not require either a subject matter or pedagogy test, allow applicants to take either NES or ETS tests, or, in the case of Florida, use a test developed by an in-state institution of higher education.
- Certification exam fees in all of the other states are generally comparable to the Texas fee cost ($72 per test). States using ETS generic tests charge a $70 fee for the subject matter tests and an $80 fee for the pedagogy (teaching skills) test. Five of the eight other states using NES tests (excluding California) have subject matter test fees that cost at least 90 percent or more of the test fee charged in Texas. All four of the other states using NES pedagogy tests have test fees that are within the 90 percent or higher range.

Comments

States establish certification requirements for new educators to ensure that students will be taught by competent teachers. While teacher certification requirements vary among the states, there are some common themes. States typically prescribe a bachelor's degree coursework or a major in a specific subject area and passage of one or more assessments/examinations. Often, states will perform criminal history background checks on prospective educators prior to issuing teaching certificates.

The goal of certification assessment is to determine whether a test-taker has the knowledge to perform adequately as a teacher. Assessments fall into four categories: basic skills/knowledge, subject matter, teaching/pedagogic skills, and performance assessments. The variety of tests used and the combination of test requirements vary considerably among the states. Some states mandate only basic skills, subject tests, teaching tests, or performance assessment; others require some combination of the first three.

To provide a sense of the specific requirements in place among the nine states, including Texas, that contract with National Evaluation Systems (NES) for custom-developed teacher certification assessments,

the next section offers a summary of these provisions. Also, this section provides a comparison of assessment fees charged by the nine NES states, as well as information on assessment fees in states that use the generic Education Testing Service (ETS) examinations.

Certification Requirements and Assessment Costs in NES-Contracting States

Table 1 summarizes the general requirements for certification in the nine NES states. All of these states require a bachelor's degree to become a certified teacher—in fact, all 50 states have such a requirement. Five of the NES states require both pedagogy and subject matter tests for certification. Overall, 15 states, including the five shown in Table 1, mandate both types of exams. Also, four NES states dictate state and national fingerprint-based criminal background checks prior to certification (Texas only requires state-level, name-based background checks). Nationally, 24 states require candidates to submit fingerprints for FBI and state background checks.

As indicated in Table 2, of the eight other states that use custom-developed exams under contracts with NES, two states charge more than Texas for subject matter tests, three charge about the same (within ten percent of Texas' charge of $72), and three charge less. Comparing pedagogy tests, of the four NES states that require such exams, one state charges more than Texas and the other two charge comparable fees.

A comparison of total exam costs for states using ETS exams would be confusing because these states require a differing mix of pedagogy and subject matter exams for a prospective teacher to become certified. The ETS Praxis subject matter test fees are typically $70, while the Praxis pedagogy exam fee is $80. But states using ETS tests vary in the number and combination of tests they require. For example, in Kentucky the majority of certification areas require two subject matter exams and a pedagogy test, while in the District of Columbia an applicant typically must take three subject tests but no pedagogy test. Consequently, although per-test fees for ETS tests in

TABLE 1
CERTIFICATION REQUIREMENTS FOR STATES USING TESTS DEVELOPED BY NES
FISCAL YEAR 2002

STATE	BACHELOR'S DEGREE	TESTS REQUIRED			BACKGROUND CHECK	
		BASIC SKILLS/ KNOWLEDGE	PEDAGOGY	SUBJECT MATTER	STATE LEVEL	NATIONAL/FBI LEVEL (FINGERPRINTS)
New Mexico	★	★	★	★	★	★
Massachusetts	★	★		★		
Michigan	★	★		★		
Texas	★		★	★	★	
New York	★	★	★	★	★	★
Arizona	★		★	★	★	★
Oklahoma*	★	★	★	★		
Colorado	★			★	★	★
Illinois	★	★		★		

*An assessment of teaching performance also is required for the five-year standard certificate.
Source: National Association of State Directors of Teacher Education and Certification.

TABLE 2
TEACHER CERTIFICATION EXAM FEES
STATES USING TESTS DEVELOPED BY NES
FISCAL YEAR 2002

STATE	PEDAGOGY	SUBJECT MATTER	COMBINED COST
New Mexico	$73	$89	$162
Massachusetts	NR	80	80
Michigan	NR	79	79
Texas	72	72	144
New York	70	70	140
Arizona	75	65	140
Oklahoma	140	60	200
Colorado	NR	55	55
Illinois	NR	44	44

NR = Not required.
SOURCE: State Board for Educator Certification.

these states are comparable to Texas, the mix of tests required by ETS states makes a clear comparison difficult.

It should be noted that some states also require other types of tests, such as basic skills and general knowledge exams. As a result, the overall cost for all certification exams in these states is somewhat higher than what would be indicated by simply adding together the fee for the pedagogy and subject matter tests.

As the two tables indicate, among the five states that require both pedagogy and subject matter tests, Texas ranks third to the lowest cost for states in combined charges after New York and Arizona. However, the Texas combined cost varies from these two states by less than five percent. Compared to the three nearest states (Colorado, Oklahoma, and New Mexico), Texas' subject matter test is the third lowest, and is the absolute lowest when comparing it with the two states (Oklahoma and New Mexico) that require both types of tests. Five of the other eight states using NES custom-developed tests (excluding California) have subject matter test fees that are at least 90 percent or more of the test fee charged in Texas ($72). All four of the other states using NES custom-developed pedagogy tests have test fees that are within the 90 percent or higher range.

To provide more insight into the logic underlying other states' specific assessment rules, results from a survey of six states are summarized below. The original intent of the survey was to determine the cost of developing certification assessments, but because test contractors tend to fold the cost of test development into overall examination fees, the survey was broadened to cover assessment requirements and the kinds of tests used by the selected states. States were selected so there would be two from each of the following categories: custom-developed teacher certification test; generic or "off-the-shelf" test; and a mix of the two. The states discussed in this report are Oklahoma and New Mexico (custom), North Carolina and New Jersey (generic), and California and Florida (mixed).

Assessment Requirements of Selected States

Oklahoma

Oklahoma teaching candidates must pass the Oklahoma General Education Test, Oklahoma Subject Area Test, and Oklahoma Professional Teaching Examination (pedagogy) in order to receive a standard teaching certificate. The current professional teaching exams include the following: early childhood, elementary, middle level, and prekindergarten–12. In the 2002–03 school year Oklahoma will be moving to only two professional teaching exams: PK–8 and 6–12. Also, first-year candidates for the five-year standard teaching certificate are monitored and evaluated by a residency committee, which approves or disapproves the candidate for the standard certificate. These first-year candidates receive guidance from a mentor teacher, administrator, and higher education representative.

NEW MEXICO

Currently teaching candidates in New Mexico are required to take the New Mexico Teacher Assessments (NMTA) exam only. The NMTA includes the New Mexico Assessment of Teacher Basic Skills that measures reading, written communication, and mathematical skills; the New Mexico Assessment of Teacher Competency for elementary (grades K–8) and secondary (grades 7–12) levels, both of which are general pedagogy tests; and the New Mexico Assessment of Teacher General Knowledge that measures knowledge of science processes, history and social science processes, arts and humanities, and written analysis and expression. Subject area tests introduced in 2002 will include elementary education, language arts, reading, science, social studies, and mathematics.

NEW JERSEY

New Jersey applicants for licensure in subject teaching fields must pass the appropriate ETS Praxis II Subject Assessment(s). Applicants for licensure in elementary education are required to pass the Elementary Education: Content Knowledge test from the Praxis Series.

NORTH CAROLINA

First-time applicants for a North Carolina teaching license are required to pass an ETS Praxis II subject assessment. Individuals are required to take only one subject assessment even if they are eligible for more than one area of licensure.

FLORIDA

Florida requires teaching candidates to pass the state's College Level Academic Skills Test (essay, English language skills, reading, and mathematics), a professional education exam, and a subject area exam to become fully certified. All candidates for initial certification must pass the Professional Education examination. This test assesses pedagogical knowledge in five areas: personal development, appropriate student behavior, planning instruction, implementing instruction, and evaluating instruction. Candidates must also pass the Subject Area Exam to become fully certified. All of the state's testing requirements may also be met by passing the approved Praxis Series test offered by ETS.

CALIFORNIA

California teaching candidates applying for their first teaching credential are only required to pass the California Basic Educational Skills Test (CBEST). This test is not a measure of teaching skills or abilities. Instead, CBEST assesses proficiency in basic reading, writing, and mathematics skills that are needed by all educators from K–12 and adult education. A general pedagogical examination is not required. However, California is currently developing a model Teaching Performance Assessment (TPA) that will primarily be a pedagogical assessment. Teacher preparation programs in California will have the option of either developing and administering their own assessment that meets California's standards or administering the TPA.

Subject area assessments are not necessarily required for California teaching candidates to become fully certified. These assessments are used in lieu of completion of a state-approved preparation program in the subject areas for which the candidate has applied for a teaching credential. The Multiple Subject Assessments for Teachers (MSAT) is used in lieu of an approved program for candidates applying for California's Multiple Subject Teaching Credential. This license authorizes teaching in a self-contained classroom environment and is generally used in elementary school classes (K–6) and also in core classes in middle school. California also issues a Single Subject Teaching Credential which authorizes teaching in departmentalized settings, generally in grades 7–12. The state allows candidates for this credential to take Single Subject Assessments for Teaching (SSAT) as well as Praxis II exams offered by ETS in place of completion of a state-approved program. The same subject area assessment is used for all grades. English and mathematics credentials require test-taking

candidates to pass both the appropriate SSAT and a Praxis II exam.

Teacher Assessment Issues

Custom exams vs. generic exams

The issue of a national "off-the-shelf" test versus a custom-designed test based on state standards continues to be widely debated with no clear consensus. Opponents of custom tests see using a standardized national test as an effective way to reduce state costs. On the other hand, there are many who believe that a national test is "culturally biased" and inappropriate for their state's population. New Mexico's response to the survey stated that they continually defend their use of a customized test. However, when the state used a national standardized exam, they had to repeatedly defend that approach to people who believed that the test content and standards were inappropriate for New Mexico.

Approximately 40 states rely on standardized tests in their teacher licensing process. The Praxis series of licensing tests is used by approximately 30 states. National Evaluation Systems currently develops and administers customized exams for 10 states: Arizona, California, Colorado, Illinois, Massachusetts, Michigan, New Mexico, New York, Oklahoma, and Texas.

Development and administration of custom tests

The State of Florida develops its own teacher exams. The contractor for their current six-year contract is the Institute for Instructional Research and Practice at the University of South Florida. The test development and administration cost is approximately $84.

