

CONFIDENTIAL

Maine: Delivering Efficient Government



January 5, 2008

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CONTEXT

- **Maine has made significant strides to increase government efficiency over the past five years**, reducing state spending by ~\$140M in the last supplemental budget
- **Current economic environment, however, calls for tough, fact-based choices** to reduce ~\$830M structural gap for 2010-2011 biennial budget
- **In this context, the Maine Council on Competitiveness asked McKinsey & Co., a leading global management consultancy**, to apply a business-based approach to identify the next level of efficiency opportunities
- During the course of their work together, **the Council on Competitiveness and McKinsey identified ~\$100-180M in annual savings**, to be realized over 3 years
 - Majority of savings derived from standardizing service delivery and consolidating administrative functions
- **While we believe these savings are realistic, real work is still required to implement the changes necessary to capture them**
 - This report should serve as the foundation of a program that implements the actions required to deliver the next step-change governmental efficiency

THINGS WE WERE INTERESTED TO LEARN...

K-12 EDUCATION

- 2x variation or more between top & bottom 25% of K-12 districts in non-instructional costs
- In special education, there is up to 500% variance in diagnoses of certain conditions by region (e.g., autism, emotional disabilities, etc.)

DHHS

- Maine reimburses critical access hospitals at 117% of cost while most states reimburse at 101% of cost, and rates have not been revised in ~3 years
- Despite having 4,300+ service providers receiving payments from DHHS, the top 10% receive 90% of the payments

CORRECTIONS

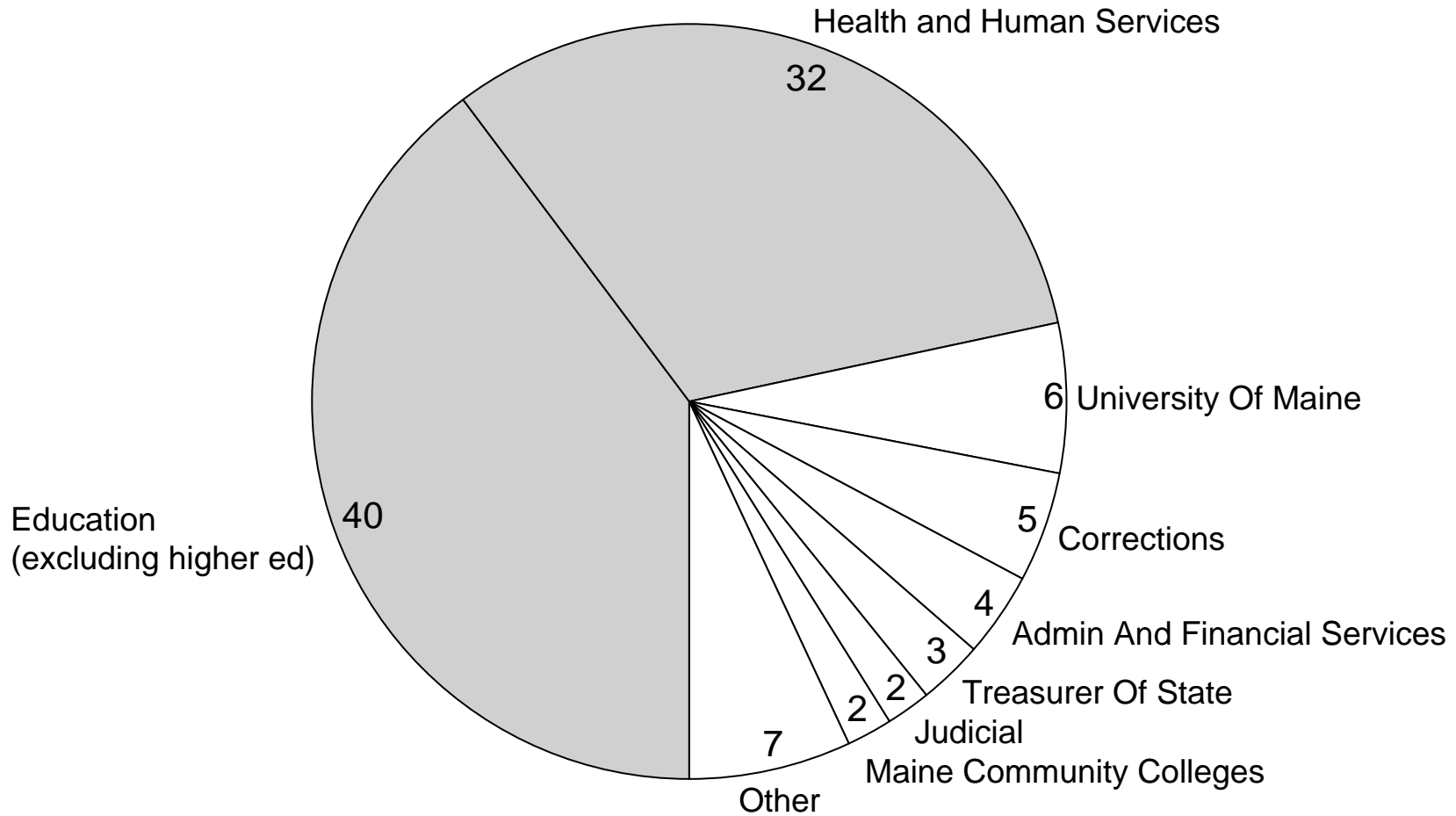
- Pre-trial population in jails ~62%, with average length of pre-trial stay ~3x longer than the U.S average
- Maine's jail occupancy rates vary from 54 – 114% of capacity

PURCHASING

- There are 49 separate temporary employee contracts with 8 different vendors

EDUCATION AND HEALTH & HUMAN SERVICES REPRESENT OVER 70% OF 2009 STATE GENERAL FUND BUDGET

Expenditures, \$ Millions



Findings

- Maine K-12 education and community college expenditures are the fastest growing categories in Maine
 - State K-12 education funding has increased dramatically primarily as a result of citizen-initiated legislation

MAINE'S EXPENDITURES ARE GROWING FASTER THAN ITS REVENUES, DRIVEN BY INCREASING MANDATED SPENDING

Maine's expenditures are growing slower than peer states (but still 2x the rate of revenue)...

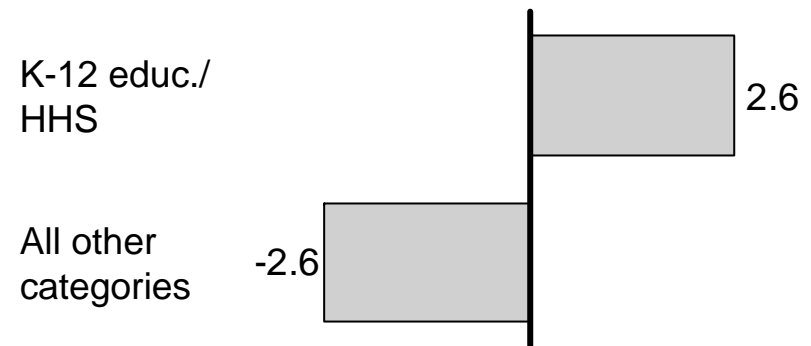
...and mandated spending for healthcare and education is "crowding out" other spending

Inflation-adjusted compound annual growth rate (CAGR) 2004-2008, Percent

Peer state*	Revenues	Expenditures
Mississippi	5.2	5.0
West Virginia	4.3	4.7
Washington	3.3	2.6
North Dakota	3.0	4.3
South Dakota	2.7	3.3
Vermont	2.1	3.3
Iowa	2.0	3.2
Massachusetts	1.9	2.3
Arkansas	0.8	2.0
Maine	0.5	1.0
New Hampshire	0.4	0.9
Oregon	-0.4	3.8

