

MINUTES

LEGISLATIVE BUDGET COMMITTEE

October 4-5, 2004
Room 123-S—Statehouse

Members Present

Senator Steve Morris, Chairman
Representative Melvin Neufeld, Vice Chairman
Senator Dave Kerr
Representative Clark Shultz
Representative Bill Feuerborn

Members Absent

Senator Henry Helgerson
Representative Dean Newton

Staff

Alan Conroy, Kansas Legislative Research Department
J. G. Scott, Kansas Legislative Research Department
Leah Robinson, Kansas Legislative Research Department
Michele Alishahi, Kansas Legislative Research Department
Audrey Dunkel, Kansas Legislative Research Department
Deb Hollon, Kansas Legislative Research Department
Norman Furse, Revisor of Statutes
Bruce Kinsey, Revisor of Statutes Office
Theresa Kiernan, Revisor of Statutes Office
Gordon Self, Revisor of Statutes Office
Judy Bromich, Administrative Analyst, Senate Ways and Means Committee
Nikki Feuerborn, Administrative Analyst, House Appropriations Committee
Mary Shaw, Committee Secretary

Conferees

Dr. Robert Masters, Vice President for Academic Affairs, Kansas Board of Regents
Dr. Richard Burke, President, Dodge City Community College and Chairman, Southwest
Kansas Task Force
Randy Nelson, Vice President of Engineering, Cessna Aircraft Company
Marvin Burris, Vice President for Finance and Administration, Kansas Board of Regents
Robert Hemenway, Chancellor, University of Kansas

Dr. Fred Cholick, Dean of Agriculture, Kansas State University, Extension Systems and Agriculture Research
Eric King, Director of Facilities, Kansas Board of Regents
Duane Goossen, Budget Director, State of Kansas, and Secretary, Kansas Department of Administration
Dr. Ed Berger, President, Hutchinson Community College
David Monical, Executive Director of Governmental and University Relations, Washburn University
George Mihel, President, North Central Technical Colleges, Beloit
Rae Anne Davis, Deputy Secretary, Operations, Kansas Department of Social and Rehabilitation Services
Steve Stotts, Director of Taxation, Kansas Department of Revenue
Clarence Norris, Commissioner, Office of the State Bank Commissioner
Doug Wareham, Vice President of Governmental Affairs, Kansas Bankers Association

October 4 Morning Session

Senator Steve Morris, Chairman, called the meeting to order at 10:05 a.m., and welcomed everyone to the meeting.

Chairman Morris welcomed Dr. Robert Masters, Vice President for Academic Affairs, Kansas Board of Regents, who presented a report on the Southwest Kansas Access Project ([Attachment 1](#)). Dr. Masters gave some background information regarding some studies that have been conducted that reflect a need to provide increased on-going access to upper division and graduate post-secondary education for residents in western Kansas. He explained that the community colleges in western Kansas have served the educational needs for those constituents seeking certificates and associate degrees. The universities have delivered many courses both face-to-face and by distance learning technologies; however, their efforts to offer complete programs have often resulted in cancellation because of student attrition and failure of the programs to break even from a cost perspective.

Dr. Masters explained that in June of 2002, the Kansas Board of Regents formed the Southwest Kansas Task Force. The results of a survey taken by the Task Force indicated a perceived need for programs in education, business, and nursing at both the bachelor and masters degree level. In response to a call for proposals from the Task Force to address the issue of access, a blended proposal, the Regents' University-Community College Partnership, was submitted by Fort Hays State University, Kansas State University, Emporia State University and Dodge City Community College. The proposal was designed to include all community colleges in the region and extend geographical access to all of western Kansas. The Board of Regents approved the proposal presented by the Task Force at its April 2003 meeting. The Board directed Academic Affairs staff to work on an implementation plan. The Board approved the Western Kansas Implementation Plan at its June 2003 meeting. The Western Kansas Implementation Plan was detailed in Dr. Master's written testimony.

Dr. Masters presented details of current programs. The Regents' University-Community College Partnership (ACCESS US), designated the Western Kansas Educational Compact, which includes the Presidents of the three participating universities and the Presidents of the six area

community colleges, to serve in a formal planning and advisory capacity. Of the \$200,000 approved by the 2003 Kansas Legislature, \$155,000 has been committed to the ACCESS US initiative:

- \$50,000 for the Bachelor of Technology Leadership (BTL) at Pratt Community College;
- \$55,000 for the Bachelor of General Studies (BGS) degree in Business at Dodge City Community College; and
- \$50,000 for the Bachelor of Nursing (BSN) at Pratt Community College.