New Mexico, Oklahoma, and California contracted with National Evaluation Systems (NES) to develop customized teacher certification exams. These states do not pay directly for either test development or administration; their costs for test development and administration are figured into the candidates' test fees (paid directly to NES). Development costs for Texas, however, are paid directly to NES. The specific details and costs governed by the contract between SBEC and NES are discussed in Appendix B to this report.

Conclusion

This report has compared Texas' teacher testing fees and certification requirements with the eight other states that use custom-developed teacher tests exclusively. The report raises several key points. Texas is among 15 states that require teachers to pass both a teacher skills test (pedagogy) and a subject matter test to become fully certified. Texas is among an even smaller number of states (nine) that require teachers to take custom-developed tests that reflect the education priorities of the state. Finally, the $72 per test fee charged by SBEC is quite reasonable compared to the test fees charged by other custom-test states (total cost range: $140 to $200 among the custom test states that require both the pedagogy and subject matter tests; Texas: $144).

Appendices

This report concludes with two appendices. **Appendix A** provides a comparison of the current Texas educator certification structure to the emerging structure that will reflect the Texas Essential Knowledge and Skills. **Appendix A.1** shows how the transition from the old/current structure to the new structure is being phased in. It should be noted that under the certificate structure that existed through fiscal year 2000, there were 132 different educator certificates. Currently (fiscal year 2002) there are 125 certificates. Beginning in the fall of calendar year 2005, after the current structure is completely replaced (according to SBEC plans), there will be 65 educator certificates.

Appendix B provides summary information about the current contract between SBEC and NES. This five year, $8.7 million contract governs the method and cost of Texas educator examination development (see Tables 6 and 7). In other words, it indicates how, and how much it will cost, to replace the old certificate

structure with a new one—as well as incorporating the new master teacher tests/certificates and adjusting to the new out-of-state teacher provisions of House Bill 1721, Seventy-seventh Legislature, 2001.

Appendix A

TABLE 4
NEW, OLD, AND CURRENT CERTIFICATES IN TEXAS
WITH IMPLEMENTATION/DELETION DATES

NEW STANDARDS-BASED CERTIFICATES	OLD CERTIFICATES
AVAILABLE BEGINNING FALL 2000	**NOT AVAILABLE AFTER AUGUST 31, 2001**
Principal Superintendent	Mid-Management Administrator Superintendent
	NOT AVAILABLE AFTER AUGUST 31, 2001
	Supervisor Supervisor, Special Education Supervisor, Vocational Visiting Teacher Visiting Teacher

NEW STANDARDS-BASED CERTIFICATES	CURRENT CERTIFICATES
AVAILABLE BEGINNING FALL 2001	**NOT AVAILABLE AFTER AUGUST 31, 2003**
Technology Applications 8–12* Computer Science 8–12* *These certificates are being offered prior to tests becoming available (in 2004) because this is a new curriculum area that TEA requires for graduation, thus the need for certified Technology Applications/ Computer Science teachers. Completion of an SBEC-approved, standards-based program is necessary to receive one of these certificates.	Information Processing Technologies I Endorsement * Information Processing Technologies II Endorsement* Computer Information Systems 6–12* *These credentials are still being offered to candidates who complete an SBEC-approved program, although the associated tests have been deleted due to out-of-date content. Programs are being encouraged to transition to the new standards for Technology Applications and Computer Science.

NEW STANDARDS-BASED CERTIFICATES	CURRENT CERTIFICATES
AVAILABLE BEGINNING FALL 2002	**ASSOCIATED TESTS NOT AVAILABLE AFTER AUGUST 31, 2003***
Generalist EC–4 Bilingual Generalist EC–4 Mandarin Chinese French German Korean Spanish Vietnamese	Early Childhood Education Endorsement Early Childhood Education Delivery System Elementary Self-Contained PK–6 Elementary Self-Contained 1–6, Specialization Certificates: Elementary Art Elementary Biology Elementary Earth Science *See Appendix A.1 for explanation of Board policy regarding issuance of these certificates after 08/31/03.

TABLE 4 *(CONTINUED)*
NEW, OLD, AND CURRENT CERTIFICATES IN TEXAS WITH IMPLEMENTATION/DELETION DATES

NEW STANDARDS-BASED CERTIFICATES

AVAILABLE BEGINNING FALL 2002

Generalist 4–8

Bilingual Generalist 4–8
- Mandarin Chinese
- French
- German
- Korean
- Spanish
- Vietnamese

English Language Arts and Reading 4–8

Mathematics 4–8

Science 4–8

Social Studies 4–8

English Language Arts and Reading/Social Studies 4–8

Mathematics/Science 4–8

CURRENT CERTIFICATES

ASSOCIATED TESTS NOT AVAILABLE AFTER AUGUST 31, 2003

- Elementary English
- Elementary Geography
- Elementary Health
- Elementary History
- Elementary Mathematics
- Elementary Music
- Elementary Physical Education
- Elementary Reading
- Elementary Speech Communications
- Elementary Theatre Arts

Elementary Self-Contained 1–8, Specialization Certificates:
- Elementary Earth Science
- Elementary English
- Elementary French
- Elementary Generic Special Education
- Elementary Geography
- Elementary German
- Elementary Health
- Elementary History
- Elementary Latin
- Elementary Life-Earth Science
- Elementary Mathematics
- Elementary Music
- Elementary Physical Education
- Elementary Physical Science
- Elementary Reading
- Elementary Russian
- Elementary Social Studies
- Elementary Spanish
- Elementary Speech Communications
- Elementary Theatre Arts

Elementary Self-contained Bilingual PK–6:
- Mandarin Chinese
- French
- German
- Korean
- Spanish

TABLE 4 *(CONTINUED)*
NEW, OLD, AND CURRENT CERTIFICATES IN TEXAS
WITH IMPLEMENTATION/DELETION DATES

NEW STANDARDS-BASED CERTIFICATES

AVAILABLE BEGINNING FALL 2002

English Language Arts and Reading 8–12
Mathematics 8–12
Science 8–12
Life Science 8–12
Physical Science 8–12
Social Studies 8–12
History 8–12
Bilingual Education EC–4, Supplemental
Bilingual Education 4–8, Supplemental
School Counselor All-Level
School Librarian All-Level
Technology Applications All-Level*

*As with Technology Applications 8–12 and Computer Science 8–12, this certificate will be offered prior to a test becoming available (in 2004). This certificate will help meet the need for qualified teachers of this new Technology Applications curriculum area. TEA requires this curriculum be offered. Completion of an SBEC-approved, standards-based program will be necessary to receive this certificate.

CURRENT CERTIFICATES

ASSOCIATED TESTS NOT AVAILABLE AFTER AUGUST 31, 2003

Elementary Self-Contained Bilingual 1–6:
- Mandarin Chinese
- French
- German
- Korean
- Spanish

Elementary Self-Contained Bilingual 1–8:
- Mandarin Chinese
- French
- German
- Korean
- Spanish
- Vietnamese

English 6–12
English Language Arts Composite 6–12
Reading 6–12
Mathematics 6–12
Composite Science 6–12
Biology 6–12
Earth Science 6–12
Life/Earth Science 6–12
Physical Science 6–12
Physics 6–12
Chemistry 6–12
Composite Social Studies 6–12
Economics 6–12
Geography 6–12
Government 6–12
History 6–12
Psychology 6–12
Sociology 6–12
History 6–12
Bilingual Endorsement
Counselor, All-Level
Counselor, Special Education, All-Level
Counselor, Vocational, All-Level
Learning Resources Specialist, All-Level
Learning Resources Endorsement

TABLE 4 *(CONTINUED)*
NEW, OLD, AND CURRENT CERTIFICATES IN TEXAS WITH IMPLEMENTATION/DELETION DATES

NEW STANDARDS-BASED CERTIFICATES	CURRENT CERTIFICATES
AVAILABLE BEGINNING FALL 2003	**NOT AVAILABLE AFTER AUGUST 31, 2003***
Special Education All-Level Reading Specialist All-Level Trade and Industrial Education 8–12 Educational Diagnostician All-Level English as a Second Language, Supplemental Special Education, Supplemental Physics/Mathematics 8–12* *This composite certificate was approved by the SBEC Board on May 10, 2002. The implementation date of the certificate and associated test has not yet been determined, but the earliest would be fall 2003.	Generic Special Education PK–12 Generic Special Education 1–8 Reading Specialist All-Level Trades and Industry, Pre-Employment Lab 6–12 Trades and Industry, Co-op 6–12 Occupational Orientation 6–12 Educational Diagnostician All-Level English as a Second Language All-Level Generic Special Education All-Level Early Childhood-Handicapped PK–6 Endorsement Seriously Emotionally Disturbed/Autistic Endorsement Severely/Profoundly Handicapped Endorsement *The Board has not yet considered an Overlap Year for the tests associated with these certificates.
NEW STANDARDS-BASED CERTIFICATES	**CURRENT CERTIFICATES**
AVAILABLE BEGINNING FALL 2004	**NOT AVAILABLE AFTER AUGUST 31, 2004***
Family and Consumer Science 8–12 Health Science Technology Education 8–12 Technology Education 6–12 Gifted and Talented, Supplemental NOTE: New tests will be available in fall 2004 for Technology Applications and Computer Science.	Home Economics Education Health Science Technology Industrial Technology[1] [1]Due to the out-dated nature of the content of the test for this certificate, the test will be deleted in fall 2003. Gifted and Talented Endorsement *The Board has not yet considered an Overlap Year for the tests associated with these certificates.

TABLE 4 *(CONTINUED)*
NEW, OLD, AND CURRENT CERTIFICATES IN TEXAS WITH IMPLEMENTATION/DELETION DATES

NEW STANDARDS-BASED CERTIFICATES

AVAILABLE BEGINNING FALL 2005

Agricultural Science and Technology 8–12
Business Education 8–12
Journalism 8–12
Languages Other Than English 8–12
- French
- German
- Latin
- Russian
- Spanish

Marketing Education 8–12
Math/Physical Science/Engineering 8–12
Speech 8–12
Art All-Level
Dance All-Level
Deaf and Hard-of-Hearing All-Level
Health All-Level
Music All-Level
Physical Education All-Level
Theatre Arts All-Level

CURRENT CERTIFICATES

NOT AVAILABLE AFTER AUGUST 31, 2005*

Agriculture, Ornamental Horticulture 6-12–
Agriculture, Production 6–12
Business Administration 6–12
Business Basic 6–12
Business Composite 6–12
Business Secretarial 6–12
Office Education 6–12
Journalism 6–12
Languages Other Than English 6–12
- French
- German
- Latin
- Russian
- Spanish

Marketing Education (Career and Technology) 6–12
Marketing Education (Skill/Experience-Based) 6–12
Speech Communications 6–12
Speech Communications/Theatre Arts (PK–12)
Art 6–12
Dance 6–12
Hearing Impaired All-Level
Health 6–12
Music 6–12
Physical Education 6–12
Theatre Arts 6–12
Art All-Level
Music All-Level
Physical Education All-Level
Theatre Arts All-Level
Visually Impaired All-Level

*The Board has not yet considered an Overlap Year for the tests associated with these certificates.