K-12 Education & HHS vs. all other categories

Maine inflation-adjusted CAGR in General Fund spending
Percent, 2004-2008

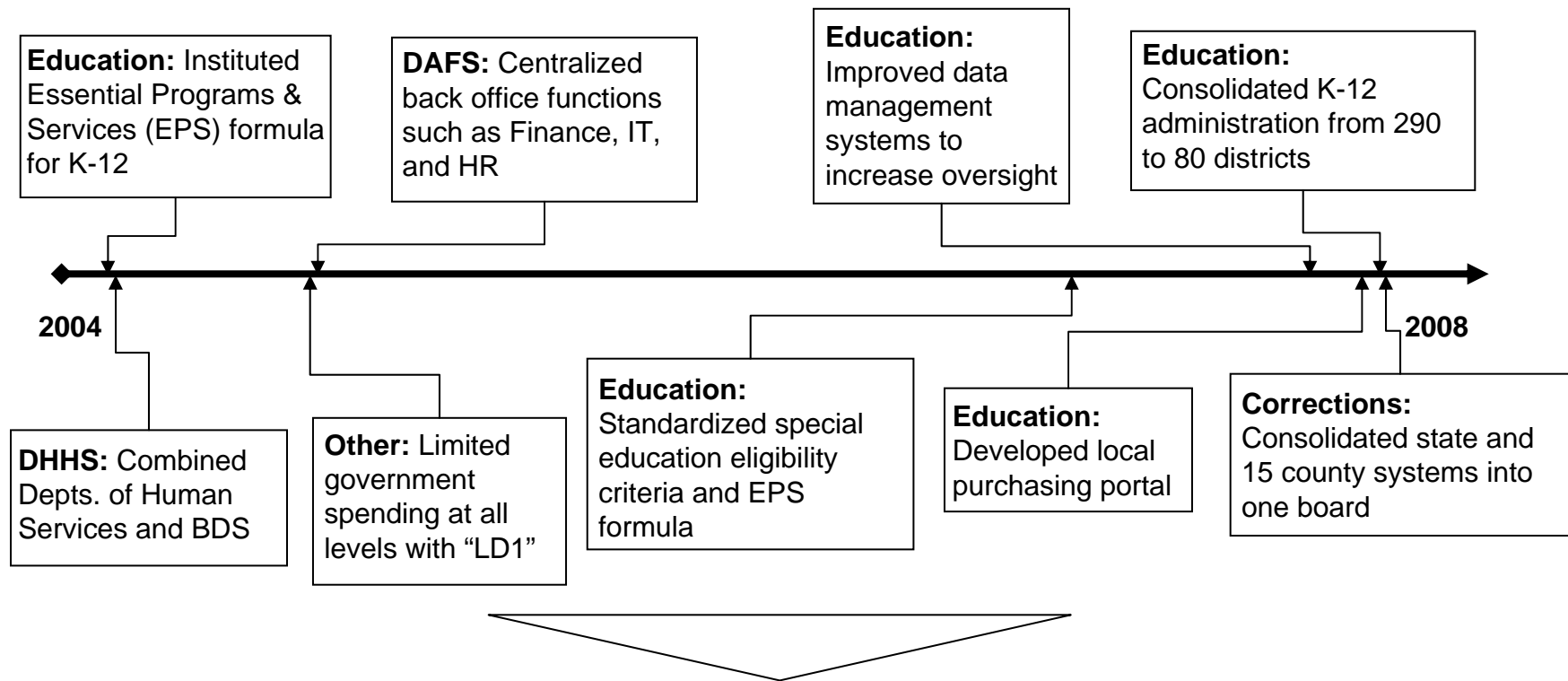


Education / HHS GF spending increased \$465M vs. \$22M for all other categories

* Peer states chosen based on rural state groupings outlined in Brookings Inst. methodology plus inclusion of additional New England states and "quality of place" states

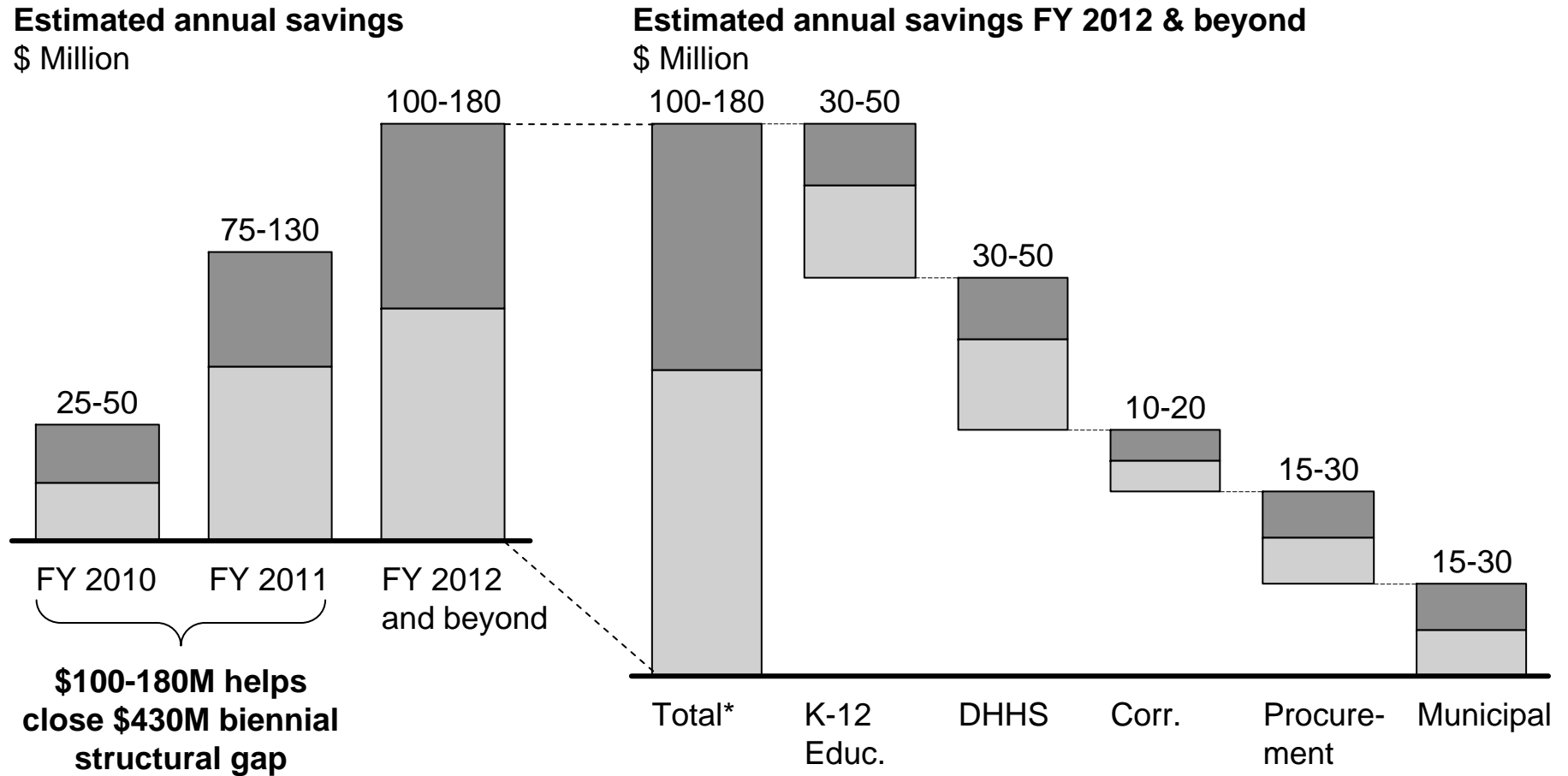
IN THIS ENVIRONMENT, MAINE HAS INCREASED EFFICIENCY IN A NUMBER OF AREAS

SORTED BY ENACTMENT DATE



- **Efficiency improvements and service changes in the last supplemental budget achieved ~\$130M of spend reduction**
- **Many efforts have focused on consolidating administrative and back office functions, but there have also been some program reductions**
- **...but more opportunities to increase efficiency exist...**

\$100-\$180M OF ANNUAL GENERAL FUND SAVINGS ARE ACHIEVABLE THROUGH EFFICIENCY CAPTURE AND SERVICE CHANGES



These figures do not include savings from avoiding cost increases in additional areas (e.g., higher transport costs, facilities heating, etc.)