Both the BTL and BGS programs offered by Fort Hays State University failed to maintain the needed enrollment. The Board of Regents reimbursed Fort Hays State University \$13,776 for tuition lost because of student attrition during Fall 2003 and Spring 2004. Because of low enrollment Fort Hays has withdrawn the request to offer the BSN program, which would have started in the Fall of 2004. The Board of Regents will be looking at ways to be more effective in responding to the needs of western Kansas, for example, to determine if there is a need for:

- more advertising and marketing of programs;
- student scholarships;
- better data collection; and
- need to better support student readiness for college.

The results of these programs are detailed in Dr. Master's written testimony. In conclusion, Dr. Masters noted that to cement the trust of the people of western Kansas, it is vitally important that long-range planning and funding for this worthy initiative continues. This initiative of the Kansas Board of Regents, supported by the Kansas Legislature, is designed to provide the opportunity for under-served populations in western Kansas to have direct access to upper division and graduate programs.

Questions and discussion followed. Representative Neufeld asked a question regarding the program the Legislature passed and inquired why the Board of Regents in the ACCESS US program limits the program to face-to-face students only. In response, Dr. Masters explained that he thought the idea came from the proposal made by universities and the community college. Initially, it was purely face-to-face, but then they decided that they would have a blending of face to face, and distance learning courses. Dr. Masters noted that Fort Hays State University has been offering a lot of courses in western Kansas through distance learning with the Fort Hays State University Virtual College. Representative Neufeld mentioned that he felt what was envisioned by the Legislature regarding the program would be to have the same class taught at Pratt, Dodge City, and Liberal, and the professor shows up in different places, utilizing distance learning for the other locations. Dr. Masters explained that the Board of Regents is receptive to looking at different options because they are also concerned with enrollment figures and have asked for a full report at their October Board meeting.

Chairman Morris expressed his surprise about the lack of success with the nursing program that was offered by Fort Hays State University, considering the need for nurses. Dr. Masters responded that the Board of Regents has asked the institutions to follow-up because there were some eighty people originally initially interested in the nursing program in Pratt.

Chairman Morris asked Dr. Masters if he would come back to the November meeting to give the Committee an update regarding the ACCESS US and noted that legislative changes might be needed for the program. Dr. Masters responded that he would be available to attend the next meeting.

The Chairman welcomed Dr. Richard Burke, President, Dodge City Community College and Chairman of the Southwest Kansas Task Force, who addressed the Regents Southwest Kansas Access Project. (No written testimony was submitted.) Dr. Burke provided information pertinent to western Kansas that was from an article titled "Hispanic Population Grows in Southwest Kansas" published in the Hutchinson News. He noted that one of the reasons he is addressing it, is because of the growth in western Kansas in the Hispanic population. Dr. Burke explained that the Hispanic population in southwest Kansas in the year 2000 was 48,261 and in 2003 the population was 51,810 while the total population has declined. Growth in Ford County (Dodge City) and Seward County (Liberal) led the way. Ford County 2003 population is 33,012 with 14,188 Hispanics, or approximately 48 percent of the total. The enrollment at Dodge City public schools from first grade through the eighth grade is 70 percent Hispanic. The enrollment last year in high school was 58 percent Hispanic.

Dodge City Community College has designed a lot of programs that are designed to capture the Hispanic market and programs related to beef packing plants. They not only have the industrial maintenance programs, but they also have welding programs. They have started an English language course where they teach Hispanic men in upper level management how to speak and write in English.

Dr. Burke noted that regarding a question that Representative Neufeld had asked earlier in the meeting that it was the Regents Southwest Kansas Access Project's understanding that only face-to-face instruction could occur. He emphasized that there are two basic needs for the program: scholarships (people need money because they just cannot afford it); and marketing.

Dr. Burke noted that there is some skepticism in all locations because people want to know if these programs will continue. He hoped that the Legislature would allow them to use some of the \$200,000 dedicated to this initiative for scholarship and marketing purposes. Dr. Burke provided an example that Dodge City Community College spent approximately \$13,000 on publicity and marketing to get the project going in the Dodge City area, and there was no way to recoup the \$13,000 from the \$200,000.