SOURCE: State Board for Educator Certification.

Appendix A. 1

State Board for Educator Certification Policy Regarding the ExCET Tests To Be Deleted on August 31, 2003 and the Issuance of Associated Certificates after that Date

Because the ExCET Professional Development and foundation curriculum-area tests will not be offered after August 31, 2003, the SBEC Board has approved the following policies to address those candidates who will not have completed their testing requirements by that date.

- If by August 31, 2003, a candidate has achieved a passing score on one of the deleted ExCET tests, that test score will remain valid for certification until August 31, 2004.
- If by August 31, 2003, a candidate has not passed one of the ExCET tests to be deleted on that date, the candidate must then take and pass a corresponding TExES test in order to be certified.
- NOTE: The content area test passed, not the pedagogy test passed, will determine the certificate issued (ExCET-based content area, elementary or secondary or TExES-based content area, EC–4, 4–8, 8–12, or All-Level).

Table 5 shows sample combinations of deleted ExCET and new TExES tests that will be valid for certification during the 2003–04 academic year.

TABLE 5
COMBINATIONS OF DELETED EXCET AND NEW TEXES TESTS THAT WILL BE VALID FOR CERTIFICATION DURING 2003–04

TEST TAKEN DURING 2002–03	TESTS TAKEN DURING 2003–04	CERTIFICATE AWARDED
CANDIDATE A **IF:** Content ExCET – PASS (Secondary Math 6–12) Pedagogy ExCET – FAIL (Professional Development Secondary)	**THEN:** Content test—none required Pedagogy TExES – PASS (Pedagogy and Professional Responsibilities, All-level or 8-12)	**AND:** Old ExCET-Based Certificate (Secondary Math 6–12)
CANDIDATE B **IF:** Content ExCET – FAIL (Secondary Math 6-12) Pedagogy ExCET – PASS (Professional Development Secondary)	**THEN:** Content TExES– PASS (Mathematics 8-12) Pedagogy test—none required (Mathematics 8-12)	**AND:** New TExES-Based Certificate (Mathematics 8-12)

Source: State Board for Educator Certification.

Appendix B

Texas Test Development and Administration Contract

Beginning in 1984, the Texas Education Agency entered into a contract with National Evaluation Systems (NES) for the testing of educators that was similar to contracts held by Oklahoma, New Mexico, and California whereby applicants paid test fees directly to the contractor. After several continuances of the contracts with NES, the State Board for Educator Certification (SBEC), with the approval of the General Services Commission (now the Building and Procurement Commission), issued in early 1999 a Request for Proposal inviting vendors to submit bids and methods for helping SBEC implement a comprehensive new testing program. NES was selected as the contractor.

Subsequent to the award of this contract, Section 2113.203, Texas Government Code, (Seventy-sixth Legislature, 1999) was enacted, which requires that state agency to collect all examination fees charged and use appropriated money to pay the test provider for the cost incurred. Now all examination fees collected by NES must be deposited with the Treasury within three working days of receipt, and the SBEC must use state funds to pay NES "up front" to develop exams. SBEC's five-year contract with NES was for $29.5 million for test administration and $9.5 million for test development for the period September 1, 1999 through August 31, 2004.

Since that time, about $1 million has been added by actions of the 2001 Legislative Session to fund the development of the Master Mathematics Teacher and Master Technology Teacher standards and exams. The Seventy-seventh Legislature also placed a $2.8 million cap (SBEC rider #9) on test development costs for the 2002–03 biennium. This cap has resulted in the NES contract being reduced to $8,701,983. To stay within the $2.8 million cap, the implementation schedule was revised, and some tests scheduled to be fully redeveloped will be updated or adopted using existing tests from other states.

Summary of Contract Specifics

Under the current test administration contract, the state must reimburse NES for the costs of providing four test administrations plus one limited test administration. The current base cost per examination is $64.77 (fiscal year 2003). The agency must also reimburse NES for other program-related services such as late and emergency registration, change of registration, and score report reprints. The amount SBEC reimburses NES for test administrations and other services for the remainder of the contract is determined on a year-to-year basis upon mutual agreement of the agency and NES. This takes into consideration such issues as the scoring of new tests, additional test site expenses necessitated by the mandate that all testing sites be located no more than 50 miles from an educator preparation program

TABLE 6
CURRENT TEST ADMINISTRATION COSTS PER TEST

CATEGORY	COST PER TEST
Registration	$19.43
Administration	22.67
Test Scoring	22.67
TOTAL	$64.77

Note: NES may charge SBEC for other costs such as late fees. These other charges, and a higher number of registrations versus tests actually administered, will result in the cost per test administered exceeding $64.77.
Source: State Board for Educator Certification.

facility, and an inflation rate of 3 percent. NES invoices the agency on a monthly basis for goods and services delivered.

TABLE 7
TEST DEVELOPMENT COSTS FOR ExCET/TExES/MASTER TEACHER TESTS
SEPTEMBER 1, 1999 – AUGUST 31, 2004

CATEGORY	COST
STANDARDS AND DEVELOPMENT COMMITTEES	
36 committees	$1,685,083
EXAMINATION DEVELOPMENT FOR TESTING FIELDS (GENERALLY ONE FIELD EQUALS ONE TEST)	
15 fields with both selected response and/or constructed response items (one is technology applications) averaging $145,670 each	$2,185,000
38 fields with both selected response and/or constructed response items averaging $77,370 each*	$2,940,000
10 fields with tests adopted from existing tests	No charge
1 superintendent field	$175,500
Exam review panels–cost of temporary duty release for members	$140,400
32 release form tests @ $34,000**	No charge
1 Master Reading Teacher test and Representative form	$332,000
1 Master Reading Teacher placement test	$157,000
3 Master Mathematics Teacher tests (3 levels) and representative form tests	$647,000
1 Master Technology Teacher test and representative form tests	$440,000
TOTAL	**$8,701,983**

*Tests in this category to include expansion and validation of current item banks to match new standards.
**Release forms to be developed and sold by NES.

Source: State Board for Educator Certification.

Accounting for Clinical Partners' Research Expenditures for Health-related Institutions

This review focuses on the issues of primary clinical partners and their relationship with health-related institutions and whether health-related institutions should use primary clinical partner research expenditures to determine formula funding. In addition, the review includes an evaluation to determine the extent to which health-related institutions account for primary clinical partner research expenditures.

Significant Findings

- All of the health-related institutions have clinical partners or affiliation agreements with other healthcare delivery organizations and systems.
- Primary clinics/affiliated hospitals finance research ventures of full-time faculty members of health-related institutions.
- None of the health-related institutions include the primary clinics/affiliated hospitals as component units of the institution in their annual financial reports.
- The standard accounting and reporting model among federal and state governments and academic institutions is to allocate expenditures that have been separately budgeted and accounted for by an organizational unit only once. This cost accounting concept prevents double counting and reporting of expenditures among organizational units.

Significant Concern

- For all health-related institutions except for Texas A&M University System Health Science Center, research expenditures by their primary clinics/affiliated hospitals are separately budgeted and accounted for by the primary clinic's/affiliated hospital's financial system. In other words, the other health-related institutions do not include research expenditures of their primary clinics/affiliated hospitals as the institution's own.

Recommendations

- **Recommendation 1:** The Legislature should continue the current accounting concept of allowing health-related institutions to only include research expenditures of the institution's component units for formula calculations for the Research Enhancement and Educational & General Space Support strategies.
- **Recommendation 2:** The Legislature should consider amending the rider for Texas A&M University System Health Science Center related to the inclusion of research expenditures conducted by the institution's faculty under contract with its primary clinical partner in the formula calculations for the Research Enhancement and Educational & General Space Support strategies. The rider should only allow the institution to include research expenditures for formula calculations if the primary clinical partner and the institution agree to cost-share expenses and the cost-shared expenditures are accounted for in the institution's financial system. This recommendation would result in a estimated savings or redistribution of approximately $235,000 for the 2004–05 biennium.

Comments

Formulas are incorporated as a methodology for funding the health-related institutions. The formulas consist of three elements, which are contained in Section 33, Page III-240, General Appropriations Act, 2002–03 Biennium.

- The Instruction and Operations Support Formula, which allocates funding per full-time-equivalent student based on a funding weight that is determined in accordance with the student's instructional program.
- The Infrastructure Support Formula provides funding to health-related institutions for plant support and utilities based on the predicted square feet at the institutions multiplied by a rate per square foot. The figure for predicted square feet is produced by the Higher Education Coordinating Board's (Coordinating Board) space projection model.
- The Research Funding Formula provides health-related institutions a base amount of research enhancement funding, plus additional funding based on a percentage of research expenditures reported to the Coordinating Board.

For the purpose of this report, this review focused on the two formulas that contain research expenditures as a component, Research Funding and Infrastructure Support, and the rider for Texas A&M University Health Science Center (Texas A&M HSC), Rider 2, Page III-177, General Appropriations Act (2002–03 Biennium), which calls for research conducted by Texas A&M HSC faculty under contract with its primary clinical partner to be considered in the formula calculations for the Research Enhancement and Educational & General (E&G) Space Support strategies.

The following analysis included in this report relates directly to the relationship of clinical partners/affiliated hospitals with health-related institutions and the accounting and reporting of research expenditures.

Clinical Partners/Affiliated Hospitals

All of the health-related institutions have clinical partners or affiliation agreements with other healthcare delivery organizations and systems. Often, the revenue and expenditures of clinical partners/affiliated hospitals, which support health-related institution activities or faculty, are not recorded in the medical school accounts, but on the books of these clinical partners/affiliated hospitals. In addition, clinical partners/affiliated hospitals may pay, in whole or part, the salaries of full-time faculty. This occurs when a faculty member supervises residents or performs medical care as a member of the staff of a clinical partner or affiliated hospital, or conducts research under its sponsorship or that of an affiliated research institute.