* Estimate assumes no change to existing federal policy and regulatory environment

Source: Team analysis, 2008 General Fund budget

K-12 education

POTENTIAL SAVINGS OPPORTUNITY FOR STATE WITHIN K-12 EDUCATION IS ~\$30 – 50 MILLION

<u>Opportunity</u>	<u>Next steps</u>	<u>State savings potential* \$ Millions</u>
① Adjust EPS targets for non-instructional expenses	<ul style="list-style-type: none"> • Share potential cost-reducing actions with districts • Hold committee hearings and adjust EPS 	25-30
② Encourage sharing of special ed service provider pools	<ul style="list-style-type: none"> • Identify schools that use specialist contractors • Encourage pooling with similar districts to hire specialists 	Improved service delivery
③ Regionalize special ed designation	<ul style="list-style-type: none"> • Set statewide special ed diagnosis standards • Move from localized Pupil Evaluation Teams (PETs) to regionalized teams that follow new guidelines 	Equal treatment of students
④ Standardize and consolidate teacher health contracts	<ul style="list-style-type: none"> • Require transparency on teacher health benefits and spending • Consolidate volume and renegotiate contracts 	5-20

Does not include local savings of ~\$30-50M

30-50

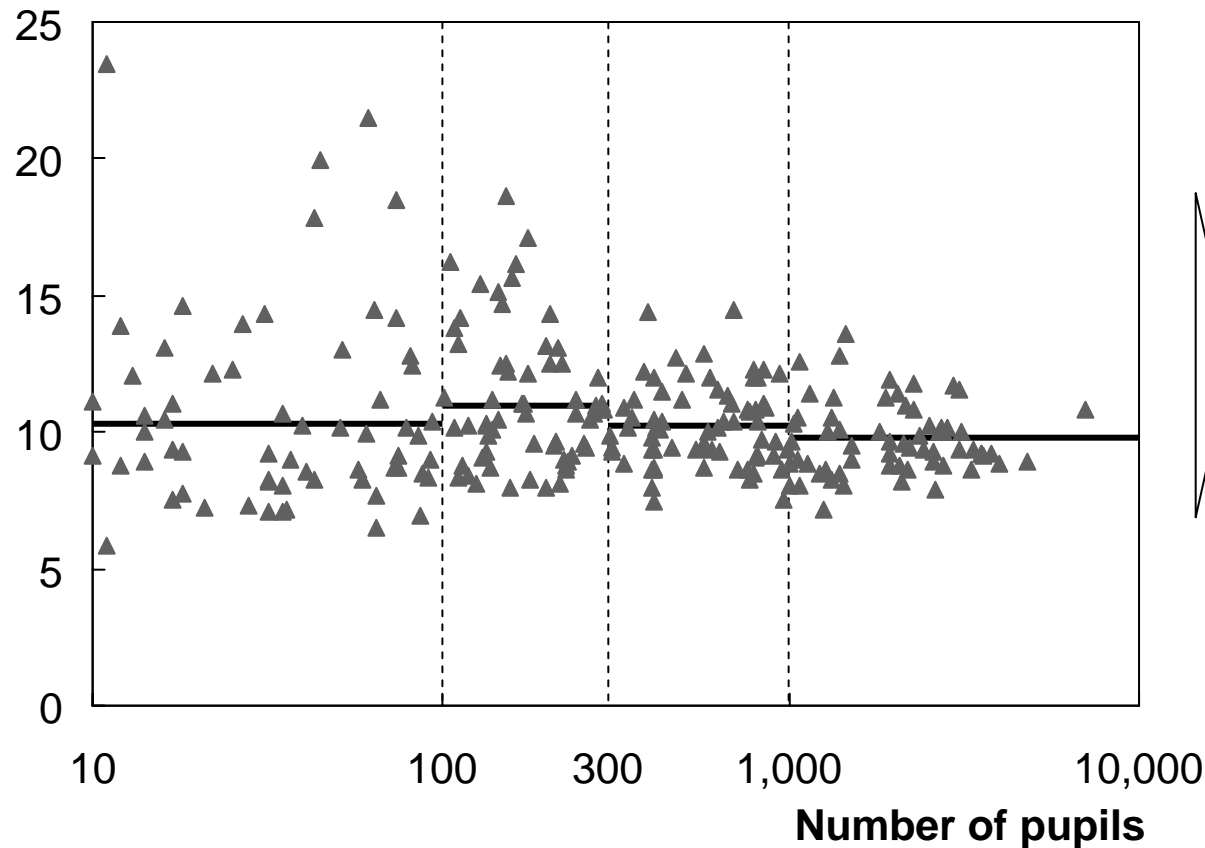
* Net of potential savings from new school district reorganization/consolidation plan

Source: State of Maine data

1 THERE IS SIGNIFICANT VARIABILITY IN TOTAL SPENDING PER PUPIL, REGARDLESS OF DISTRICT SIZE

Total spend per pupil for Maine school districts* by district size

\$ Thousands per pupil



- Variability between top and bottom 25% of districts with over 1,000 students is about \$4,800 per student, or 54%

* Based on sample of 258 school districts; excludes 25 districts with <10 pupils

Source: State of Maine data; team analysis

K-12 education
VARIABILITY IS SIGNIFICANT EVEN AMONG COMPARABLE SCHOOL DISTRICTS

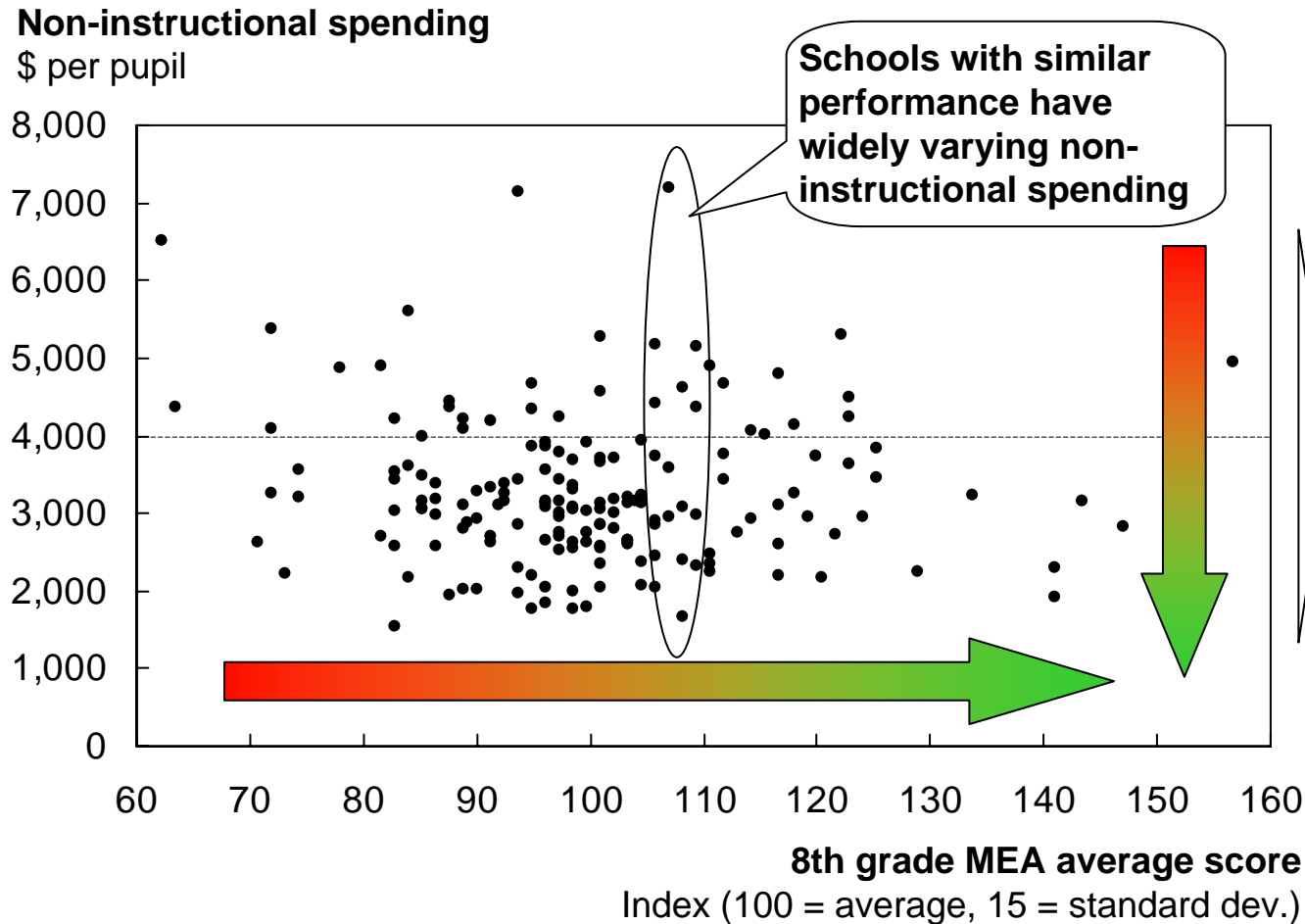
Peer group definition	School district	State share	Total cost per pupil (\$/pupil)
<ul style="list-style-type: none"> • School districts with a population between 400 and 410 pupils • “Rural-distant” location type* • State share of funding >60% 	Dixmont	75%	7,453
	Washburn	83%	8,723
	Dayton	63%	9,335
	Chelsea	78%	10,462

40% difference in cost per pupil between Dixmont and Chelsea (comparable districts)

* Based on Institution of Education Sciences classification

Source: State of Maine data; IES National Center for Education Statistics; Team analysis

1 STUDENT PERFORMANCE IN A SCHOOL DISTRICT IS UNRELATED TO PER-PUPIL NON-INSTRUCTIONAL SPENDING



- Lack of relationship holds true even after controlling for school size
- This suggests that reducing cost variability will not adversely affect instruction quality

① ② SAD 22 IN HAMPDEN HAS REDUCED NON-INSTRUCTIONAL COSTS AND IMPROVED SPECIAL ED SERVICES

MAINE CASE STUDY

SAD 22 has taken several actions...

