*Senate Budget and Fiscal Review—Mark Leno, Chair*

# SUBCOMMITTEE NO. 4 Agenda

**Senator Richard D. Roth, Chair**
**Senator Steven M. Glazer**
**Senator Janet Nguyen**
**Senator Richard Pan**

**Wednesday, May 18, 2016**
**1:30 p.m. or Upon Call of the Chair**
**State Capitol - Room 112**

Consultant: Mark Ibele

## Part A

### ITEMS PROPOSED FOR VOTE-ONLY

## ITEMS FOR DISCUSSION AND VOTE



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# ISSUES PROPOSED FOR VOTE ONLY

## C.S. 12.00 STATE APPROPRIATIONS LIMIT

### Issue 1: Revised State Appropriations Limit (May Revision)

**Governor's Proposal.** The Administration requests that the budget bill be amended to reflect the updated change in the State Appropriations Limit (SAL). The revised limit of $99.787 billion is the result of applying the growth factor of 5.96 percent. The revised 2016-17 limit is $950 million above the $98.837 billion estimate in January.

**Staff Comment:** Staff has no concerns with this technical change.

**Staff Recommendation:** Approve the revised State Appropriations Limit.

**Vote:**

## 0500 GOVERNOR'S OFFICE

### Issue 1: Director of Immigrant Integration (May Revision)

**Governor's Proposal**. The May Revision requests $200,000 to provide funding for the State Director of Immigrant Integration, established as part of the 2015 Budget Act in SB 84 (Committee on Budget and Fiscal Review), Chapter 25, Statutes of 2015. The director serves as the statewide lead for the planning and coordination of immigrant services and policies in California.

**Staff Comment:** Staff has no concerns with this proposal.

**Staff Recommendation:** Approve as proposed.

**Vote:**

## 0750 LIEUTENANT GOVERNOR'S OFFICE

### Issue 1: Personnel Support (May Revision)

**Governor's Proposal.** The Administration requests that the budget for the Lieutenant Governor's Office be increased by $9,000 to account for an increase in operational costs for personnel activities.

**Staff Comment:** Staff has no concerns with this proposal.

**Staff Recommendation:** Approve as proposed.

**Vote:**

## 0110/0120 STATE LEGISLATURE

### Issue 1: Constitutional Adjustment (May Revision)

**Governor's Proposal.** The Legislature's budget for 2016-17 was proposed in January to be $121.5 million for the Senate and $160.1 million for the Assembly. Under the terms of Proposition 140, the growth in the Legislature's budget is constitutionally limited to the growth in the state's appropriation limit (SAL). The year-to-year SAL increase is calculated to be 5.96 percent in the Governor's May Revision. Applying this to the legislative budget would result in funding of $128.780 million for the Senate and $169.683 million for the Assembly.

**Staff Comment.** The Senate's budget was held constant from 2008-09 to 2009-10, reduced by a negative SAL of -1.77 percent in 2010-11, received no increase in the subsequent two years (2011-12 and 2012-13), then received increases of 5.8 percent in 2013-14 and 0.48 percent in 2014-15 and 4.55 in 2015-16. Legislative increases were forgone because of the state's budget constraints during the previous recession. The combined spending by the Senate and the Assembly is still well below the State Appropriations Limit. Funds from the Senate and Assembly appropriations are also used to fund the Legislative Analyst's Office.

**Staff Recommendation.** Staff recommends that the Legislature's (Senate and Assembly) budget be adjusted as provided in the State Constitution, resulting in a total increase for the Legislature of $16.8 million, and that the Legislative Analyst's Office receive its SAL-adjusted share from the Senate and the Assembly.

**Vote.**

## 0985 CALIFORNIA SCHOOL FINANCE AUTHORITY

### Issue 1: Charter School Facilities (May Revision, BBL and TBL)

**Governor's Proposal.** The Administration has several proposals for the California School Financing Authority (CSFA) related to charter schools, specifically: providing resources for workload for the state's charter school facility grant program and the federal charter school facilities incentive grant program; and providing $20 million Proposition 98 funding for a charter school start-up grant program and resources for the administration of the program. The substance of these proposals will be heard in Subcommittee No. 1 on Education.