A review of health-related institutions found only the institutions identified in Table 1, Primary Clinics and Affiliated Hospitals, have research programs in which (1) health-related institution faculty are paid and based in a primary affiliated hospitals, where they do research and are involved in teaching; and (2) the affiliated entity primarily pays the research expenditures; therefore, health-related institutions have not recorded the research expenditures in the institution's financial reports. This review also found that health-related institutions may contribute financing for research ventures on a case by case basis and will record these expenditures in the institutions's financial reports. In addition, this review noted the following health-related institutions do not have any research programs that fit the conditions noted above:

- The University of Texas Health Science Center at Houston;
- The University of Texas Health Center at Tyler;

TABLE 1
PRIMARY CLINICS AND AFFILIATED HOSPITALS

INSTITUTION PRIMARY CLINIC/ AFFILIATED HOSPITAL	PERCENTAGE OF THIRD YEAR, FOURTH YEAR, AND GRADUATE STUDENTS TAUGHT AT FACILITY	WHO PAYS RESEARCH EXPENDITURES
TEXAS A&M HEALTH SCIENCE CENTER		
Scott and White Clinic	• 100 percent of third and fourth year students • 98 percent of graduate students	Scott and White
THE UNIVERSITY OF TEXAS MEDICAL BRANCH AT GALVESTON		
Shriners Hospital - Burn Institute	• 2 percent of third and fourth year students • 5 percent of graduate students	Shriners Hospital
THE UNIVERSITY OF TEXAS HEALTH SCIENCE CENTER AT SAN ANTONIO		
Audie L. Murphy Memorial V.A. Hospital	• 25 percent of third and fourth year students • 5 percent of graduate students	VA Medical Center
THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER AT DALLAS		
Howard Hughes Medical Institute	• 0 percent of third and fourth year students • 5 percent of graduate students	Howard Hughes Medical Institute
THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER AT DALLAS		
Veterans' Administration Medical Center	• 10 percent of third and fourth year students	Federal Veterans' Administration
THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER AT DALLAS		
Texas Scottish Rite Hospital	• 5 percent of third and fourth year students	Scottish Rite
THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER AT DALLAS		
Moncrief Cancer Center	• 1 percent of third and fourth year students	Moncrief Cancer Center

SOURCE: Legislative Budget Board Survey of Health-related Institutions, April 2001.

- The University of Texas M. D. Anderson Cancer Center;
- University of North Texas Health Science Center; and
- Texas Tech University Health Sciences Center.

This review also noted that none of the institutions in Table 1 reported these clinical partners as component units in their Annual Financial Reports (AFRs) as required by Governmental Accounting Standards Board (GASB), Statement No. 14. GASB No. 14 establishes standards for defining and reporting on the financial entity. This statement would require clinical partners to be included as part of the component units of the institutions if the clinical partners met the following conditions:

- The institution is financially accountable for the clinical partner;
- The institution can impose its will on a clinical partner if it can influence the programs, projects, or activity of the clinical partner; and
- The exclusion of a clinical partner from the institution's financial statements would cause the financial statements to be misleading or incomplete.

Recommendation 1 states that the Legislature should continue the current accounting concept of allowing health-related institutions to only include research expenditures of the institution's component units for formula calculations for the Research Enhancement and Educational & General Space Support strategies.

RESEARCH EXPENDITURES

The Coordinating Board noted in their report, Research Expenditures, April 2001, that research expenditures are a widely accepted quality or performance measure for higher education institutions. Most institutions and states track these numbers and report them. Federal and state government planners use this data for science policy analysis, national studies, legislative hearing reports, and budget formulation sessions. Higher education institutions use the information primarily for policy analysis and publicity. Table 2 provides an overview on research expenditures accounted for by primary clinics/affiliated hospitals during fiscal years 1999 and 2000. In addition, Table 2 shows the potential impact of additional state appropriations on formula funding for the 2002-03 biennium if institutions were authorized to report these expenditures to the Coordinating Board.

A review of the institutions listed in Table 2 revealed that none of the institutions accounted for expenditures that were separately budgeted and accounted for by the primary clinic's/affiliated hospital's financial system. This accounting standard is based on the Office of Management and Budget's (OMB), Circular A-21, which establishes principles for determining cost applicable to grants, contracts and other agreements with educational institutions. This standard requires that each type of cost be allocated only once to a particular cost objective (i.e., project, sponsored agreement, or institution). Adherence to this cost accounting concept is necessary to prevent double counting.

This review also found the principle for determining cost as outlined in OMB Circular A-21 is used by both federal and state agencies, such as the National Science Foundation and the Coordinating Board, to develop reporting guidelines for research expenditures among institutions of higher education. However, as noted in Table 2, Texas A&M HSC is the only institution authorized to report these expenditures for budgetary considerations.

Recommendation 2 would amend the rider for Texas A&M HSC related to the inclusion of research expenditures conducted by the institution's faculty under contract with its primary clinical partner for formula calculations for the Research Enhancement and Educational & General Space Support strategies. The rider should only allow the institution to include research expenditures for formula calculations if the primary clinical partner and the institution agree to cost-share expenses and the cost-shared expenditures are accounted for in the institution's financial system.

CONCLUSION

Because this information is used to make policy and management decisions, it is important that the data be reported accurately and completely, and be comparable among institutions of higher education. Therefore, the implementation of recommendations identified in this report, which are based on established standards and accounting methods, would provide uniformity among the institutions during budget formulation sessions.

TABLE 2
PRIMARY CLINICS AND AFFILIATED HOSPITALS RESEARCH EXPENDITURES

INSTITUTION PRIMARY CLINIC/ AFFILIATED HOSPITAL	WHO ACCOUNTS/REPORTS FOR RESEARCH EXPENDITURES FINANCED BY PRIMARY CLINIC/ AFFILIATED HOSPITALS[1]	RESEARCH EXPENDITURES/ FORMULA AMOUNT			
		1999		2000	
		EXPENDED (IN MILLIONS)	FORMULA	EXPENDED (IN MILLIONS)	FORMULA
TEXAS A&M HEALTH SCIENCE CENTER					
Scott and White Clinic	Scott and White Clinic, Texas A&M HSC also reports research expenditures for formula funding purposes	$5.2	$296,000	$5.0	$285,000
THE UNIVERSITY OF TEXAS MEDICAL BRANCH AT GALVESTON					
Shriners Hospital - Burn Institute	Shriners Hospital	$3.8	$215,000	$4.3	$245,000
THE UNIVERSITY OF TEXAS HEALTH SCIENCE CENTER AT SAN ANTONIO					
Audie L. Murphy Memorial V.A. Hospital	Audie L. Murphy Memorial V.A. Hospital	$6.9	$389,000	$6.4	$361,000
THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER AT DALLAS					
Howard Hughes Medical Institute	Howard Hughes Medical Institute	$12.8	$724,000	$13.8	$782,000
THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER AT DALLAS					
Veterans' Administration Medical Center	Veterans' Administration Medical Center	$5.2	$293,000	$4.3	$242,000
THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER AT DALLAS					
Texas Scottish Rite Hospital	Texas Scottish Rite Hospital	$3.0	$170,000	$3.0	$170,000
THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER AT DALLAS					
Moncrief Cancer Center	Moncrief Cancer Center	NA	NA	NA	NA
TOTAL RESEARCH EXPENDITURES[2]		**$36.9**	**$2,100,000**	**$36.8**	**$2,100,000**
TOTAL RESEARCH FORMULA AMOUNT FOR 2002–03 BIENNIUM		**$752.3**	**$63,100,000**		

[1]All primary clinics, and affiliated hospitals account for and report expenditures through their financial systems.
[2]Does not include Texas A&M Health Science Center.
SOURCES: Legislative Budget Board; Texas Health-related Institutions.

Development of the Offender Information Management System

In 1989, House Bill 2335, passed by the Seventy-first Legislature, created the Department of Criminal Justice, a consolidation of the Adult Probation Commission, Department of Corrections, and the parole supervision function of the Board of Pardons and Paroles. This resulted in the assemblage of disparate information systems from each agency. These individual agency systems were combined as mandated by House Bill 2335 to create the Corrections Tracking System. The system monitors offenders on community supervision (often referred to as probationers), prison inmates, and parolees and maintains a record of their activities within the correctional system.

This review provides information and recommendations related to the ongoing development of the Offender Information Management System, an effort to re-engineer major components of the Corrections Tracking System by the Department of Criminal Justice. The agency anticipates that implementation of the Offender Information Management System will provide for greater public safety by maintaining all offender data in a single database and enabling the agency to better track offenders from incarceration through parole.

Upon completion, the Offender Information Management System will provide the Board of Pardons and Paroles, the Department of Criminal Justice Parole Division, the Department of Criminal Justice Institutional Division, and the Department of Criminal Justice State Jail Division with a comprehensive automated offender management system and an active link to the Federal Bureau of Investigation's National Crime Information Center. Connectivity to the Automated Fingerprint Identification System, maintained by the Department of Public Safety, will provide a more efficient means for the positive identification of offenders supervised by the Department of Criminal Justice.

This report outlines the general concept behind the Offender Information Management System and provides a history of its development. Recommendations are provided for the continued development of the system.

Significant Concerns

- Continued scope changes and system redesign of the Offender Information Management System during planning and development make it difficult to assess both its present and future functionality and capabilities. Resolution of development issues has not been proactively addressed and may affect end users upon full implementation.
- The agency has formulated an aggressive development plan for the next stage of the project (Phase III, Period 2) which will commence before full evaluation of the current effort (Phase III, Period 1) has been completed. Details of these phases are discussed later in this report.
- Business processes and system design requirements will not be finalized before the start of the next phase of the project (Phase III, Period 2). This will result in project scope changes during the project and will cause additional delays.

RECOMMENDATIONS

- **Recommendation 1:** The Department of Criminal Justice should demonstrate that the current system meets the business needs of the agency and the technical capabilities, performance, and specifications identified during the development phase of the project. The agency should confirm that all product requirements are satisfied. Senior management of the Department of Criminal Justice, the Board of Pardons and Paroles and the Parole Division of the Department of Criminal Justice should provide the Governor and the Legislature a letter of certification validating the usability and functionality of the current system (Phase III, Period 1).

- **Recommendation 2:** The Department of Criminal Justice should provide a detailed project plan for the next phase of the project (Phase III, Period 2) to the Governor and the Legislature. This plan should include a detailed description of tasks, deliverables, milestones, work efforts, responsible individuals, and due dates. The agency should provide performance measures to assist in evaluating the progress of the project. Furthermore, it should continue to provide monthly status reports to the Quality Assurance Team (staff of the State Auditor's Office and Legislative Budget Board) that track project status, change management, risk management, issue and action items, deliverables, and scheduled accomplishments.