- Used the purchasing portal...



...that have improved service and reduced costs

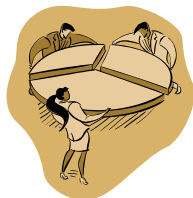
...which saved \$14K, or 50%, on certain supply costs

- Joined an educational partnership...



...which resulted in 80 – 90% savings on several staff trainings and cost reductions in other shared services

- Hired and shared special ed resources with 4 other districts, instead of contracting specialists...



...which reduced specialist costs by ~30%, while ensuring students get high-quality service

- Identified a “business / operational manager”



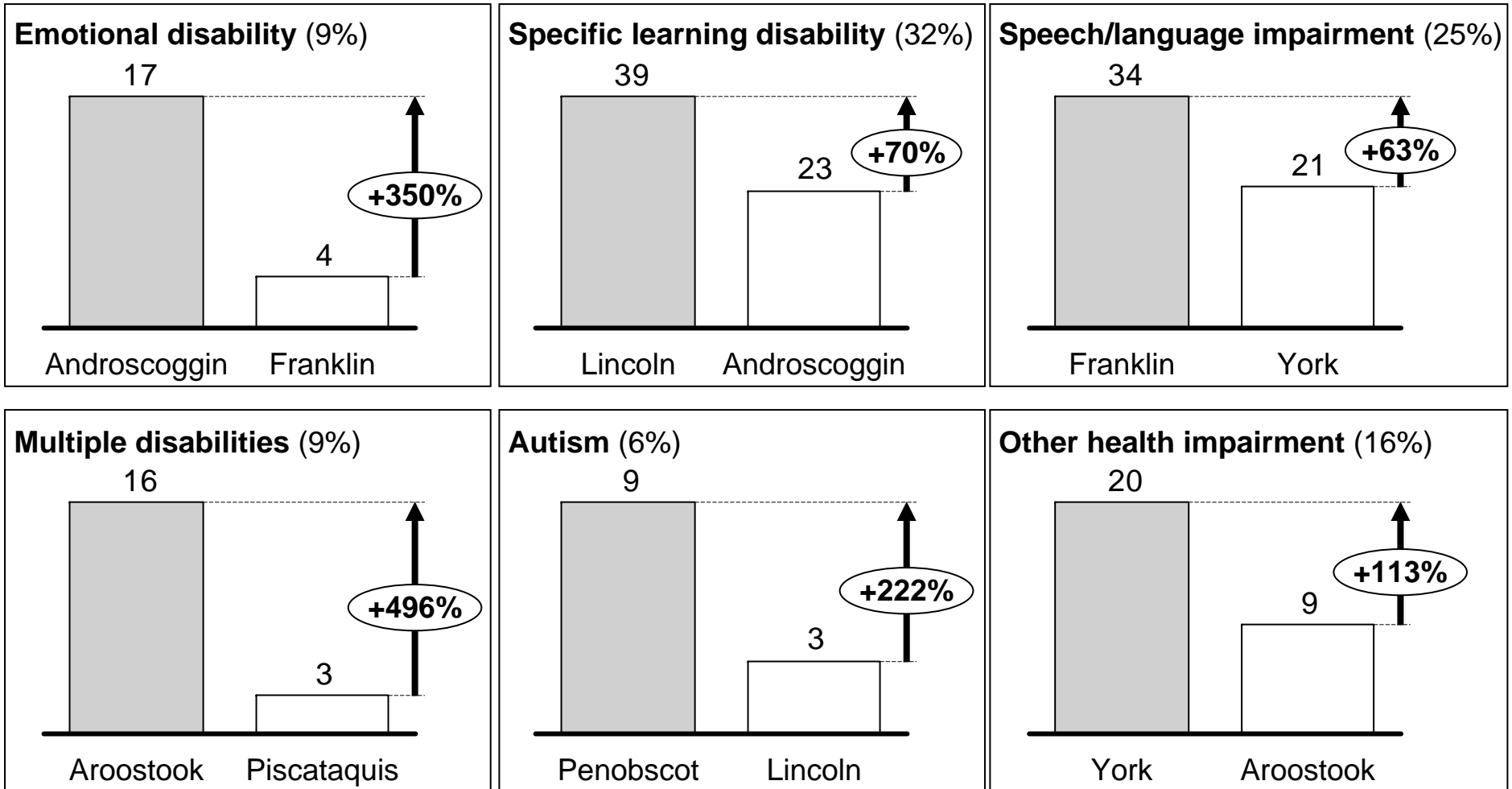
...which provided a qualified individual who can focus the district on operational efficiencies

Hampden is also high-performing

3 SIGNIFICANT SPECIAL ED DESIGNATION VARIABILITY BY COUNTY OFFERS AREA FOR IMPROVED, MORE CONSISTENT SERVICE

Students with specific disabilities (State average, percent)

Highest and lowest percent of county special ed population, 2007-08



4 DECENTRALIZED NEGOTIATION OF AND LITTLE TRANSPARENCY INTO TEACHER BENEFIT CONTRACTS OFFERS OPPORTUNITY FOR SAVINGS

Current situation	Potential actions
<ul style="list-style-type: none">• K-12 schools paid ~\$237 million in teacher benefits in 2004-05<ul style="list-style-type: none">– This does <u>not</u> include an additional \$182 million paid to State Retirement Fund• Health benefit contracts currently negotiated by individual teachers' unions with very little transparency	<ul style="list-style-type: none">• Increased transparency: State and school districts need to be aware of teacher health costs and benefit packages• Consolidated negotiation: School districts should work together to increase negotiating leverage<ul style="list-style-type: none">– In addition, state must investigate savings from negotiating state employee, municipal employee, and university employee health benefits together with teacher benefits• Tiered service providers: Encourage employees to use preferred service providers by using incentives• Incentives for preventative care: Assess cost savings from creating incentives for employees to take preventative care

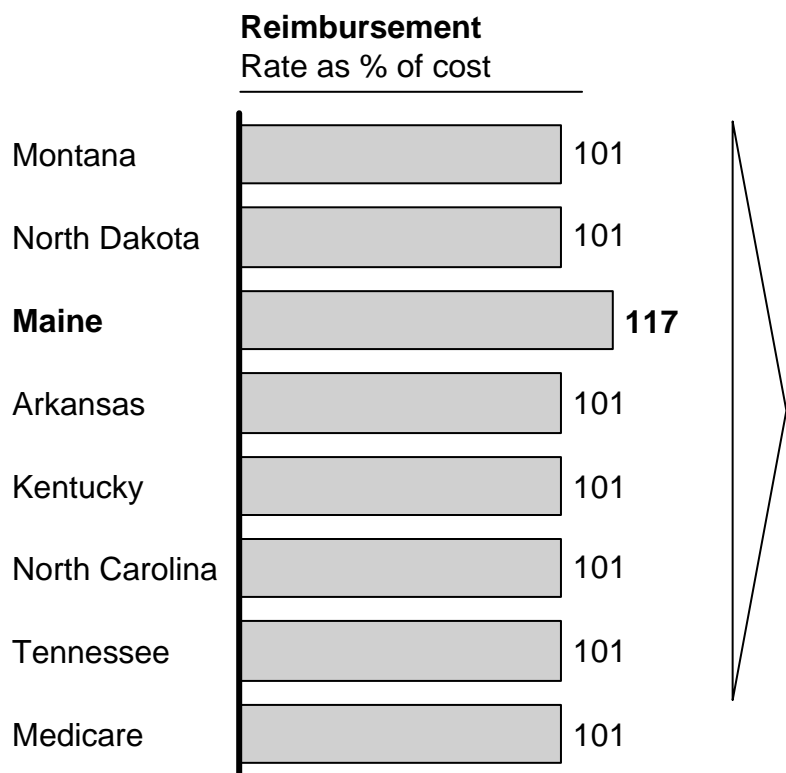
Taking these steps should reduce costs by 2-10%, based private and public sector experience