**Staff Comments.** The proposals will be heard in Subcommittee No. 1 on Education, with Subcommittee No. 4 taking a conforming action.

**Staff Recommendation.** Conform to action in Subcommittee No. 1 on Education.

**Vote.**

## 8885 Commission on State Mandates

### Issue 1: Post Election Manual Tally (May Revision)

**Governor's Proposal.** The Administration proposes funding the Post Election Tally Mandate at a cost of $625,288 in one-time costs incurred between October 20, 2008 and November 28, 2008.

**Background.** The statewide cost estimate for this mandate was recently determined. There will be no on-going costs as the mandate has expired. This will be a one-time payment as both the reimbursement and claim periods for this mandate have already expired, so no additional costs will be incurred and no additional claims can be filed.

**Staff Comment.** Staff has no concerns with the proposal.

**Staff Recommendation.** Approve the May Revision request.

**Vote.**

## 0840 State Controller's Office

### Issue 1: Post-Employment Benefits Workload Automation (May Revision BCP)

**Governor's Proposal.** In the May Revision, the State Controller's Office (SCO) requests $883,000 ($503,000 General Fund) in 2016-17 for eight positions, and $573,000 ($327,000 General Fund) in 2017-18 for five positions, to automate the deduction, remittance and reporting for Other Post-Employment Benefit (OPEB) prefunding. With the requested resources, the SCO will be able to support OPEB automation, and implement all required changes to the uniform state payroll system (USPS) and associated business processes to comply with the mandated requirements of collective bargaining. Once this automation is finalized, the USPS will have the capability to accommodate OPEB deductions for any future bargaining units (BUs). Additionally, the SCO will have the necessary support to continue the manual workload related to retroactivity and pursue a solution to synchronize the historical data with the newly automated system data.

**Background.** The USPS is a decentralized system, with participating departments and agencies for entering data into the system to accurately generate personnel and payroll records. As a control agency, the SCO has a statewide responsibility to manage the personnel resources of the state, account for salary and wage expenditures, and provide data to the retirement systems necessary for calculation of employee retirement benefits. OPEB significantly affects how the SCO carries out this core responsibility and requires the SCO to make programming changes to the USPS and related business processes. Additionally, as the mandated reporter for the State of California, the SCO is responsible for generating reports to CalPERS, the California Department of Human Resources (CalHR), and various unions on OPEB activity.

The personnel payroll services division (PPSD) currently creates OPEB deductions outside of the payroll system for several BUs. This process consists of using a monthly, point-in-time program, which involves creating deduction transactions and then deducting approved amounts from eligible employee payments during the master payroll process. Those amounts, plus approved corresponding employer share amounts, if applicable, are then transferred to specific accounts in the California Public Employees' Retirement System (CalPERS). While the timing of the current program being utilized to create OPEB deductions does not allow for automated system calculations related to retroactive adjustments in pay, the BUs currently being processed are subject to deductions calculated off of base pay, are small in population, and have little movement by their employees. Because of these static factors, PPSD has been able to process the correct deductions, with some manual corrections along the way.

As a result of the contract, BU 06 will likely begin adopting the OPEB program as early as July 1, 2016. In addition, tentative agreements for BU 09 and BU 10 will become effective July 1, 2017. PPSD cannot accommodate the introduction of any new BUs to the current point-in-time program that creates deductions outside of the normal payroll process, and does not have sufficient resources to develop and implement OPEB as a real time payroll deduction. As the population of employees subject to deductions grows, the risk of applying incorrect deductions may also increase. With a larger population, and more complex criteria, there is a greater chance that employment history transactions affecting pay may occur between when the program is run and the end of the pay period. In addition, BUs 06, 09 and 10 utilize pensionable pay as the basis for OPEB deductions which would require staff to manually review the monthly deductions for accuracy and calculate any adjustments.

**Staff Comments.** Staff has no concerns with this proposal

**Staff Recommendation.** Approve as proposed.

**Vote.**

# ITEMS FOR DISCUSSION AND VOTE

## 0509 GOVERNOR'S OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

### Issue 1: California Small Business Development Center Program (May Revision)

**Governor's Proposal:** The Governor's Office of Business and Economic Development (GO-Biz) has requested one time appropriation of $1.5 million (General Fund) as a partial match of federal funds to support the Small Business Development Center (SBDC) network.