COMMENTS

In 1994, the Texas Performance Review published its report, "Behind the Walls - The Price and Performance of the Texas Department of Criminal Justice." This report, in addition to other assessments performed by the State Auditor's Office and the Criminal Justice Policy Council, and internal audits conducted by the Department of Criminal Justice (TDCJ), identified several issues. These assessments and reports recognized the need for enhanced technology and data management tools to support the mission of TDCJ. All assessments pointed to problems with the existence of autonomous applications, databases, and computer hardware. Unique database applications result in inefficient information sharing, a lack of real-time data, and redundancy and inaccuracies in data collection. Additional consequences include insufficient resources to adequately track and manage offenders on parole and community supervision (probation), problems responding in a timely manner to informational inquiries, and the inability to provide timely notification when a parolee or probationer has been rearrested. These reviews prompted TDCJ to evaluate its business processes and re-engineer them for offender management[1] and offender information management.[2]

In December 1994, TDCJ retained professional services at a cost of $580,000 to provide a third-party evaluation of the business processes and automation needs of the agency. The final report, presented in May 1995, provided recommendations for aligning current business process to business strategy. Some guiding principles included simplification of processes, elimination of manually intensive tasks, elimination of redundancy, reduction of system inefficiencies, and improvement of the reliability of offender management information. The consultant provided two assessments of the processes relevant to the management of offender information. The first was an "As-Is" of the current environment followed by a "To Be" evaluation of recommendations for

[1]Offender Management is the set of processes performed to supervise, rehabilitate and reintegrate the offender from the point of adjudication to the completion of his/her sentence. Deloitte & Touche Consulting, 1998.

[2]Offender Information Management is the set of activities that record, maintain, and provide information about an offender to effectively perform Offender Management processes. Deloitte & Touche Consulting, 1998.

alignment of process to strategy. The objective of the "To Be" analysis was a clear vision for the future of the Offender Management and Offender Information Management System business processes.

The re-engineered business processes and their automation created the concept of the Offender Information Management System (OIMS). Re-engineering is defined as "the fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in performance,"[3] such as quality, service, and speed. The re-engineered OIMS intends to provide these improvements through simplification of processes, the ability to respond to management inquiries, and the availability of real-time data. Current plans for OIMS provide a comprehensive framework for dealing with two main offender divisions within the Department of Criminal Justice: inmates and parolees. These offender divisions impact the TDCJ Institutional Division, the TDCJ State Jail Division, the TDCJ Parole Division and the Board of Pardons and Paroles.

The current manual process for inmate and parole tracking is labor intensive and redundant. Table 1 provides examples of redundant data elements collected during the intake process for each inmate. Approximately 457 redundant data entries are made during the intake procedure. The agency concurs with the findings of the vendor that the data elements in Table 1 require business process re-engineering and automation into a single offender database. The OIMS upon completion will resolve the issues found in previous audits by providing a single, web-enabled database and access to real-time data. The capture of offender demographic information will be part of a single offender record in which all data elements will be entered once and flow from intake/classification through discharge. Presently, it takes a staff of 93 employees and 125 days to gather and process information through the classification/intake process for each offender.

[3]Hammer, Michael & Champy, James. 1995. *The Re-engineering Revolution*. New York: HarperCollins Publishers.

RE-ENGINEERING STEERING COMMITTEE

TDCJ's Executive Director established the Re-engineering Steering Committee (RSC) in January 1996. The RSC is responsible for executive oversight and governance of the re-engineering development strategy as well as monitoring implementation. The committee is chaired by TDCJ's Chief Information Officer and is composed of Division Directors from the agency's major divisions, the General Counsel to the Texas Board of Criminal Justice, and the Executive Assistant to TDCJ's Executive Director. A project sponsor for the OIMS initiative is responsible for overall executive direction and guidance, resolution of strategic issues, or escalation of issues to the RSC, if necessary. The project sponsor communicates project

TABLE 1
SAMPLE OF REDUNDANT OFFENDER INFORMATION MANAGEMENT SYSTEM DATA ELEMENTS

DATA ELEMENT	NUMBER OF TIMES COLLECTED DURING INTAKE PROCESSING
Offender's name	84
TDCJ number	84
Race	32
Date of birth	30
Gender	21
Unit of assignment	21
County of conviction	18
Offender's age	13
Weight	11
State identification number (SID)	8
Prior TDCJ number	7
Sentence begin date	7
Date of sentence	7
Length of sentence	7

SOURCES: Deloitte and Touche Consulting; Department of Criminal Justice.

direction to the TDCJ Project Management Office (PMO). The PMO is responsible for controlling all activities related to the design, development, implementation, and closeout of the project. The PMO also oversees the OIMS vendors, resolving or escalating issues as required in addition to its day-to-day responsibilities and project operations.

PROJECT PHASES

Table 2 outlines the phases, subprojects, and expenditures for the Offender Information Management System. The project has been divided into phases and subprojects to facilitate the entire development effort through a building block approach. A phased implementation allows subsequent efforts to build upon functionality developed in previous phases. Figure 1 depicts the project timeline relative to the phase history. Presently, Phase III, Period 1 is under development. Phase III, Period 2 is in the planning stages.

PHASE I

Phase I was conducted in conjunction with an independent project manager provided by the Department of Information Resources (DIR). The project commenced in December 1996 and was completed in April 1997.

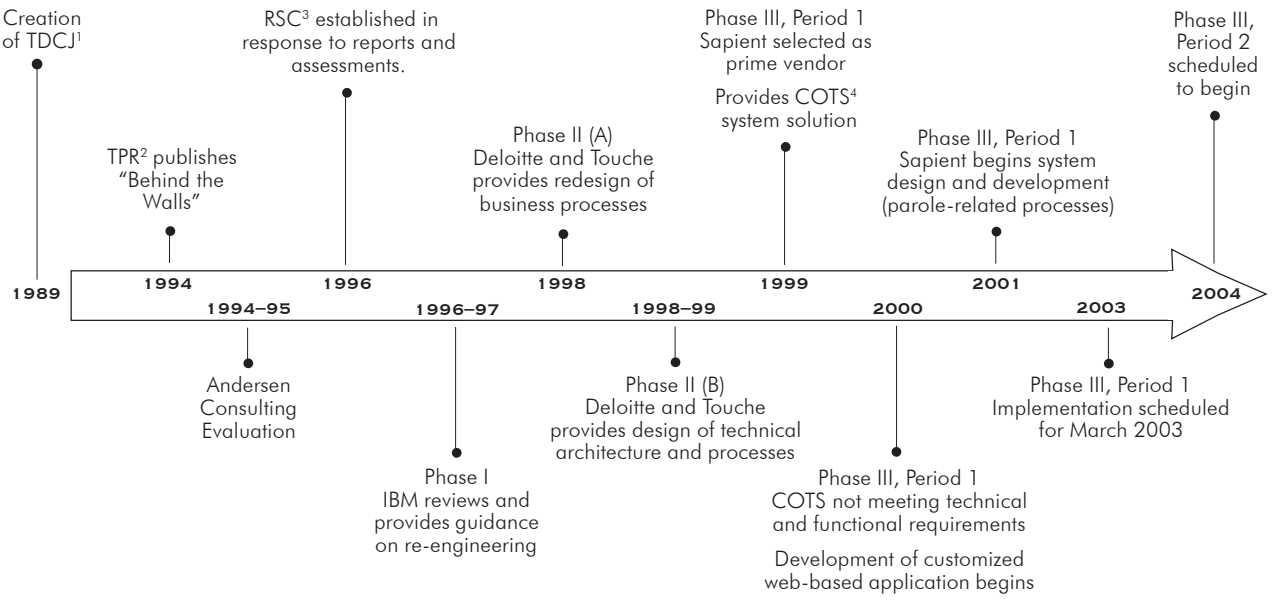
The main objective of Phase I was to ensure business processes were recorded, to document the current technological environment of TDCJ and to develop a vision of the desired future environment. In addition, Phase I defined the relationships between processes and how they were to be re-engineered. TDCJ, in

TABLE 2
OFFENDER INFORMATION MANAGEMENT SYSTEM: PHASE DESCRIPTIONS, CONTRACTORS AND EXPENDITURES

PROJECT PHASE / CONTRACTOR / DESCRIPTION	DATES	EXPENDITURES
PRE-PHASE I		
Andersen Consulting Provide initial assessment of business processes	12/94–05/95	$580,000
PHASE I		
IBM[1] Develop business objectives and document existing processes	12/96–04/97	$974,650
DIR[2] Oversee results presented by IBM	12/96–04/97	255,858
Subtotal, Phase I		$1,230,508
PHASE II (A)		
Deloitte and Touche Expand mapping of offender management processes and redesign key offender information management processes	01/98–07/98	$2,472,383
PHASE II (B)		
Deloitte and Touche Complete redesign and information technology process design	05/98–08/99	$6,816,322
Logicon Provide independent verification and validation of results presented by Deloitte and Touche	05/98–08/99	859,323
Subtotal, Phase II A & B		$10,148,028
PHASE III, PERIOD 1		
Sapient Develop software for parole-related processes	10/99–	$23,606,376
Logicon Provide independent verification and validation of software development by Sapient	10/99–01/02	2,405,058
Deloitte and Touche Define and implement procedures and/or technologies for changes in business environment	10/99–05/00	298,055
Subtotal, Phase III, Period 1		$26,309,489
GRAND TOTAL		**$38,268,025**

[1]International Business Machines.
[2]Department of Information Resources.
NOTE: TDCJ staff salaries and other indirect costs are not included in project costs until Phase III, Period 1.
SOURCES: Legislative Budget Board; Department of Criminal Justice; Deloitte and Touche Consulting.

FIGURE 1
OFFENDER INFORMATION MANAGEMENT SYSTEM
RE-ENGINEERING PROJECT TIMELINE



[1]TDCJ = Consolidation of Adult Probation Commission; Department of Corrections; Parole Supervision function of Board of Pardons and Paroles.
[2]TPR = Texas Performance Review (Comptroller of Public Accounts)
[3]RSC = Re-engineering Steering Committee (within TDCJ)
[4]COTS = Commercial-off-the-shelf.