DHHS
POTENTIAL SAVINGS OPPORTUNITY FOR STATE WITHIN DHHS IS
\$30-50 MILLION

Opportunity	Next Steps	Potential state savings \$ Millions
① Standardize payments to providers	<ul style="list-style-type: none"> • Decide on payment changes • Hold public hearing • Amend State Plan • Re-write MaineCare Benefits Manual to reflect payment changes 	15 – 25
② Adopt disease management & wellness programs	<ul style="list-style-type: none"> • Select diseases and beneficiaries to target • Decide who should run the program • Obtain Federal approval • Evaluate the program 	15 – 25
③ Adjust beneficiary cost-sharing	<ul style="list-style-type: none"> • Decide which provider services should receive cost-sharing adjustments • Set copayment in line with peer states and according to rules in Deficit Reduction Act 	TBD
④ Adopt integrated care plan	<ul style="list-style-type: none"> • Decide what beneficiaries to cover under managed care • Select a health plan/private payor • Design data collection process • Set up process to evaluate managed care 	TBD
		30 – 50

1 MAINE'S CRITICAL ACCESS HOSPITAL REIMBURSEMENT RATES ARE SIGNIFICANTLY HIGHER THAN MOST PUBLIC PAYORS' RATES

Reimbursement rate to critical access hospitals
2007



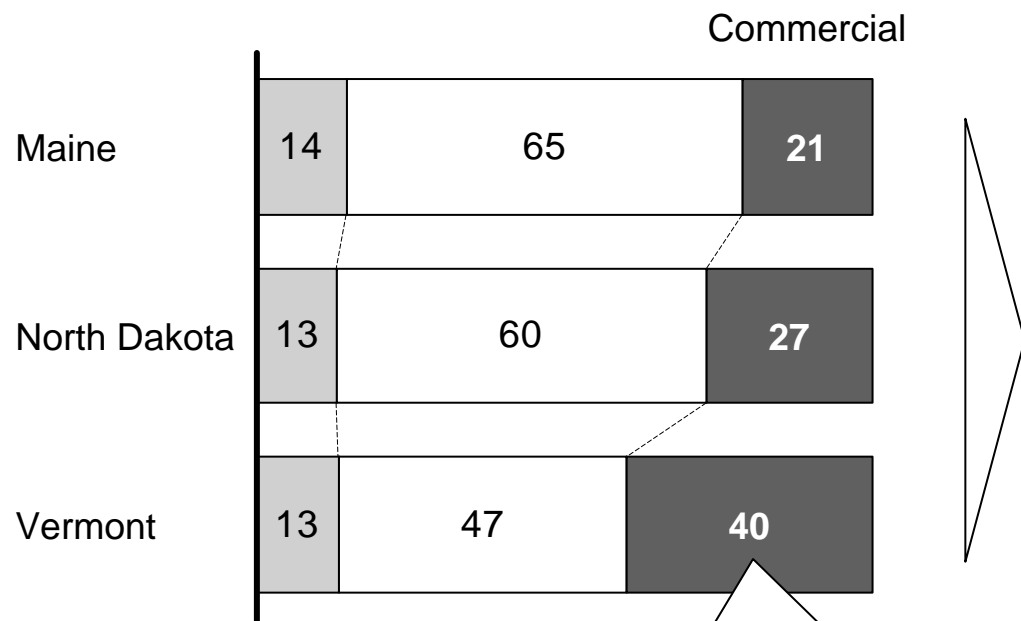
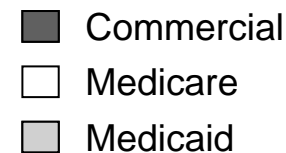
Maine savings from adjusting critical access hospital reimbursement rate

Adjusted payment Percent	Average hospital profitability Percent	Maine's potential savings \$ Millions
112%	4.83%	2.5
107%	4.19%	5.0
101%	3.43%	8.0
		2.5 – 8.0

1 LOW COMMERCIAL PAYOR MIX TYPICALLY INDICATES LOWER PROFITABILITY...

Hospital Days By Payor Type

Percent of total days, 2006

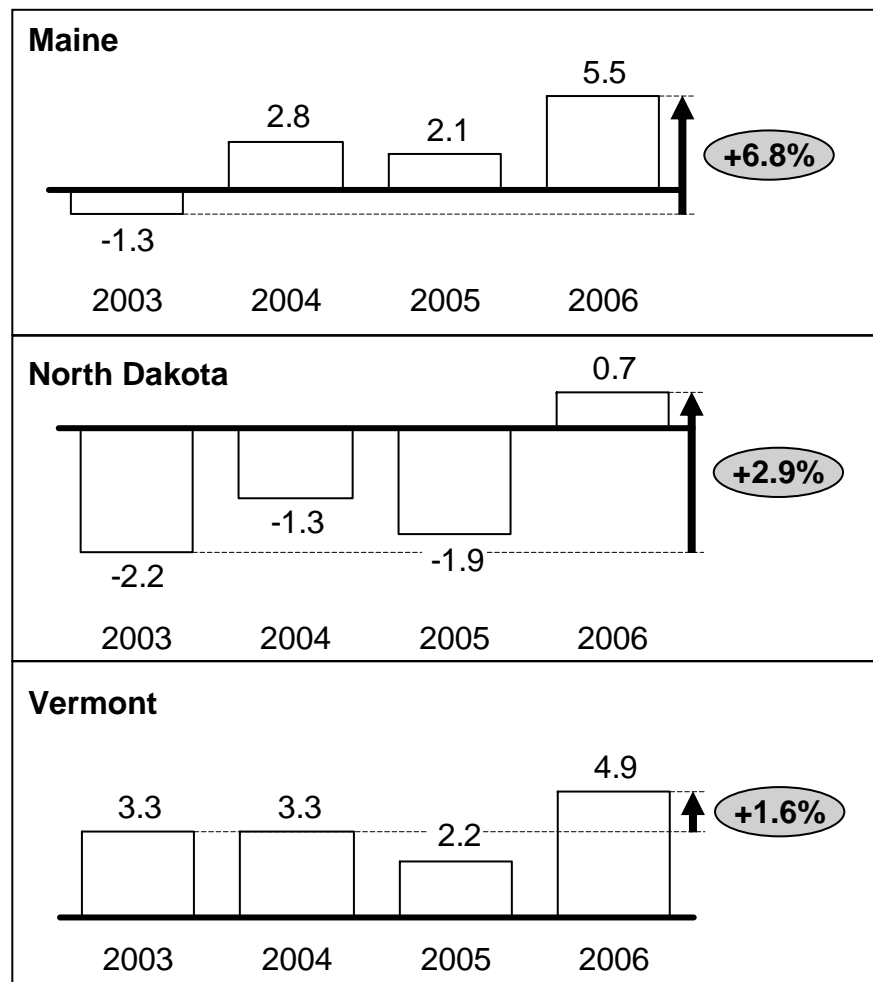


- Maine's proportion of patient days that are reimbursed by a commercial payor is significantly lower than comparison states
- Poor payor mix indicates that Maine's CAHs may have lower profitability

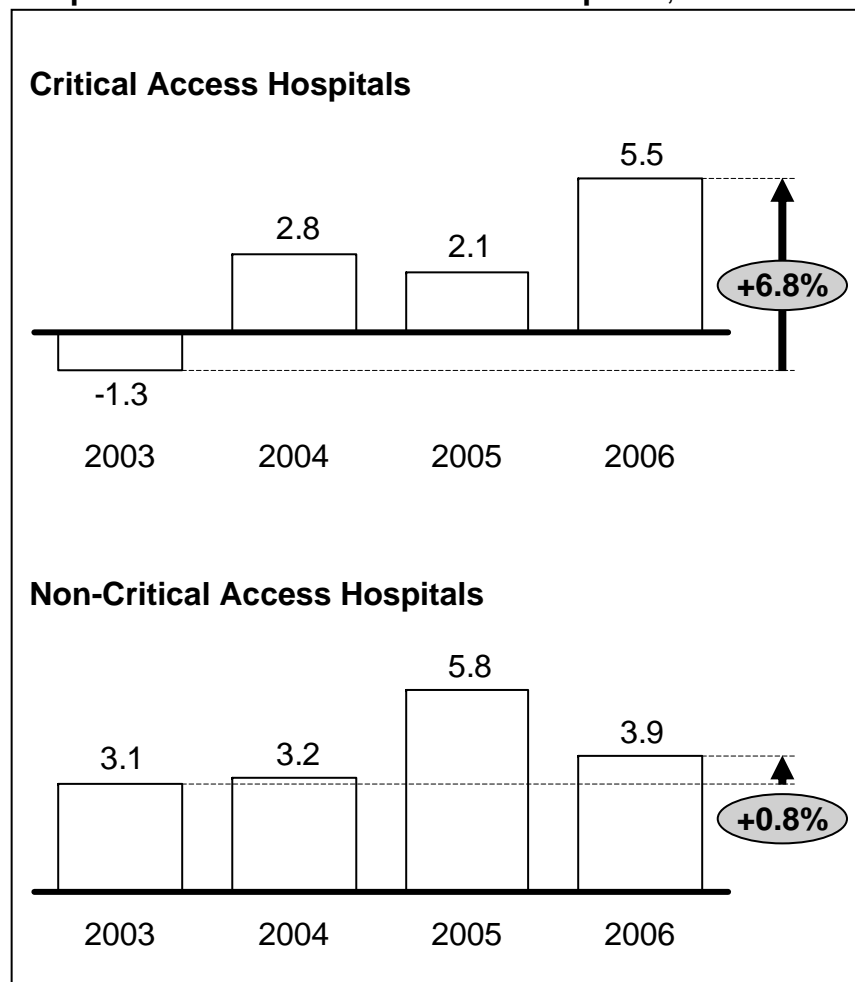
Hospitals typically receive a much higher payment rate from commercial payors