Dr. Burke mentioned that he will be providing copies of a report to the Committee that they will be making to the Kansas Board of Regents in reference to a survey that was completed in May and June of 2004 regarding new data figures at Dodge City Community College. Chairman Morris requested that Dr. Masters of the Kansas Board of Regents look at the information that Dr. Burke presented regarding clarification of face-to-face courses, scholarships and marketing, and report back to the Legislative Budget Committee at its November meeting with an analysis.

In regard to the amount of money for scholarships for the courses, Representative Neufeld asked Dr. Burke what kind of funding he was suggesting. He suggested that if they could use \$100,000 of the \$200,000 they would use 75 percent of the \$100,000 for scholarships and 25 percent for marketing, leaving a \$100,000 safety net for the colleges and universities. Chairman Morris mentioned that more work needs to be done for those that live in western Kansas, and would like to see this program proceed.

Chairman Morris welcomed Randy Nelson, Vice President of Engineering, Cessna Aircraft Company, who presented information regarding the Aviation Research Initiative in Wichita

(Attachment 2). Mr. Nelson distributed copies of the Executive Summary of NIS (NIAR/Industry/State Research) 2004 Projects (Attachment 3). Mr. Nelson addressed the current situation regarding the aviation research initiative in Wichita.

Mr. Nelson explained that the aviation industry is a major contributor to the economic vitality of Kansas, and has the potential for significant growth as a cluster of innovation. He emphasized that the aviation industry in Kansas must be able to compete in a global economic environment far different than in the past. They will not be able to do it alone. Mr. Nelson expressed the need to continue future product research, and noted that with the help of the Legislature, significant progress has been made.

Mr. Nelson noted that two specific incidents that have come from the leveraging made possible state funding:

- The institute has been able to leverage the state funding to receive additional federal funds. Through enhancement by state funding, the institute has been acknowledged as a center of excellence for advanced materials by the FAA.
- NASA has awarded the institute a national center of advanced composite materials award for additional research.

Mr. Nelson requested continued support including appropriation of the \$2 million which will be requested for aviation-related research during the 2005 Legislative Session. In conclusion, he thanked the Legislature for its support.

Committee discussion and questions followed regarding the global economic environment and the aviation industry. Chairman Morris mentioned that he hoped that the Governor's FY 2006 budget would reflect the \$2 million and feels like this is money well-spent. The Chairman requested a breakdown of the percentage of U.S. made aircraft verses the European made aircraft in use today. John Frederick of Boeing indicated that he could provide that information.

The meeting recessed at 11:20 a.m.

Afternoon Session

The meeting reconvened at 1:40 p.m.

The Chairman welcomed Marvin Burris, Vice President for Finance and Administration, Kansas Board of Regents, who spoke about higher education block grant funding (Attachment 4). Mr. Burris provided background on the budget model for state universities. He mentioned that prior to FY 2002, the Governor and the Legislature established state university budgets using the general use model, with the general use budget generally defined as expenditures from State General Fund appropriations and tuition revenues. In October 2000, the Board of Regents approved a new budget model called the operating grant/tuition ownership model, under which each university, except the special mission institutions, would receive a state operating grant, and would retain ownership of and accountability for its tuition revenue.

Mr. Burris addressed the implementation, challenges to implementation, and unresolved issues of the Operating Grants/Tuition Ownership. This information is detailed in his written testimony.

In regard to a request by the University of Kansas and Kansas State University and in recognition that the new budget was detrimental to two of the special mission campuses, in 2003 both universities requested that the Board of Regents revisit its original position and consider reversion to the General Use Budget Model for the KUMC and KSU-ESARP for the FY 2005 budget. The University of Kansas considered the operating grant model to be harmful to the Medical Center because KUMC supports only 12 percent of its budget from tuition. Kansas State University considered the operating grant model to be harmful to ESARP because the ESARP budget generates no tuition revenue.

Mr. Burris explained that the Kansas Board of Regents directed the State University Council of Presidents to review these funding issues from a systemwide perspective and make a recommendation. The Kansas Board of Regents endorsed the State University Council of Presidents recommendation that state university budget proposals be developed within the framework of a single budget model, that being the "operating grant/tuition ownership" model and that funding equity issues be addressed within that model. The Budget Model for state universities approach is detailed in the written testimony provided by Mr. Burris. He explained details of efforts to gain greater management flexibility through relief from state requirements and noted that the State University Council of Business Officers and the Kansas Department of Administration established three jointly staffed work groups:

1. Purchasing, Print, and Surplus Property;
2. Facilities Management; and
3. Financial Management.

Mr. Burris noted that the universities are pleased with the results so far and will continue to work with the Kansas Department of Administration and the Legislature in this area.