SOURCES: Legislative Budget Board; Department of Criminal Justice; Andersen Consulting; Deloitte and Touche Consulting.

conjunction with DIR, developed a conceptual plan which encompassed not only re-engineering of the business processes but their automation. In its final report, the vendor provided the initial timeframe for design, development, and implementation of the project. The report indicated commencement of the project in fiscal year 1997 and completion through Phase III, all periods, in fiscal year 2001 with an estimated cost of $57.6 million.

PHASE II

The overall concept for Phase II was to provide actual re-engineering design of the manual and automated information collection points within the specific areas of intake/classification, pre-release, parole direct supervision and parole violation/ revocation. Broken into two components, Phase II commenced in January 1998 and was completed August 1999. The two components are referred to as Phase II (a) and Phase II (b).

Phase II (a) focused on process redesign. The primary project objectives were as follows: expand upon the offender management business processes identified in Phase I, identify opportunities for significant improvement of the OIMS processes, and build internal TDCJ re-engineering capabilities. Specifically, the processes evaluated were those that represented entry of an individual into incarceration and those associated with release and subsequent

parole supervision: pre-release, parole supervision, and parole violation/revocation.

Phase II (b) centered on the redesign of the agency's computer information technology and how the change would support the re-engineered offender management processes. The project included definition of standards for computer hardware, software and network operations. This phase also developed an implementation plan as well as a transition plan for each re-engineered offender management process.

Results realized from the consolidated efforts in Phase II (a) and (b) provided a foundation for Phase III, development and implementation. Phase III targets the systems and processes redesigned in Phase II.

PHASE III

Broken into modules, Phase III, Period 1 concentrates on parole-related processes. Phase III, Period 2 will focus on selected incarceration (institutional/classification) related processes. Phase III, Period 3 will implement additional processes related to incarceration (e.g., scheduling and grievances). Each period is based on a two-year development time frame. Parole-related processes were prioritized for public safety reasons in an effort to improve supervision and the quality of case management information.

In October 1999, TDCJ selected a prime vendor for development of Phase III, Period 1. A second vendor was selected to oversee objective quality assurance. The initial implementation proposal used a commercial-off-the-shelf system as the foundation for OIMS. In May 2000, a decision was made to halt customization of the commercial-off-the-shelf system because the software product proposed for customization could not be modified within the project timeline to meet the defined technical and functional requirements. The independent verification and validation vendor concurred with this decision.

In August 2000, the RSC approved a change in the OIMS agreement with the vendor to reflect the development of a web-based, custom-built application. The vendor commenced redesign of the application in September 2000 with a scheduled completion date of November 2000. In December 2000, TDCJ reviewed the design deliverable and found it inadequate. During the December 2000–September 2001 timeframe, TDCJ advised the vendor that performance of the project manager and key staff were not meeting expectations. The vendor acknowledged the deficiencies and replaced the project management staff. An assessment made by the new project manager resulted in a change in the application development methodology to resolve the outstanding design issues with processes affecting the TDCJ Parole Division and the Board of Pardons and Paroles. The design phase was extended to October 2001 to facilitate the review of documentation by the new project management team and complete the remaining technical design processes. This extension also pushed the implementation date for Phase III, Period 1 back to August 2002.

Application development began in February 2002 and was completed in April 2002. From May 2002 through October 2002, the vendor and TDCJ tested the system, continued documentation of the application and developed training materials. Additional development issues were discovered during this time, which were severe enough to delay implementation through March 2003. The vendor is currently working to resolve the remaining open issues.

The first training session on the use of the system was held September 2002. This "train-the-trainer" session provided instruction for TDCJ employees on OIMS and the knowledge to train other TDCJ personnel on the system. The training materials are being revised for future sessions based upon the feedback received. Upon completion of the "train-the-trainer" sessions, an estimated ten weeks of end user training will begin. Actual system deployment is scheduled for March 2003, 19 months behind the original implementation schedule.

To date, the Department of Criminal Justice has received the following, as part of a turnkey solution, from Phase III, Period 1:

- services, including system requirements specifications, software code and product, hardware and network configuration drawings and training materials;
- a network that is compliant with industry standard protocol and hardware;
- over 2,400 computers (desktops and laptops) that are in use by parole officers to transmit case information electronically via Lotus Notes email;
- a parole records imaging subsystem with TDCJ Parole Division personnel trained in the use of the necessary hardware and software;
- software products to support the OIMS environment; and
- integration/connectivity with the Texas Law Enforcement Telecommunications System for access to the Texas Crime Information Center and the National Crime Information Center.

The vendor has completed the application development with application windows and workflow processes built into the product to provide automatic notification of events and action items.

The Internal Audit Division of TDCJ continues to follow the progress of the OIMS project and expects to continue its review in fiscal year 2003 and participate in a post-implementation review. Article IX, Sec. 6.19 of the General Appropriations Act, Seventy-seventh Legislature, 2001, mandates independent oversight of major information resources projects. The Quality Assurance Team (QAT) of the Legislative Budget Board and the State Auditor's Office receives monthly progress reports from TDCJ on the OIMS project. Within six months of completion of Phase III, Period 1, TDCJ is required to submit a Post-Implementation Evaluation Report to the QAT. In order to determine if the project is successful, the QAT and the agency must evaluate the performance of the system after it is implemented. A Post-Implementation Evaluation Review will evaluate whether the project met its objectives as well as evaluate the development and management processes that brought the project to completion. The Post-Implementation Evaluation Review will also compare projected and actual costs of the project.

APPROPRIATIONS AND EXPENDITURES

Table 3 details funding for the project from the Seventy-fifth through the Seventy-seventh Legislative sessions. To date, TDCJ has received appropriations of approximately $33.2 million. The agency has been permitted per legislative rider to carry forward a total of $24.6 million from prior biennia for Phase III, Period 1. TDCJ has requested $12.0 million in additional funding for Phase III, Period 2 in the 2004–05 biennium.

Table 2 includes expenditures from the initial pre-Phase I assessment through Phase III, Period 1. The pre-Phase I expenditures are classified as part of the effort that fueled the initiative to evaluate the current functions, re-engineer business processes, and automate the offender information management function.

TABLE 3
APPROPRIATIONS FOR THE OFFENDER INFORMATION MANAGEMENT SYSTEM

IN MILLIONS

LEGISLATURE	APPROPRIATION
Seventy-fifth Legislature (1998–99)	$19.9
Seventy-sixth Legislature (2000–01)	13.3
Seventy-seventh Legislature (2002–03)	0.0
TOTAL APPROPRIATIONS	**$33.2**

NOTE: TDCJ has also expended $7.2 million in agency funds not specifically appropriated for the OIMS project. TDCJ has used its unexpended balance authority to bring forward unexpended balances from previous biennia.
SOURCE: Legislative Budget Board.

TDCJ identified $1.8 million in their 1994–95 and 1996–97 operating budgets for Phase I expenditures. An additional $2.9 million was used from the agency's Information Resources Strategy during the 1998–99 biennium to compensate for additional project costs. The agency used an additional $2.5 million from their Information Resources Strategy during the 2000–01 and 2002–03 bienniums. In Table 2 items such as staff salaries and other indirect costs are not included in the total project costs until Phase III, Period 1 when the agency established the Project Management Office for the OIMS initiative. Prior to Phase III, salary expenditures within TDCJ were distributed to the programmatic operations they supported. Salary and indirect costs for Phase III, Period 1 total $2.1 million.

Commencement of Phase III, Period 2, intake, classification and reclassification is planned for September 2003. The concept for Period 2 involves a modular approach in development and deployment. This type of development effort allows TDCJ to break up a large complex project into a series of less-complex projects or modules. As each module is completed, end users can be trained and it can be deployed. Then, development on the next module may begin. Software developed in such an incremental manner can be delivered to the end user much earlier than that of a project with 100 percent of its software under development at one time. The traditional method, used in the first period of Phase III, resulted in a larger design, development, and deployment effort for the agency.

Initial activities for Period 2 of Phase III include re-evaluation of the business processes identified in Phase II (a) and (b) and development of a Project Management Plan with documentation following a standard software development methodology. The redesign of the institutional processes will also address connectivity to the Automated Fingerprint Identification System maintained by the Department of Public Safety. Period 2 is scheduled for completion in August 2005. Costs for Phase III, Period 2 are estimated at $14.6 million. In-house staff salaries account for $2.6 million; contract workforce is estimated at $7.3 million; and hardware and software to support the TDCJ Institutional Division are estimated at $4.7 million.

Phase III, Period 3 is planned for the implementation of additional processes related to incarceration, such as scheduling and grievances. This period is expected to begin upon completion of Phase III, Period 2. The agency has not submitted current cost estimates for this part of the project. In 1999, TDCJ provided an estimate of $12.9 million for Period 3.

CONCLUSION

By March 2003, the Department of Criminal Justice will have spent $40.4 million on a system that has not fully met operational expectations. The concerns identified with this project include continuous scope redefinition, requirements refinement and system redesign during the development phase. The Department of Criminal Justice must pursue a well planned and thoughtfully executed strategy for the next phase of the OIMS project to ensure that project goals are met as efficiently as possible. The modular approach for development in Phase III, Period 2 will require stringent design and testing for each module to ensure all modules function as required for system compatibility and functionality.

Success of the project must be gauged not only by post-implementation performance measures, but also by the usability and functionality of the OIMS by end users. TDCJ must focus on the post-deployment activities of Period 1 to ensure it represents the desired solution before starting future phases as suggested in Recommendation 1. Post-deployment activities could include software application updates, error fixes, and the resolution of computer compatibility issues.

Retention of Experienced Correctional Officers

Following a three-year decrease in the number of filled correctional officer positions, the Department of Criminal Justice (TDCJ) has in recent months shown an increase in filled positions. This report provides information on correctional officer staffing levels within the Department of Criminal Justice. First, background information is provided on staffing levels at the Department of Criminal Justice for the last several fiscal years. Second, a discussion of turnover rates and how they relate to TDCJ's correctional officer staffing levels is provided. Third, an examination is made of what TDCJ has done to improve correctional officer staffing levels by reducing turnover rates and increasing the number of applicants for correctional officer positions.

For purposes of this report, prison unit staffing percentages and references to correctional officer vacancies or shortages are defined as the number of correctional officer positions filled compared to the number of positions needed for ideal security levels as determined by TDCJ. TDCJ reports that all prison units currently maintain necessary security levels through a combination of positions filled and use of overtime.