1 ... HOWEVER, MAINE'S CAH PROFITABILITY HAS INCREASED FASTER THAN THAT OF COMPARISON STATES

Average profit margin for critical access hospitals, Percent



Maine's average profit margin for critical access hospitals and non-critical access hospitals, Percent

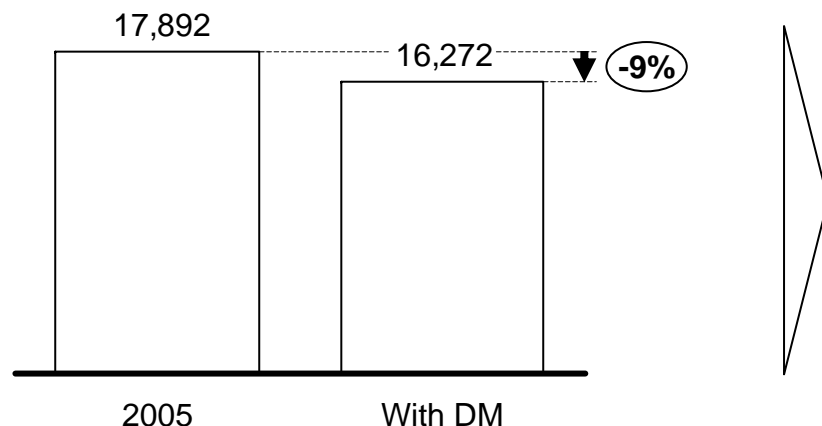


2 EXPANDING DISEASE MANAGEMENT FOR DISABLED MEDICAID POPULATION COULD YIELD SIGNIFICANT RETURN

WYOMING CASE STUDY

Initial target pop.

Annual cost per disabled beneficiary for Wyoming Dollars



Maine's potential savings by achieving results similar to Wyoming's program

Disabled* Enrolled, %	Disabled Enrolled, Thousands	Cost, \$ Millions	Net Savings** \$ Millions
25	7	3	9
50	20	9	23
75	33	14	TBD
100	44	20	TBD

Potential Savings ~10 - 25

Wyoming State Disease Management Program

- Wyoming made their DM program open to all disabled beneficiaries – 7,800
- Saved \$1,620/beneficiary in the first year of their program (after \$450/person cost) for a total of \$8.8M Net Savings
- Savings attributed to reduction in clinical utilization (Decreased average length of inpatient stay by 29%, and ER utilization by 13%)
- Improved prevention measures such as diabetes testing, eye exams, glucose monitoring, statin usage, and cholesterol monitoring

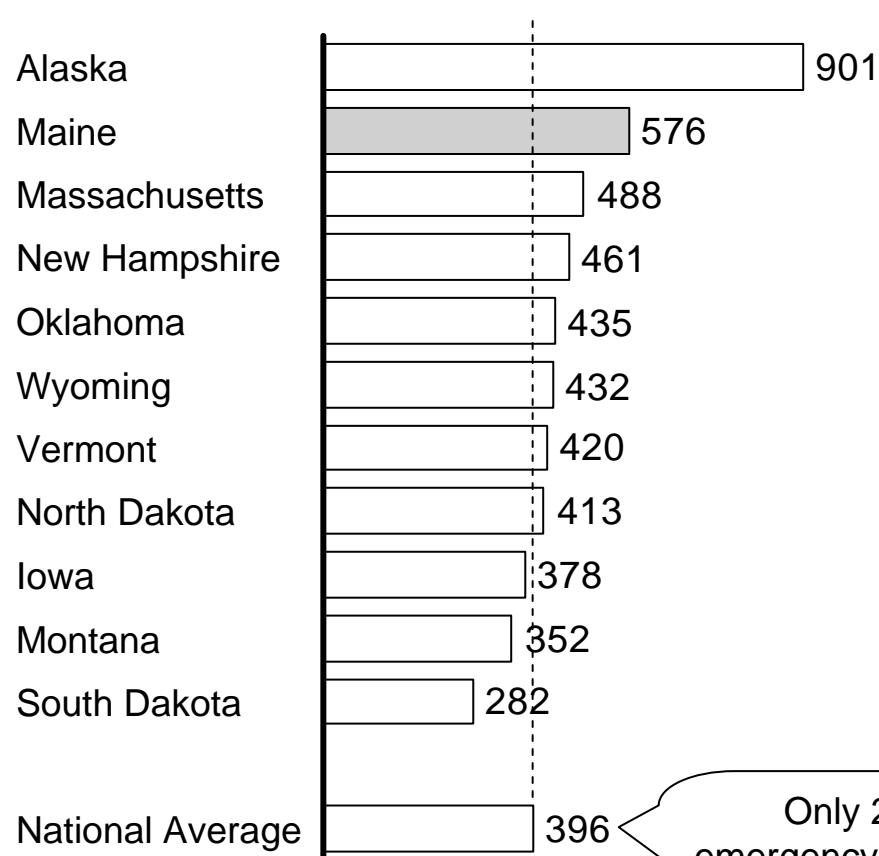
* Disability evaluation under Social Security (Blue Book- June 2006)

** Accounts for disabled beneficiaries already enrolled in Schaller Anderson

2 EMERGENCY DEPARTMENT UTILIZATION IN MAINE IS 45% HIGHER THAN NATIONAL AVERAGE

Hospital emergency department visits

Per 1000 population, 2006



Only 20% of emergency department visits nationally are for emergent conditions

Care Setting	Average Cost \$ per visit
Emergency Department	364
Physician Office	56

People who frequently visit emergency facilities for non-emergency conditions:

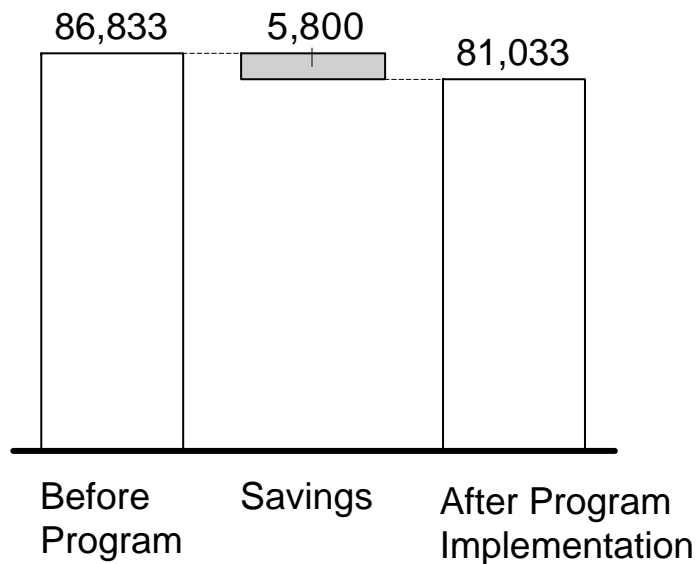
- Do not receive optimal care
- Generate unnecessary costs for Medicaid
- Are not adequately educated how to utilize the health care system

2 MAINE COULD SIGNIFICANTLY REDUCE ED UTILIZATION BY IMPLEMENTING A PROGRAM SIMILAR TO OKLAHOMA'S

OKLAHOMA CASE STUDY

Savings attained from implementing an emergency department utilization

Total cost, \$ Thousands, 2007



Emergency Department Utilization Project

- Identify high utilizers
- Refer them to case management
- Discuss appropriate utilization with PCPs and provide them with patient admitting diagnosis
- Provide extreme utilizers with intensive therapy