Chairman Morris welcomed Robert Hemenway, Chancellor, University of Kansas, who presented information regarding higher education block grant funding ([Attachment 5](#)). Chancellor Hemenway thanked Senator Morris and Representative Neufeld for their continued interest in the important topic of the way higher education in Kansas is funded.

The Chancellor spoke from an individual institution point of view about the operating grant model and addressed specifically the impact on the University of Kansas Medical Center. He explained that under the rejected general use model, tuition was tied to appropriations and basically if enrollment went up, the State General Fund dollars went down, basically an offset situation.

Chancellor Hemenway explained that about five years ago the University of Kansas Hospital was turned from a state agency into a public authority and forced to live by market principles. Since the hospital has been free of the costs of doing business as a state agency it has gone from being a \$175 million a year hospital to almost a \$400 million a year hospital that is seeing 6,000 more patients per year than it did previously.

The Chancellor explained that current block or operating grant/tuition ownership was designed by the Regents and the State Budget Director to simplify the complex Regent's budgeting formula and to impose greater accountability on the institutions. He felt that the block grant has been a good system with a number of good effects that has forced the universities to secure student

support when tuition increases have been necessary to maintain educational quality in the face of declines in state revenue. It has made the universities more accountable for good management because the leaner they make their administration, the more funds made available for the classrooms to do their core business which is to educate students.

Chancellor Hemenway indicated that, just as the block grant was established, the state's budget crisis began. As a result, Governor Graves was unable to fund it in either FY 2003 or FY 2004. In FY 2005 Governor Sebelius recommended funding, but only at \$5 million and that was a problem for the universities because \$5 million did not even pay for the cost of their employees' health insurance. The Governor's support of the block grant in FY 2005 was a positive thing, but salaries were not included in the block grant and were calculated separately.

Having now had three years to analyze the grant/tuition ownership model, Chancellor Hemenway mentioned that the Regents have recognized the special status of institutions like KUMC and K-State's ESARP (the Extension Service) and how they could be hurt by the model being applied to them since tuition plays little or no role in their funding. The Chancellor noted that the Kansas Geological Survey, a unit of KU, has similar issues as KUMC and K-State's ESARP (the Extension Service) in that it does not raise any tuition on its own.

The Chancellor focused on those needs that affect the medical center with details in his written testimony. He provided information regarding the services that the Medical Center provides all across Kansas and noted that without the KU Medical Center, none of these services would exist in Kansas. Chancellor Hemenway indicated that the existing operating grant/tuition ownership system works very well for their regular undergraduate and graduate programs, but it does not work well for special purpose campuses like the Medical Center. The Chancellor encouraged the Legislature to work with the Regents to find answers and implement solutions to this ongoing problem.

The Chancellor also expressed concern regarding tuition paid to the University of Kansas and why the university should not receive the interest that the tuition funds earn. He noted that SB 490, introduced during the 2004 Session, would have addressed this.

In response to the Chancellor's comments concerning SB 490, the Chairman noted that the state has a finite amount of money and providing it to one area of the budget at the expense of another budget. Senator Kerr noted that last year agencies were required to make BEST savings contributions on top of the other things that the Chancellor mentioned. Chancellor Hemenway mentioned that he felt that the BEST contributions were a one-time thing and if that was done on a continuing basis, it might be a problem.

Chairman Morris welcomed Dr. Fred Cholick, Dean of Agriculture and Director of Kansas State Research and Extension, Kansas State University, who addressed the higher education block grant funding ([Attachment 6](#)). Dr. Cholick thanked the 2004 Legislature for its commitment to the program evidenced by the addition of \$500,000 to the Research and Extension budget.

Dr. Cholick also provided the Committee with budget issue talking points that were submitted to the Board of Regents in 2003. In response to a question by the Chairman, the Dean indicated that, while Kansas leads the nation in county extension support with approximately \$17 million in the extension budget, the money is actually controlled by boards at the county level.

Representative Neufeld expressed concern regarding consolidation of extension districts, noting that some county commissioners feel that this districting takes away local control of extension.

Dr. Cholick responded that legislation can be crafted to require that there will be individuals from each county serving on this new district board.

The Chairman welcomed Eric King, Director of Facilities, Kansas Board of Regents, who provided an update on state university deferred maintenance projects ([Attachment 7](#)). Mr. King provided copies of the Regents' "Report on State University Deferred Maintenance and Capital Renewal, Fall 2004" ([Attachment 8](#)). Mr. King provided background information regarding the study that was completed and the results.