**Background:** The SBDC provides training to small business owners, including in the areas of start-up assistance, planning for growth and expansion, technology and innovation, and access to capital. The funds will be used for competitive grants to the 44 SBDC offices, and require quarterly reports on results. After receiving no funding from the General Fund from 2004 through 2010, the SBDC program received a one-time $6.0 million in 2011 and then $2.0 million in General Fund in 2014 and 2015. No General Fund was received in 2012 or 2013.

The federal Small Business Administration (SBA) provides up to $13.1 million of federal grant funds to California SBDC network, if the state can meet the required one-to-one match. Absent this match, any available funds are reallocated to other states. Of the required match, 50 percent of the match can be in-kind match and the other 50 percent must be in the form of a local cash match. Go-Biz administers the SBDC grant, which is designed to assist in providing some of the local cash match needed by local organizations. Although the SBDC competitive grant does not fulfill the entire cash match requirement, the SBDC activities related to the grant are designed to attract additional cash match to the SBDC network.

**Staff Comments:** The proposal will help with SBDC funding, but there should be additional efforts to stabilize support for the program, especially given the erratic nature of state support. In addition, the proposal will only allow for a partial draw on available federal funds, unless additional resources can be accessed.

**Staff Recommendation:** Approve the May Revision request.

**Vote:**

## 7730 FRANCHISE TAX BOARD

### Issue 1: Earned Income Tax Credit Outreach (May Revision)

**Governor's Proposal.** In the May Revision, the Franchise Tax Board (FTB) requests $2 million for education and outreach efforts related to the California Earned Income Tax Credit (EITC) that was implemented in the 2015 tax year.

**Background**. The EITC provides a targeted, refundable credit for wage income (excluding self-employment) and focuses on the lowest-income Californians - households with incomes less than $6,580 if there are no dependents or $13,870 if there are three or more dependents. The state program complements the existing federal EITC and matches 85 percent of the federal credits up to half of the federal phase-in range and then tapers off relative to the maximum wage amounts.

FTB collaborated with a wide breadth of government and non-government agencies to develop a detailed communication plan to reach California taxpayers who might qualify for both the federal and state credits. Efforts included: compilation and analysis of demographic information regarding the targeted population, web support activities (including CalEITC4me.org, ftb.ca.gov, and taxes.ca.gov); direct mailer campaign to California taxpayers who did not have a state filing requirement but may qualify for the new California EITC credit; educational outreach for taxpayers, tax professionals, legislative staff, and other groups.

**Staff Comment.** Despite efforts to reach the intended population, early analysis suggests that a significant proportion of the population that is eligible for the program has not participated and additional outreach resources are warranted. In its last return report, FTB indicated that 362,000 EITC returns had been received – well below the expected number of 600,000. These returns allowed for credits in the amount of $180 million, also well below the expected amount. Staff has no concerns with this proposal, but the committee may ask for more specifics and details on the expected use of the funds and whether they are sufficient for the purposes.

**Staff Recommendation.** Approve the May Revision request.

**Vote.**

## 0860 BOARD OF EQUALIZATION

### Issue 1: Prepaid Mobile Telephony Services Surcharge Resources (May Revision)

**Governor's Proposal.** In the May Revision, the Board of Equalization (BOE) requests 3.7 positions and $1.3 million (Special Funds) in 2016-17, and 2.3 positions and $188,000 in 2017-18 and ongoing, to continue processing mandated workload associated with AB 1717 (Perea), Chapter 885, Statutes of 2014, which imposes a surcharges on prepaid mobile communication services. The additional resources would include funding for personnel in the data analysis section, return analysis unit, audit and information section, and compliance and technology section.