- Emergency department utilization per capita was 10% higher in Oklahoma than the National Average
 - Maine is 45% higher than National average
- **If Maine reduced their ED utilization by same 7% as Oklahoma they could save \$1 Million**

Corrections

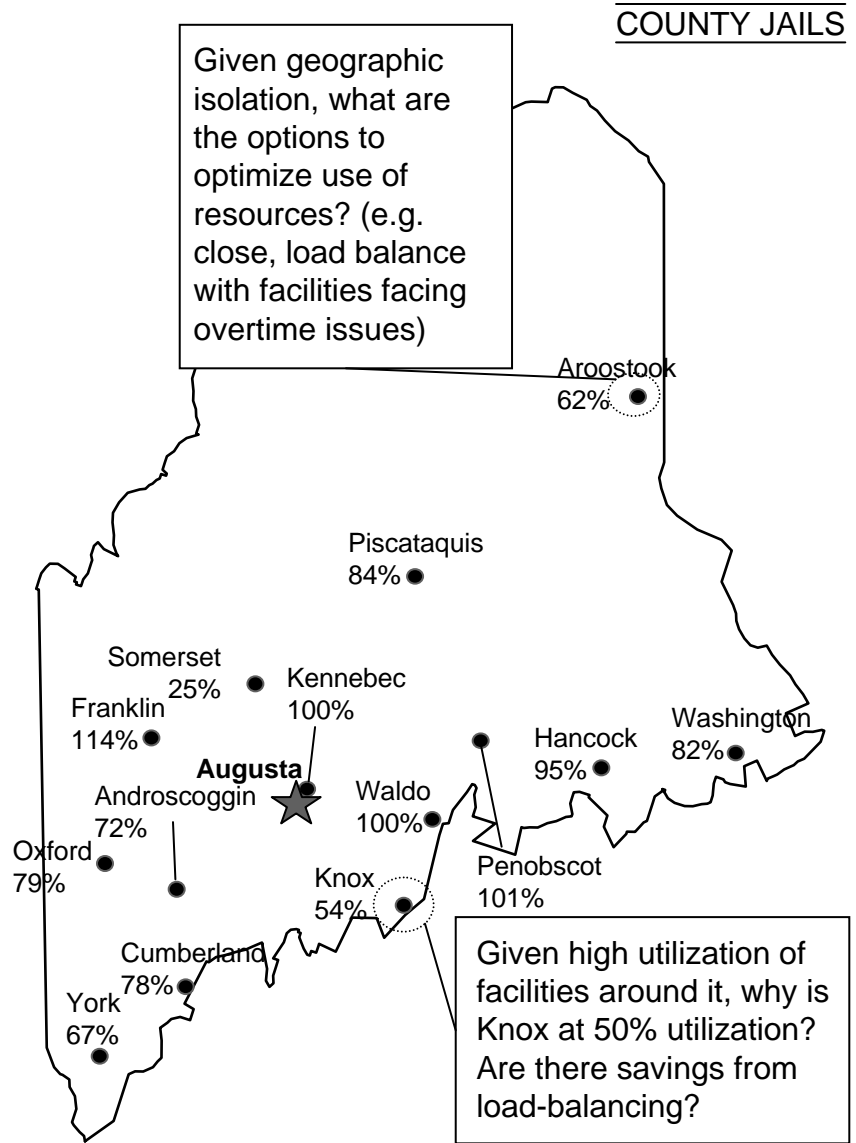
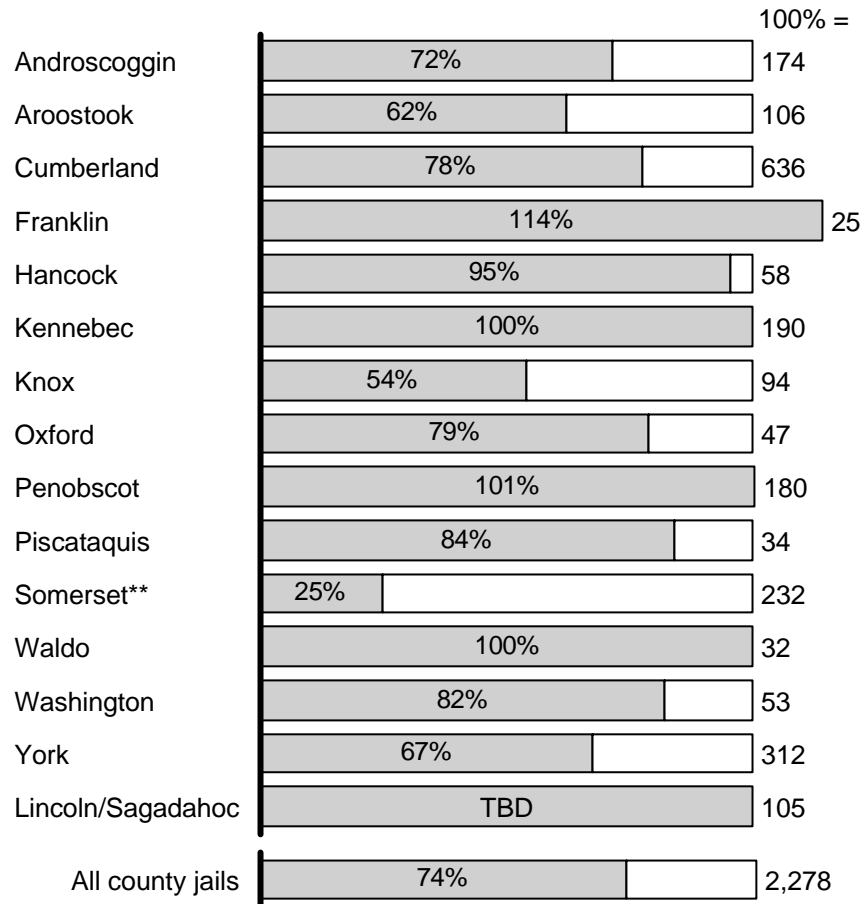
POTENTIAL SAVINGS OPPORTUNITY WITHIN CORRECTIONS IS \$10-20 MILLION

<u>Opportunity</u>	<u>Next Steps</u>	<u>Potential state savings \$ Millions</u>
① Right-size jail facilities	<ul style="list-style-type: none">• Coordinate staffing and capacity among county jails & potentially close facilities	5 – 10
② Fully fund pre-trial services	<ul style="list-style-type: none">• Use less-expensive ways to process/ sanction lower risk inmates• Improve pre-trial services	3 – 5
③ Reduce operating expenses	<ul style="list-style-type: none">• Standardize operating, admin, and purchasing expenses by centralizing vendor and demand management	2 – 5
		<hr/> 10 – 20

Corrections

LOW UTILIZATION OF SOME COUNTY JAILS CREATES OPPORTUNITY FOR \$7-10M* IN SAVINGS

Total beds available and Capacity utilization for county jails
% utilization, # of beds



* Assumes total annual cost per bed of ~\$31K and potential capacity utilization increase to 82 - 87% by closing some facilities

** Capacity includes new facility not yet fully online

Source: State of Maine data

FUNDING PRE-TRIAL SERVICES REDUCED EXPENDITURES BY ~\$10M PER YEAR IN NORTH CAROLINA (WHICH HAD SIMILAR ISSUE TO MAINE)

NORTH CAROLINA CASE STUDY

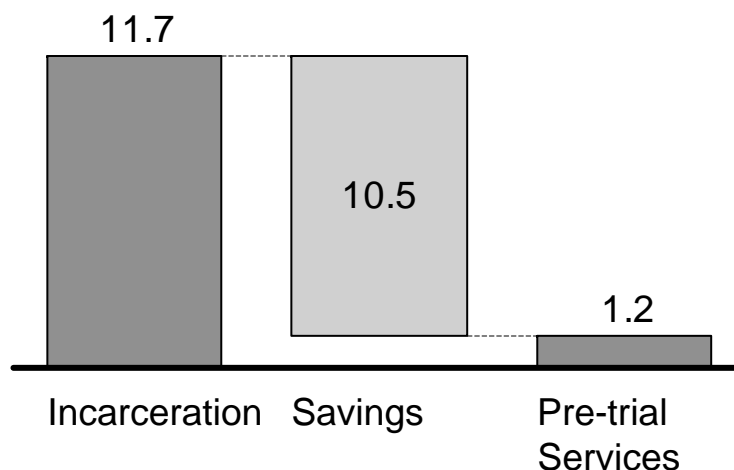
Pre-trial services

- Provide judicial officers with information to assist them in setting bail
- Monitor and supervise defendants released from custody while awaiting disposition of criminal charges