He noted that the primary factors leading to the current state of deferred maintenance on the university campuses is a lack of funding coupled with the age of the buildings. Mr. King mentioned that it is important to note that 80 percent of the total building inventory is at least twenty years old. Heating, ventilation, electrical, and plumbing systems, if they have not already been replaced, are either worn out or are about to wear out. He explained that these systems have reached the end of their useful life. Mr. King noted that the average life cycle of the components that make up buildings is 23 years.

Mr. King explained that during the past summer and early fall, facilities audits were performed on the 537 campus education and general buildings. He noted that to prevent a further maintenance backlog, \$74 million per year is required, without factoring inflation, to adequately maintain the university campuses.

Chairman Morris mentioned that the Joint Committee on State Building Construction has looked at the situation the past couple of years and realizes there is a problem, but noted it will take a lot of money to fix the problem. Representative Neufeld asked if there are any possible recommendations or solutions from the Board of Regents. Mr. King responded that the Regents have had a brainstorming session, and contacted other states to gather information, but there is really no solution. Representative Neufeld asked that the Board of Regents approach the Governor to put this in her budget plan to begin working on a long-range plan. The Chairman agreed with Representative Neufeld that the Board of Regents should approach the Governor.

Chairman Morris welcomed Duane Goossen, Director, Division of the Budget, and Secretary, Kansas Department of Administration, who presented a brief description of the Kansas Board of Regents Operating Grant ([Attachment 9](#)). Director Goossen mentioned that this is the fourth year of the operating grants and explained that the operating grant model provides the universities increased flexibility in managing their budgets. Only State General Fund dollars are appropriated and no limitations are placed on other funds, giving universities full control over expenditures and tuition revenue. He noted that the universities must still follow the state's salary plan for classified employees and abide by the state's purchasing and administrative regulations.

The Chairman asked about health insurance increases noting it is something he is frequently asked to address. Director Goossen explained he does not anticipate that costs for the employer share of health insurance are going to go up. He felt that health insurance increases for the universities should not be an issue in the coming budget, but noted that it certainly has been an issue in prior years.

The Chairman welcomed Dr. Ed Berger, President, Hutchinson Community College, who presented a report regarding the Kansas Community Colleges and the higher education funding grants ([Attachment 10](#)). Dr. Berger mentioned that the KACCT vision is for responsive, affordable, accessible, and quality learning opportunities.

Dr. Berger addressed accountability, core indicators of success, SB 345, and performance based funding in his written testimony. Committee questions and discussion followed.

Chairman Morris welcomed David G. Monical, Executive Director of Governmental and University Relations, Washburn University, who addressed Higher Education Block Grant Funding ([Attachment 11](#)). Washburn University is the only university in the state currently operating under block grant funding. They receive an annual appropriation from the State of Kansas for operating expenditures. On the expenditure side, Mr. Monical mentioned that Washburn University faces all of the cost increase pressures faced by its sister institutions.

Regarding SB 345 funding, Mr. Monical explained that the amount of funding Washburn University receives is in part determined by the amount of lower division State General Fund support at the regional state educational institutions. As their resources increase so, too, will the resources at Washburn University. Student enrollment also is considered in the formula along with a policy controllable portion which determines the percentage of lower division funding which Washburn University receives. (For FY 2006 that is 65 percent of the costs at the regionals.)

Mr. Monical addressed the relationship of tuition and state appropriations. He mentioned that, as the Legislature looks toward implementing block grants with the state educational institutions, the more flexibility that the institutions are given will be instrumental in how successful they are in implementing block grants. Committee questions and discussion followed.

The Chairman welcomed George Mihel, President of the North Central Technical College in Beloit, Kansas, who provided a history of technical education in Kansas, current issues facing their institutions and a funding history of technical colleges ([Attachment 12](#)). Mr. Mihel detailed challenges that technical schools and colleges face today:

- The schools offer expensive, technically intense programs in a climate where their primary sources of funding are postsecondary aid and capital outlay aid. They are the only postsecondary institutions in Kansas with no taxing authority or access to any taxing authority through an affiliated school district or community college.
- The continued delivery of Adult Basic Education (ABE) offered to their students service is in serious jeopardy once autonomy is achieved for the technical college members. The ABE dollars that are currently received from the school district will no longer flow to the technical colleges, creating a need for statutory change allowing those funds currently received for delivery of ABE to flow to the new autonomous schools and not be retained by the school district.