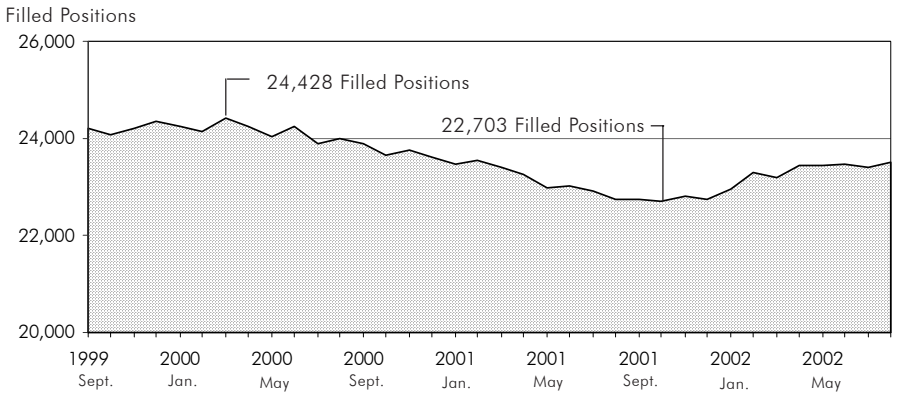
Significant Findings

- After increasing in each year from fiscal year 1999 to 2001, TDCJ's turnover rate decreased in fiscal year 2002. For fiscal year 2002 the correctional officer turnover rate lowered to 19 percent from a turnover rate of 22 percent in 2001.
- In order to compensate for correctional officer vacancies, TDCJ has made an effort to hire former correctional officers. In fiscal year 1999, former correctional officers made up only 7 percent of the total number of hires for the fiscal year. By fiscal year 2002, former correctional officers comprised 21 percent of all correctional officers hired.
- A large number of unfilled correctional officer positions meant ample opportunities for officers to work overtime. TDCJ paid out $36 million in overtime to correctional officers in fiscal year 2002. On average, 38 percent of TDCJ correctional officers worked overtime in fiscal year 2002, with an average of 16 hours worked per participating correctional officer per month.
- In attempting to lower correctional officer turnover, TDCJ has changed many of its policies regarding transfers and the trading of shifts. TDCJ has adopted a more accommodating transfer request procedure and is experimenting with a policy where officers are allowed to trade shifts.
- TDCJ has targeted many of its correctional officer retention efforts on correctional officers in their first year of employment. Of the 5,024 terminations during fiscal year 2002, 43 percent (2,155 terminations) were from correctional officers who worked less than one year.

Comments

According to the TDCJ's August 31, 2002 report of authorized and filled correctional officer positions, TDCJ employed 23,495 correctional officers. The August 2002 total number (as displayed in Figure 1) is 933 officers lower than the March 2000 peak value of 24,428, but 892 higher than the low mark of 22,703 officers which was observed in October 2001. Many Texas correctional officers in the military reserves were called into active duty after the World Trade Center attack on September 11, 2001.

FIGURE 1
FILLED CORRECTIONAL OFFICER POSITIONS, BY MONTH
FISCAL YEARS 2000–2002



SOURCES: Legislative Budget Board; Department of Criminal Justice.

Unfilled correctional officer positions are still high in certain parts of Texas. However, following October 2001, the number of correctional officers has displayed a measured increase statewide. In order to hire more correctional officers, TDCJ has employed a variety of techniques to attract correctional officer applicants and to lessen the number of correctional officers who leave employment. A key indicator of correctional officers leaving TDCJ is the turnover rate.

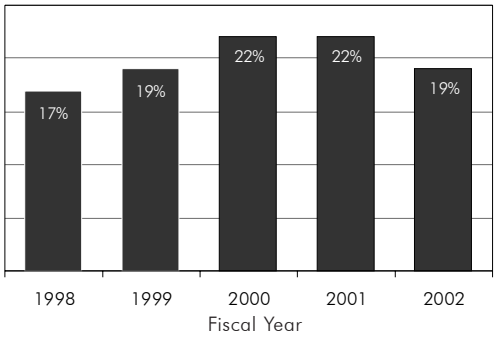
TURNOVER IN TDCJ CORRECTIONAL OFFICERS

The turnover rate for an organization is the number of persons leaving the organization as a percentage of the total number of people in the organization during a set period of time. The turnover rate for TDCJ correctional officers decreased to 19 percent in fiscal year 2002 after increasing in each year since fiscal year 1998 (see Figure 2). Turnover results in additional costs to TDCJ in several ways. First, high turnover rates can lead to a more dangerous work environment with less experienced correctional officers who are not as physically or mentally prepared for the challenges of a prison workplace. Second, the amount of time a new hire takes to reach the effectiveness of a departed, more experienced employee can equate to a high fiscal cost. When determining the cost of turnover, a variety of cost items can be considered, including the direct and indirect costs of hiring and replacing the departing employee, the time it takes to hire a replacement, and the amount of time a new hire will take to reach the effectiveness of the departed employee.

In its presentation to the Board of Criminal Justice, the Human Resources Division of TDCJ provided Figure 3 as an explanation for TDCJ's shortage of correctional officers.[1] In between fiscal year 1997 and fiscal year 2002, the number of separations, position adjustments and transfers/promotions exceeded the number of new hires for each fiscal year. A revealing component of the graph is the number of separations that reached 5,598 in fiscal year 2000. Also revealing is the absence of new positions (position adjustments in Figure 3) needing to be filled for fiscal years 2001 and

[1]Department of Criminal Justice Human Resources Division presentation to TDCJ Board, Mediation for Employment Disputes and Correctional Officer Recruitment Update. January 24, 2002.

FIGURE 2
CORRECTIONAL OFFICER TURNOVER RATES



SOURCE: State Auditor's Office.

2002. New positions were created by the prison construction program of the mid-1990s and decreased once newly constructed units were staffed in 2000.

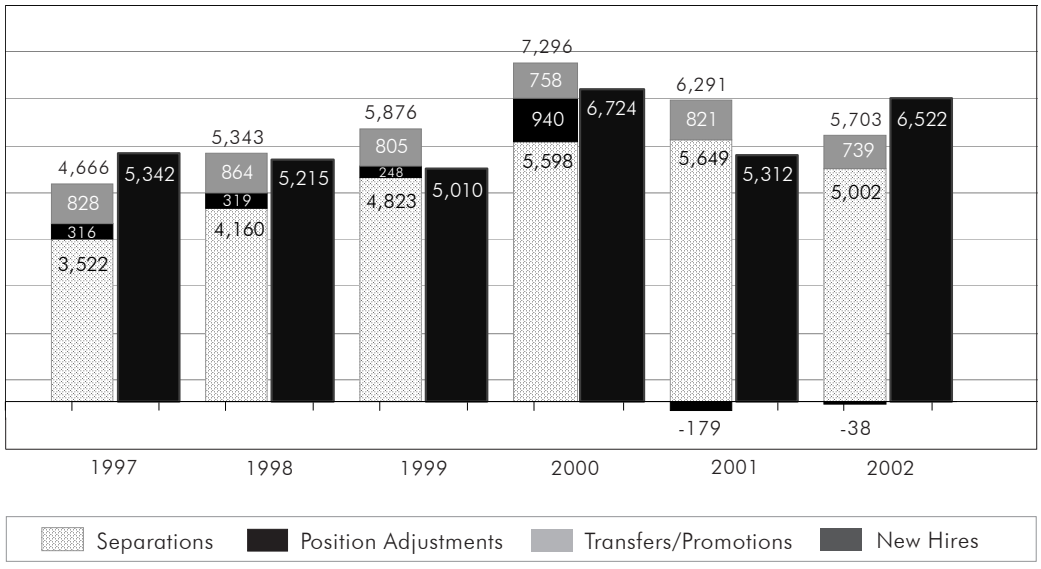
Figure 3 shows that there are two broad strategies to improve the number of filled correctional officer positions: (1) decrease vacancies by retaining more correctional officers; and (2) increase the number of new hires by attracting more correctional officer applicants. Human resource research indicates that retention is the more cost-effective strategy. With 103 prison units that TDCJ must staff, both the hiring of new officers and lowering the turnover rate are important to TDCJ maintaining proper staffing.

ACTIONS TAKEN TO RETAIN CORRECTIONAL OFFICERS

WORKWEEK SCHEDULES

A policy of TDCJ that has in many cases helped with the retention of correctional officers is the use of work schedules other than a traditional seven-day workweek with five days on and two days off. TDCJ also uses nine-day work schedules with six days on and three days off at 58 of its units, and eight-day

FIGURE 3
CORRECTIONAL OFFICER VACANCIES VERSUS NEW HIRES
FISCAL YEARS 1997–2002



NOTE: Includes separations, transfers / promotions and position adjustments due to temporary housing closures and implementation of the new staffing plan.
SOURCES: Legislative Budget Board; Department of Criminal Justice.

work schedules with four days on and four days off at 17 of its units. Figure 4 provides a more detailed explanation of the shifts available at prison units. Each plan includes scheduled compensatory time to ensure shift overlap at prison units. The amount of time worked beyond scheduled compensatory time is overtime.

According to TDCJ, a side benefit of the eight-day and nine-day work schedules is allowing correctional officers to have enough consecutive days off to work second jobs. TDCJ does not maintain centralized data on the number of correctional officers that work second jobs. Interviews with TDCJ employees indicate that eight-day and nine-day shifts have helped to retain correctional officers in some areas by allowing officers to keep second jobs. However, it is unlikely that many more units can be shifted to work schedules that allow for four consecutive days off (i.e., eight-day schedules). According to TDCJ staff, eight-day schedules work best at large units and must be offered in areas where correctional officers have the opportunity to transfer to units with more traditional work schedules. For many correctional officers, 12-hour work shifts would interfere with their schedules outside work and their ability to manage personal responsibilities, such as daycare and caring for school-aged children, and are therefore impractical.

FIGURE 4
CORRECTIONAL OFFICER WORK CYCLES

Correctional officers work one of three work cycles.

- a seven-day period in which employees work eight hours and 15 minutes for five days with two days off
- an eight-day period in which employees work 12 hours for four days with four days off
- a nine-day period in which employees work eight hours and 45 minutes for six days with three days off

A shift overlap is scheduled into each work cycle to ease the transition between shifts. The shift overlap means that all correctional officers are scheduled to work some compensatory time.

Employees who work overtime hours are paid on the monthly overtime payroll at a rate of 150 percent of their regular hourly pay.

SOURCES: Legislative Budget Board; Department of Criminal Justice.