**Background.** AB 1717 enacted the Prepaid Mobile Telephony Services (MTS) Surcharge Collection Act and the Local Prepaid Mobile Telephony Services Collection Act (Prepaid MTS Collection Acts), which imposed upon each prepaid consumer a prepaid MTS surcharge and local charge to be collected by a seller on each retail transaction involving prepaid mobile telephony services, effective January 1, 2016. The bill defines "prepaid consumer" to mean a person who purchases prepaid mobile telephony services in a retail transaction. The statute will sunset on January 1, 2020. The prepaid MTS surcharge and local charges are imposed upon the consumer of prepaid MTS, but are required to be collected by the retail seller and the direct seller. The program for retailers of prepaid MTS will be administered by the Sales and Use Tax Department of the BOE, while the program that applies to direct sellers is administered by the Special Taxes and Fees Department.

The prepaid MTS surcharge rate is subject to calculation each year by BOE. The state rate consists of the 911 surcharge rate, determined by the Office of Emergency Services, plus the California Public Utilities Commission (CPUC) end-user surcharges, which includes the annual user fee established by the CPUC. The local charge rates are to be provided by local jurisdictions to the BOE annually. The BOE is responsible for publishing the combined rate for each jurisdiction by December 1 of each year, with the published rates becoming operative April 1 of the following year.

**Staff Comments.** The BOE received substantial resources in the current year for administering the fee discussed. The BOE should be prepared to discuss the need for additional resources, in particular the change in anticipated workload that would justify the current request.

**Staff Recommendation**. Depending on satisfactory additional department information at the hearing, approve but limit funding to four years, with funding terminating with the expiration of the fee on January 1, 2020.

**Vote.**

### Issue 2: Cigarette and Tobacco Products Tax Program (State Auditor's Report)

**Budget Issue.** In March 2016, the State Auditor released a report on their audit concerning the costs to administer the Cigarette and Tobacco Products Tax Program and Licensing Program by BOE. Among the other findings of the auditor's report is that the balance in the Cigarette and Tobacco Products Compliance Fund (CTPCF) is in excess of a prudent amount. This finding suggests that the excess amount above a prudent reserve threshold could be used for program purposes.

**Background.** Cigarettes and tobacco products are subject to various federal, state, and local taxes and fees, including excise taxes (taxes on the sale or consumption of these products), which provide funds for early childhood development, environmental, and other programs. The BOE administers the collection and enforcement of these excise taxes through its Cigarette and Tobacco Products Tax and Licensing Programs. The BOE's most recent estimate is that in fiscal year 2012-13 the State lost $214 million in excise tax revenue for cigarettes and tobacco products due to the evasion of these taxes by consumers, retailers, wholesalers, and distributors. BOE estimates that measures to stop such tax evasion prevented the state from losing an additional $91 million in tobacco tax revenue that year.

The requirement that retailers, distributors, wholesalers, manufacturers, and importers of cigarettes and tobacco products be licensed is a fundamental component of the BOE's enforcement efforts. However, the fees charged for the licenses do not cover all of the licensing program's costs. In 2014-15 the licensing program received about $1.8 million, mostly from license fees, while the program cost more than $9.8 million to administer. As a result, the licensing program had a funding shortfall of roughly $8 million that fiscal year, and has experienced similar annual funding shortfalls since fiscal year 2006-07. To make up the program's funding shortfall, the Legislature approved a budget change proposal in fiscal year 2006-07 to appropriate funds from the four funds that receive taxes from cigarette and tobacco products. The BOE divided the shortfall among these four tax funds in proportion to how much cigarette tax revenue they receive. The practical effect of using these four funds to offset the $8 million shortfall is that the administrators of those funds are not able to provide the level of services or activities that they otherwise would have, absent the need to make up the licensing program's funding gap.

Even though the licensing program has a continuing funding shortfall, as of June 2015 it had accumulated more than $9 million in revenue from license fees, which are maintained in the CTPCF, that it could use to offset the costs of the licensing program and reduce its shortfall. According to the BOE, the balance in the compliance fund steadily grew from $1 million in 2006-07 to almost $9 million in 2014-15 due to various factors, including underestimating revenues and an almost $3 million fund balance increase due to an accounting adjustment by the Department of Finance. A reasonable balance for this type of fund would equate to two to three months' worth of operating expenditures.

**Staff Comments.** The Governor's budget includes spending of $2.3 million to support the licensing program, leaving $7.9 million balance remaining in the CTPCF. Based on state auditor's report and recommendations, about $5.2 million could be distributed to the various programs that benefit from the excise taxes, based on their respective shares of support of the licensing program. This would allow for retaining a prudent reserve in the CTPCF of approximately $2.7 million.