Mr. Mihel noted that the schools have approximately a 98 percent job placement rate. He mentioned that he is in the process of trying to work out a collaborative relationship with the Caterpillar organization which could provide equipment for training programs, but noted that nothing has been finalized. Mr. Mihel urged support for increased funding for technical schools and colleges.

The meeting recessed at 4:10 p.m.

**October 5
Morning Session**

The meeting reconvened at 9:05 a.m.

Chairman Morris recognized Audrey Dunkel, Kansas Legislative Research Department, who gave a report regarding rehabilitation and repair at the State Developmental Disability Institutions (Attachment 13). Ms. Dunkel explained that a requirement for State Finance Council release of capital improvement funding following review by the Legislative Budget Committee was added to address concerns about investing in repairs at a developmental disability institution that might soon be closed.

The Chairman welcomed Rae Anne Davis, Deputy Secretary, Operations, Kansas Department of Social and Rehabilitation Services, (SRS) who presented information on rehabilitation and repair projects at Parsons State Hospital and Training Center and Kansas Neurological Institute (Attachment 14). Ms. Davis explained that SRS's FY 2005 approved budget includes \$6,772,365 from the State Institutions Building Fund (SIBF) for rehabilitation and repair projects at the Kansas Neurological Institute and Parsons State Hospital and Training Center. She noted that these funds may be expended only upon approval by the State Finance Council after receiving the recommendation of the Legislative Budget Committee. The projects for which SRS is requesting Committee approval are listed in the written testimony in priority order by institution.

Committee questions and discussion followed. Chairman Morris expressed concern that there is a finite amount of money available and the Committee wants to be absolutely sure that the highest priority items would be done. The Chairman requested information regarding what is available in the SIBF for FY 2006. Staff distributed copies of the Status of the State Institutions Building Fund (Attachment 15).

Representative Neufeld requested that SRS report back to the Committee on the possibility of selling any of the staff residences on KNI. *Representative Neufeld moved, with a second by Representative Feuerborn, that the Committee recommend the State Finance Council release money for the critical and urgent projects listed in the SRS testimony. Motion carried.*

Ms. Davis, presented an update on the child welfare deferrals and the Health Care Access Improvement Program (Attachment 16). Ms. Davis explained that the Center for Medicare and Medicaid Services (CMS) deferred federal Medicaid funding for the child welfare community-based services contract retroactively to July 1, 2003, totaling \$30.5 million. She mentioned that SRS has worked extensively to comply with the new federal managed care requirements, however CMS has not approved the actuarial rates, the contracts, or the waiver SRS submitted. CMS now questions the methodology and the rate paid for targeted case management (TCM) performed by the child welfare contractors. Based on discussions with CMS, SRS is currently conducting case reads on 100 sample cases to verify TCM services were provided. In the meantime, CMS has agreed to release a small portion of the deferral.

Ms. Davis explained the status of the Health Care Access Improvement Program, details of which are found in her written testimony. She noted that CMS must approve SRS's contract with First Guard and will review changes in the capitated rate based on the increases to hospitals and physicians and the availability of assessment revenue.

Committee questions and discussion followed. Chairman Morris confirmed with staff that the cost to the state regarding the child welfare deferrals could be in the area of \$80 - \$100 million.

Representative Neufeld expressed a concern that he has heard that it is much easier than it used to be to obtain food stamps. Ms. Davis responded that there are more ways to access SRS

services which including an on-line application process, but noted that SRS will look into it into the situation.

Chairman Morris expressed concern with the retroactive issue regarding the child welfare deferrals and noted that it bothers him that CMS wants the money back considering they originally approved the plan. Ms. Davis explained that SRS is in negotiations with the regional office and things need to be tied up there.

Chairman Morris recognized Alan Conroy, Kansas Legislative Research Department, who gave an update on the State General Fund. Mr. Conroy distributed copies of Kansas Department of Revenue figures and explained information regarding taxes only for the month of September (Attachment 17).

Mr. Conroy presented an overview of the State General Fund (Attachment 18). Mr. Conroy reviewed actual FY 2004 State General Fund receipts and expenditures. He noted that the Consensus Revenue Estimating Group will meet on November 3, 2004, to revise the FY 2005 State General Fund estimate of receipts and make the first official estimate for FY 2006. Mr. Conroy also reviewed the FY 2006 major funding areas which are listed in his written testimony.