PAID OVERTIME TO CORRECTIONAL OFFICERS TO COMPENSATE FOR STAFFING SHORTAGES

Prior to October 1999, TDCJ only paid overtime to a correctional officer when the officer had accumulated more than 240 hours of unused overtime, and the officer only received pay for the number of hours over 240. Under current policy employees who work overtime hours are paid on the monthly overtime payroll at a rate of 150 percent of their regular hourly pay. TDCJ believes that if the former policy regarding overtime pay had stayed in place, the turnover rate for correctional officers would have been markedly higher for the last three years. Paid overtime accomplished the task of covering correctional officer shifts left vacant by a shortage of correctional officers, but it also provided an incentive for other officers to stay.

Over the last three years, overtime has been used by correctional officers, as well as by non-correctional officer staff, to cover staffing vacancies at TDCJ units. For fiscal years 2000 through 2002, an average of 11,145 correctional employees have worked overtime, 73 percent of whom were correctional officers.

For the last three fiscal years, TDCJ correctional officers have worked an average of 121,352 hours of overtime a month. On average, a correctional officer working overtime works around 16 hours of overtime a month and receives an overtime check of about $342. Other correctional officers work as many as 100 hours of overtime in a month; however, TDCJ

management discourages correctional officers from working more than 120 hours of overtime a month. The correctional officer career ladder has a maximum salary of $31,068 per year. Without the option of overtime pay, it is likely that more correctional officers would leave TDCJ for higher paying jobs.

In terms of covering vacant correctional officer positions, overtime has been used to provide necessary security levels at prison units. In fiscal year 1999 (prior to the current policy of overtime pay for correctional officers) TDCJ was able to fill 97 percent of its authorized officer positions. In fiscal year 2000 TDCJ was able to fill 95 percent of its authorized positions with 2 percent of the positions filled by overtime. The percentage of authorized positions filled in fiscal years 2001 and 2002 dropped to 92 percent with 3.3 percent of the positions filled by overtime.

For fiscal years 2000 through 2002 it has cost TDCJ an additional $31.6 million to cover necessary shifts with overtime pay rather than with regular salaried correctional officers. In terms of monthly differences, for the last two fiscal years an additional $1.0 million per month has been paid for overtime compared to paying officers' regular salary.

CHANGED POLICIES AT THE PRISON UNIT LEVEL TO RETAIN CORRECTIONAL OFFICERS

In order to retain more correctional officers, TDCJ has also reviewed policies at the prison unit level to determine if changes could be made that would improve the retention of correctional officers. The actions taken by TDCJ include the following:

- In February of 2002, TDCJ started a pilot program at the Holliday and Ellis Units where correctional officers can exchange workdays within the same work cycle. In units where supervisors are unable to allow officers time off for personal reasons due to staffing shortages, such a program allows greater flexibility. If after evaluation, the program appears to be practical, officers at other units may be allowed to exchange workdays within the same work cycle.
- TDCJ has also adopted a correctional officer non-emergency transfer system in which correctional officers may be eligible for transfer to another unit after six months employment rather than the past requirement of 12 months employment. Priority ranking for transfer is based on ensuring that employees work within commuting distance of their homes.
- Correctional officer supervisors have made an effort in the last three years to lower the attrition rate of first-year correctional officers. Correctional officers are most likely to quit in the first year of employment. Data from the State Auditor's Office on correctional officer terminations indicate that 44 percent of the persons leaving TDCJ are correctional officers with less than one year of experience. Through mentoring activities, senior correctional officers provide support for new officers to make it through the first year, and by doing so, increase the likelihood of retaining the officer.
- TDCJ has recently begun initiatives to improve retention such as expanding the on-the-job training program and conducting workshops with correctional officers to identify non-salary-related reasons for turnover.

ACTIONS TAKEN TO INCREASE CORRECTIONAL OFFICER APPLICANTS

RECRUITMENT OF FORMER CORRECTIONAL OFFICERS

In fiscal year 1999, 350 former correctional officers were hired by TDCJ. Former correctional officers made up only 7 percent of the total number of hires for the fiscal year. By fiscal year 2001, 885 former correctional officers were hired by TDCJ, comprising 17 percent of all correctional officers hired for the fiscal year. By fiscal year 2002 the number of former correctional officers hired by TDCJ increased to 1,419. Figure 5 graphically depicts the increase in

former correctional officers hired starting in January of 2000.

Former TDCJ correctional officers and security supervisors who separated from employment within the last 36 months can now return as a correctional officer at one career ladder step below what they were when they left, as long as they do not exceed a salary of $2,295 per month. Also serving as encouragement to former correctional officers, effective September 1, 2001, Employees Retirement System retirees can apply and be rehired by TDCJ without salary limitations. Also, retirees will be able to work 12 months in a fiscal year and continue to receive their retirement annuity without interruption.

TDCJ has actively recruited former correctional officers to encourage them to seek re-employment and to inform them of salary increases and revised rehiring procedures. For fiscal year 2000, the agency mailed recruitment letters to 990 correctional officer retirees and 6,602 former correctional officers who separated from employment for reasons other than retirement. In fiscal year 2001, the agency mailed letters to 541 correctional officers and security supervisor retirees and 4,724 former correctional officers who separated employment for reasons other than retirement.[2]

High turnover rates can have a damaging impact on the quality of the correctional officer labor force by replacing more experienced officers with new correctional officers with little or no experience. Recruitment of past correctional officers is an effective way of decreasing the negative impact of turnover.

RECRUITMENT OF TRAINING ACADEMY APPLICANTS

In order to replace the large number of exiting correctional officers, TDCJ has expanded its search for new correctional officers outside of Texas to the states of New Mexico, Oklahoma, Louisiana, Arkansas, Alabama and Mississippi. TDCJ is also participating in job fairs and focusing recruiting efforts on certain types of industries that might be experiencing layoffs. For the month of October 2002, TDCJ scheduled recruitment efforts at six job fairs across the state.

A reduced number of applicants has not been the driving force behind correctional officer vacancies. Total applicants to TDCJ for correctional officer positions have increased in each year since fiscal year 1999, although the increase from fiscal year 2000 to 2001 was only 1 percent (see Figure 6). However, the number of correctional officers hired decreased from fiscal year 2000 to fiscal year 2001 and has increased to slightly below fiscal year 2000 levels in fiscal year 2002.

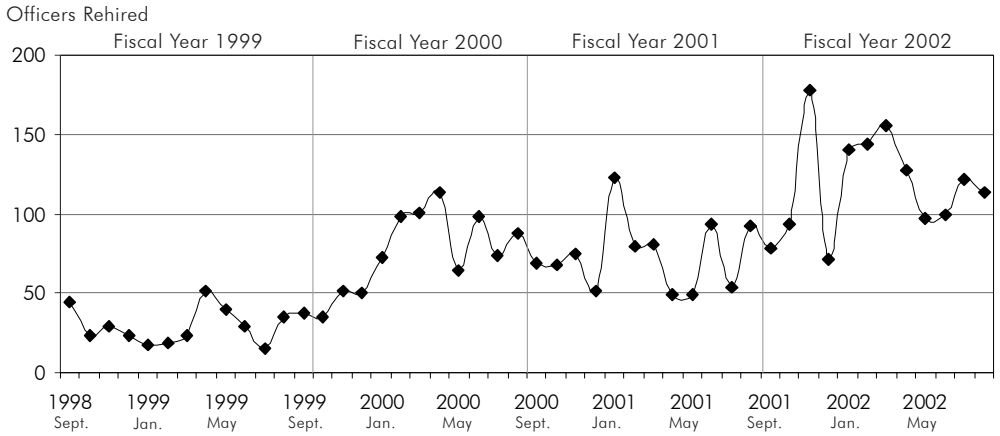
During the TDCJ application process for correctional officers, the applicant lists in order of preference the areas of the state where he or she would like to work. There are often delays in giving conditional offers of employment to applicants because the applicants have chosen areas in which the units do not have a need for new officers. These applications are held until there are openings in the units within the preferred area. In October 2001, TDCJ mailed letters to 390 correctional officer applicants who could not be offered employment at a unit in the area of their preference. Ninety-nine (25 percent of 390) of the applicants agreed to accept an alternate location; 47 (12 percent) elected to have their application remain on file until an opening occurred at a unit in their area of preference; and 244 (63 percent) did not respond to TDCJ two months following the offer of employment.

CONCLUSION

Although TDCJ is still experiencing a shortage in correctional officers when compared to levels from previous years, fiscal year 2002 indicators have been positive, resulting in an increase in correctional officers starting in January of 2002. Positive indicators of correctional officer staffing include lower turnover

[2]Department of Criminal Justice Human Resources Division letter. December 19, 2001.

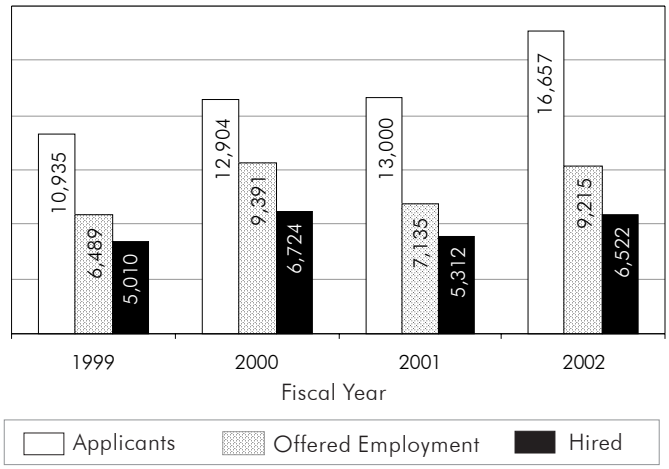
FIGURE 5
REHIRING FORMER CORRECTIONAL OFFICERS
FISCAL YEARS 1999–2002



SOURCES: Legislative Budget Board; Department of Criminal Justice.

rates for correctional officers and increased applicants for the correctional officer-training academy. Actions taken by TDCJ that have had a beneficial effect on turnover include the development of alternative shifts, pay for overtime hours, and allowing transfer requests to another unit after six months of service rather than 12 months. Likewise, TDCJ's proactive recruitment of correctional officer applicants and former correctional officers has resulted in a larger pool of potential employees. With such a large number of correctional officer positions to maintain, it will be important for TDCJ to encourage new applicants and to retain existing correctional officers. Evidence from human resource research and analysis by the State Auditor's Office indicates that retention of existing correctional officers is the more preferable of the two strategies. A low turnover rate will assure TDCJ of having an experienced correctional officer staff and will save money that would be spent in training new officers to replace experienced officers.

FIGURE 6
CORRECTIONAL OFFICER APPLICANTS



SOURCES: Legislative Budget Board; Department of Criminal Justice.