Savings accrued from fully funding pre-trial services

Total cost, \$ million*



- “Maine’s average pre-trial length of stay is about 3x longer than the US average” – *Maine Justice Policy Center*
- Pre-trial inmates represent 62% of Maine’s jail population (and growing)



* Savings based on average daily population of 1740 & length of stay of ~120 days; does not include benefits from reducing overcapacity of prisons, including less overtime by guards

Purchasing

POTENTIAL PURCHASING SAVINGS FOR STATE IS ~\$15–30 MILLION ON \$360 MILLION OF ADDRESSABLE SPEND

Opportunity	Next steps
Reduce state-agency purchased cost by	
• Reducing number of vendors	• Identify services with multiple vendors • Put combined volume out to bid, and price according to added volume
• Award standard rates for multi-contract vendors	• Ensure per-unit rates on contracts with same vendor are consistent (e.g., markup rates on temp services contracts) • Secure volume discounts for vendors with whom contract amendments are needed
• Regulating/tracking purchasing card use	• Improve controls on purchasing with procurement cards when state-awarded contracts already exist
• Consolidating local volume and investigating cross-state purchasing	• Create system to track volume from local entities using state-negotiated contracts • Encourage local governments and school districts to partake in state purchasing • Secure discounts based on added volume

Additional resources may be required to capture savings

Purchasing
**BY STANDARDIZING MARKUP RATES ON PROJECT STAFFING
 CONTRACTS, STATE COULD SAVE ~2% ON TEMP COSTS**

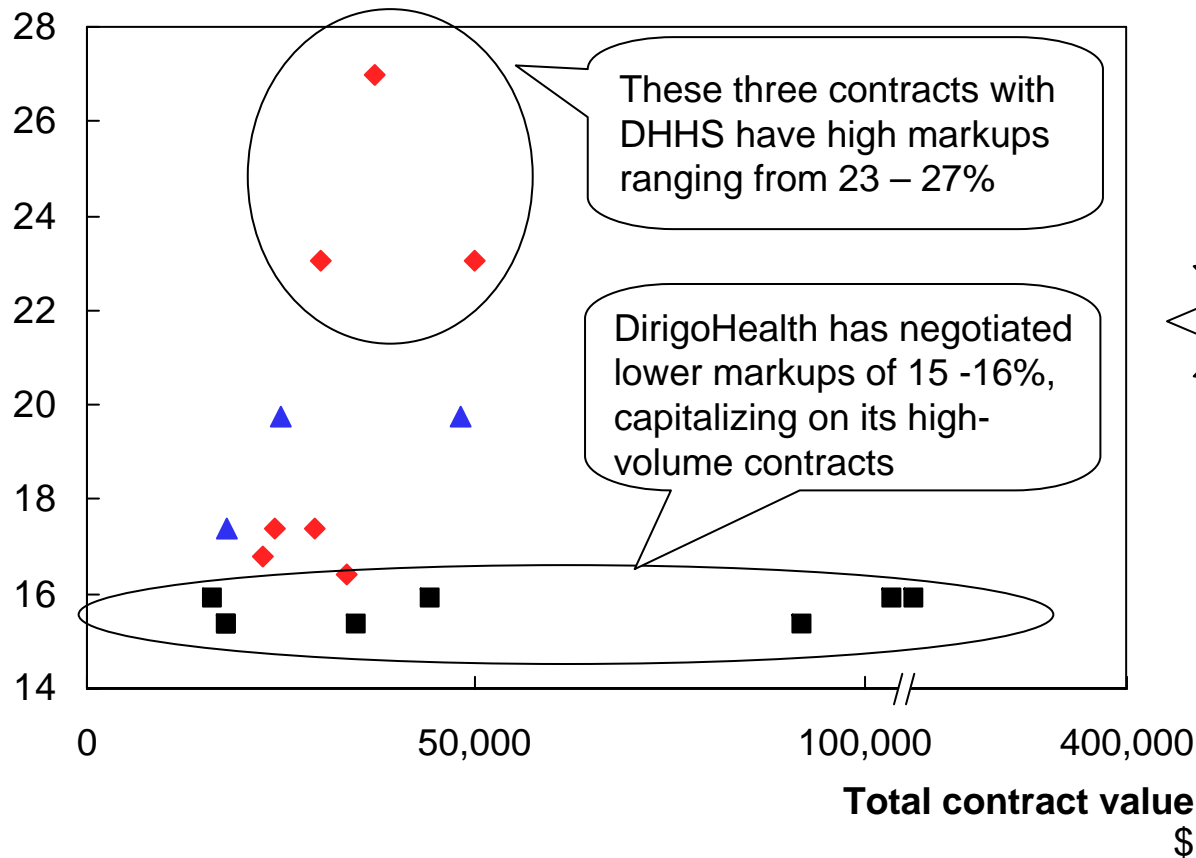
ILLUSTRATIVE

SELECT CONTRACTS FROM LARGEST TEMP SERVICES VENDOR

July 2007-May 2008

Markup over hourly wage
 Percent

- ▲ Labor
- DirigoHealth
- ◆ DHHS



**State would save \$15 – 20M
 if similar savings rate were
 present in all contracted
 services categories**

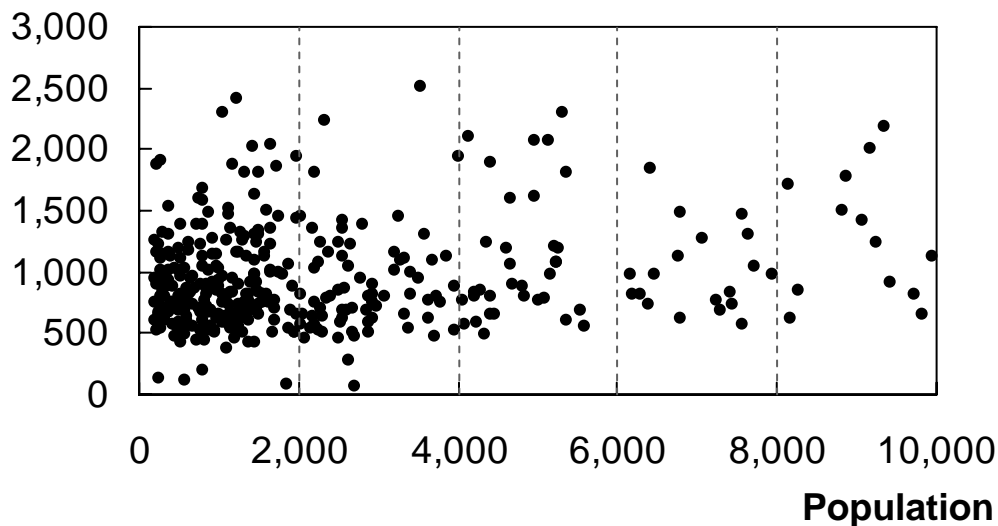
Municipal cooperation/consolidation

POTENTIAL SAVINGS OPPORTUNITY FOR STATE FROM MUNICIPAL CONSOLIDATION IS ~\$15 – 30 MILLION

Opportunity	Next steps	State savings potential \$ Millions	Level of difficulty
Investigate different levels of municipal consolidation <ul style="list-style-type: none"> – Purchasing – Back office – Service operations – Management 	<ul style="list-style-type: none"> • Have districts adopt Model Chart of Accounts, require financial reporting as precondition to receiving revenue sharing • Identify variability in various cost buckets, controlling for municipal size, valuation, etc. 	15-30	Moderate-high

Does not include significant local savings

Non-educational spending \$ per resident



- Variability suggests that even without consolidation of services, there are opportunities to reduce municipal costs for districts of all sizes

Municipal cooperation/consolidation

SEVERAL MUNICIPALITIES HAVE IMPROVED SERVICE DELIVERY AND SAVED SIGNIFICANTLY BY SHARING SERVICES

Areas of consolidation

- Code enforcement officer
- Assessor
- 9-1-1 dispatch
- “24-7” paramedic coverage
- Financial/accounting systems
- Town council/manager
- Capital equipment purchasing
- Fuel purchasing

Benefits realized

- Quality of services improved
- Several towns saved ~\$400K
- Category savings of up to 50% realized in several areas, e.g.,
 - Fuel purchasing
 - Equipment
 - Back office functions
 - Emergency response