The following State General Fund profiles were distributed by staff:

- □ A four percent out-year growth in tax receipts, the new KDOT transfer beginning in FY 2007, with a minimum ending balance of 7.5 percent maintained (Attachment 19).
- □ A four percent out-year growth in tax receipts, the new KDOT transfer beginning in FY 2007, with no minimum ending balance maintained (Attachment 20).

Chairman Morris welcomed Duane Goossen, Director, Division of the Budget, and Secretary, Kansas Department of Administration, who was present to discuss policy questions regarding financing of insurance for state buildings. (No written testimony was submitted.) Mr. Goossen explained that the policy decision made during the 2004 Legislative Session to begin paying insurance on state buildings out of the state institutions building funds has gone forward. In response to a question by Chairman Morris, Director Goossen responded that insurance bills can be paid out of the building funds or the State General Fund. He noted that as long as pressure continues on the SGF he would project that payment of the insurance bills would continue to be paid from the building funds.

Staff distributed copies of a memorandum addressed to the Committee from Leah Robinson, Kansas Legislative Research Department, regarding use of state building funds to pay insurance for state buildings (Attachment 21). Ms. Robinson provided an overview of the memorandum to the Committee.

Chairman Morris asked about agencies insuring their own vehicles. Ms. Robinson mentioned that there was a bill proposed in the 2004 Legislative Session that would have allowed agencies to purchase comprehensive coverage on their vehicles, but the bill was not passed during the session. The Chairman expressed concern that this needs to be looked at.

Representative Neufeld suggested that a note be put in the Committee report that using state building funds for paying insurance on state buildings is inappropriate as a long term policy and should not continue in the future. Representative Feuerborn mentioned that he disagreed and does

not see use of the building funds as inappropriate, but rather as a safeguard. Chairman Morris suggested recommending that the Committee discourage use of the building funds, but noted that the Committee realizes that it is a tight budget year and there are tough choices. The Chairman asked that the Committee consider this item at either the November or December meeting.

Chairman Morris recognized J. G. Scott, Kansas Legislative Research Department, who presented the following information in regard to the State General Fund ending balance. Mr. Scott reviewed the following information with the Committee (Attachment 22):

- 1990 HB 2867, Omnibus Reconciliation Spending Limit Bill, 7.5 Percent State General Fund Ending Balance.
- Information on KSA 75-6702 and KSA 75-3721.
- State General Fund Expenditures and Ending Balances (In Thousands), FY 1966-FY 2004.
- Governor's Budget Reports, FY 1988 - FY 2005.

Senator Kerr stated that during the past couple of years the Governor's Budget Report may have complied with the letter of the law, but certainly not with the spirit of the law. He noted that the actual budget detail bore no relationship to a budget with a 7.5 percent ending balance. Senator Kerr expressed concern that when the Governor prepares the budget in this manner, the legislature has an uphill battle during the entire session because they are here for such a short period of time. He questioned whether the law should be strengthened or eliminated.

Chairman Morris welcomed Duane Goossen, Director, Division of the Budget, and Secretary, Kansas Department of Administration, who noted that he was present to participate in the discussion and to answer questions. Director Goossen explained that the ending balance law has two parts:

1. When the Governor submits a budget an ending balance at the end of the budget year should be equal to 7.5 percent.
2. When the Legislature passes a budget they should pass a budget that has an ending balance projected to be 7.5 percent.

He mentioned that during the past several years there have been extraordinary budget situations. While the submitted a budget may not have met the statutory ending balance, it represented a more realistic path to take in crafting a budget for state agencies.

Director Goossen explained that FY 2004 ended with an ending balance of \$327 million or 7.6 percent. He noted that the ending balance is the result of a number of one-time things that occurred like the property tax accelerator in 2004, and federal fiscal relief (both a straight payment and also help on Medicaid rates). In addition, income tax collections at the end of the fiscal year were better than anticipated.

President Kerr expressed concern as to why he did not receive a response from the Governor's office regarding a letter that he and Speaker of the House, Doug Mays had written requesting the Governor to submit the budget as the law requires. The Committee continued a

detailed discussion regarding the ending balance law. Chairman Morris mentioned when the state gets back to a better fiscal condition, it might be a good time to consider a change in the law.

The Chairman welcomed Steve Stotts, Director of Taxation, Kansas Department of Revenue, who provided an update regarding timely reporting of State General Fund tax receipts (Attachment 23). Mr. Stotts expressed regrets on behalf of Secretary Joan Wagnon that she was unable to attend the meeting.