**Staff Recommendation.** Staff recommends that the excess fund balance of $5.2 million in the CTPCF be reallocated, based on the share of each tax fund's support of the licensing program. This would result in a CTPCF reserve of $2.7 million and the following one-time distributions: $590,000 to the General Fund; $119,000 the Breast Cancer Fund, $1.5 million to the Cigarette and Tobacco Products Surtax Fund (supports health and environmental programs); and $3.0 million to California Children and Families First Fund (supports early childhood education and health programs). The Assembly has taken a similar action and Department of Finance has indicated its support.

**Vote.**

## 0840 STATE CONTROLLER'S OFFICE

### Issue 1: 21st Century Project Management Assessment and Project Approval (May Revision)

**Governor's Proposal.** The May Revision proposes additional support for the State Controller's Office (SCO) 21st Century Project assessment efforts and refine the scope of a future payroll project. The SCO requests $2,720,000 ($1,550,000 General Fund and $1,170,000 special fund) to support four positions (and eight continuing positions effective January 1, 2017) in 2016-17, and $2,831,000 ($1,060,000 General Fund, $799,000 special funds, and $972,000 reimbursements) in 2017-18, and $2,607,000 ($932,000 General Fund, $703,000 special fund, and $972,000 reimbursements) in 2018-19 to support eight positions to complete the project assessments, convey the results of the project management assessment in a post implementation evaluation report, perform business process re-engineering of human resource management and payroll processing practices to refine the scope of the future project and complete Department of Technology project approval.

**Background.** The activities are related to a post-mortem assessment of the 21st Century Project which has been terminated. The state's payroll technology needs are being met by a reconstituted legacy system. The proposal also includes components that will begin the process of designing and procuring a new state wide payroll approach.

**LAO Comments**. The Legislative Analyst's Office (LAO) has recommended in that past that an independent third party assess the 21st Century Project. It appears, however, that the alternatives assessment would instead be conducted through the Department of Technology's new IT project approval process, which presumably would involve SCO working directly with the Department of Technology. LAO expresses concern that this approach would result in relatively narrow set of alternatives considered in the assessment. The LAO indicates that a fresh approach using an outside party may result in possible designs that depart from the state's current payroll practices. In light of the challenges of the 21st Century Project and the complexity of the state's workforce, the LAO indicates that new approaches should be considered before the state commits to spend hundreds of millions of dollars on a new project. LAO recommends that the Legislature approve the first year of the request only and the Legislature adopt supplemental reporting language requiring SCO to provide more detail on future assessment activities, as drafted:

> *It is the intent of the Legislature to continue funding assessment activities relating to the 21st Century Project efforts to replace the state's human resources and payroll management systems. No later than January 10, 2017, the State Controller's Office shall provide to the Joint Legislative Budget Committee and the fiscal committees of both houses a report that details proposed assessment activities beginning in 2017-18. The report shall at a minimum detail: (1) the results of assessments already completed and preliminary findings from ongoing assessments; and, (2) alternatives to be considered as part of Stage 2 of the Project Approval Lifecycle process before restarting efforts to replace the state's payroll system. Concerning the alternatives, the report shall address whether: (1) an independent third party should conduct the alternatives assessment; (2) the assessment should consider incrementally replacing business processes through a series of smaller projects; (3) the assessment should consider a decentralized model that integrates less complex payroll departments together and considers alternative approaches for modernizing the payroll systems of complex departments; (4) other state*

*departments or agencies should be involved in the project in addition to the State Controller's Office. This reporting requirement may be satisfied by the submission of a budget change proposal as part of the Governor's 2017-18 Budget that addresses the issues listed above.*

**Staff Comments.** Staff is in general agreement with the concerns raised by the LAO, especially the need to gain outside perspectives on an appropriate approach for the state's payroll needs. The technology in this area changes rapidly and external perspectives are an important means for the state to remain abreast of changes in this area. Prior to approval of the proposal, the committee should ascertain the manner in which outside or third-party perspectives will be incorporated in the project.

**Staff Recommendation.** Approve budget request and SRL.

**Vote.**