Mr. Stotts explained that the department deposits tax receipts with the state treasurer on a daily basis generally by 3:00 p.m. each day. He addressed the privilege tax receipts. Mr. Stotts noted that tax receipts in FY 2004 were \$25.4 million which was \$5.7 million below the previous year. He mentioned that nearly \$1.6 million of the difference from last year is due to a refund paid in July 2004. The Kansas Department of Revenue research staff is currently examining some privilege tax returns to determine the reason for the reduction in receipts. Committee questions and discussion followed.

In response to a question by Senator Kerr, Mr. Stotts responded that the tax receipts report was not made in a timely manner last May due to staff vacations over the Memorial Day holiday. He assured the Committee that now there are employees trained in the Department of Revenue to do the work involving the tax revenue reporting each month and it will not happen again.

The Chairman welcomed Clarence Norris, Commissioner, Office of the State Bank Commissioner, who presented a status on banks and banking in Kansas. (No written testimony was submitted.) Mr. Norris presented the following statistics, background and information regarding banking in Kansas as follows:

- There are 261 state-chartered banks in Kansas regulated by the State Bank Commissioner's Office.
- There are 97 national banks in Kansas which are regulated by federal regulators.
- Of the 261 state-chartered banks in Kansas, 207 of them have \$100 million in assets or less. There are 54 banks that are over \$100 million in assets.
- As of this past October, banks reported a new high in total assets of \$25 billion. Mr. Norris noted that it should mean that the banking community is doing well.
- The number of banks decreased in Kansas due to acquisitions and mergers, but the asset total has continued to go up.
- More than 8,035 individuals are employed in banks in Kansas.
- Currently deposits are over \$20 billion.
- Currently loans are over \$16 billion.
- Net interest income has been in the area \$442 million, but net interest margins continue to be squeezed in getting money to loan. Mr. Norris noted that banks and bankers have been able to manage it though.

- Banks are 80.25 percent “loaned-up” in Kansas. Mr. Norris mentioned that banks like to have at least a one percent return on assets. The average today is 1.27 percent.
- Return on equity is 12.59 percent. Mr. Norris noted that this is also good, although they would like to see 13-14 percent, but 12.59 percent is still strong.
- There are 19 problem banks due to drought conditions in Kansas. Mr. Norris noted that when he became Bank Commissioner that number was 30 and they like to see that number continue to come down.

Mr. Norris explained that banks are facing some strong challenges because of competition with credit unions. Mr. Norris noted that credit unions are not tightly regulated. Brokerage houses, insurance companies, and thrifts are also in competition with banks in Kansas.

Mr. Norris addressed what may have happened regarding declines in the privilege tax revenue declines. He noted that perhaps the growth of Subchapter S corporations in the banking industry has resulted in individual stockholders paying more and the banks paying less.

Chairman Morris welcomed Doug Wareham, Vice President of Government Affairs, Kansas Bankers Association, who presented information to the Committee regarding financial institutions tax receipts (Attachment 24). Mr. Wareham addressed some factors that might be affecting privilege tax collected from Kansas financial institutions. He also addressed the Bankers Association’s concern with the un-level (tax policy) playing field that presently exists between commercial banks and credit unions operating in Kansas.

Mr. Wareham noted that there are several tax policies that banks can take advantage of which may affect privilege taxes. Details about each of these items can be found in his written testimony:

- Post 9-11 Federal Depreciation Tax Policy;
- Community Service Tax Credits;
- State Rehabilitation/Restoration Tax Credits;
- State Job Development Tax Credit; and
- Accrual vs. Cash Basis Accounting.

Mr. Wareham addressed the tax policy advantage that credit unions enjoy and detailed one specific example. In Finney County, one can compare two financial institutions that have an almost equal share of the deposit market—Golden Plains Credit Union with \$147.7 million in deposits and Western State Bank with \$147.0 million in deposits. However, Western State paid \$379,000 in income/privilege taxes in 2003, while Golden Plains paid nothing.

In closing, Mr. Wareham explained that they believe there is not one single factor that is causing privilege tax revenue decline but there are a number of factors in play.

The next meeting is scheduled for November 8-9, 2004. The meeting adjourned at 11:50 a.m.

Prepared by Mary Shaw
Edited by Leah Robinson

Approved by the Committee on:

November 9, 2004

(date)