Senate Budget and Fiscal Review

Subcommittee No. 4 2013 Agendas

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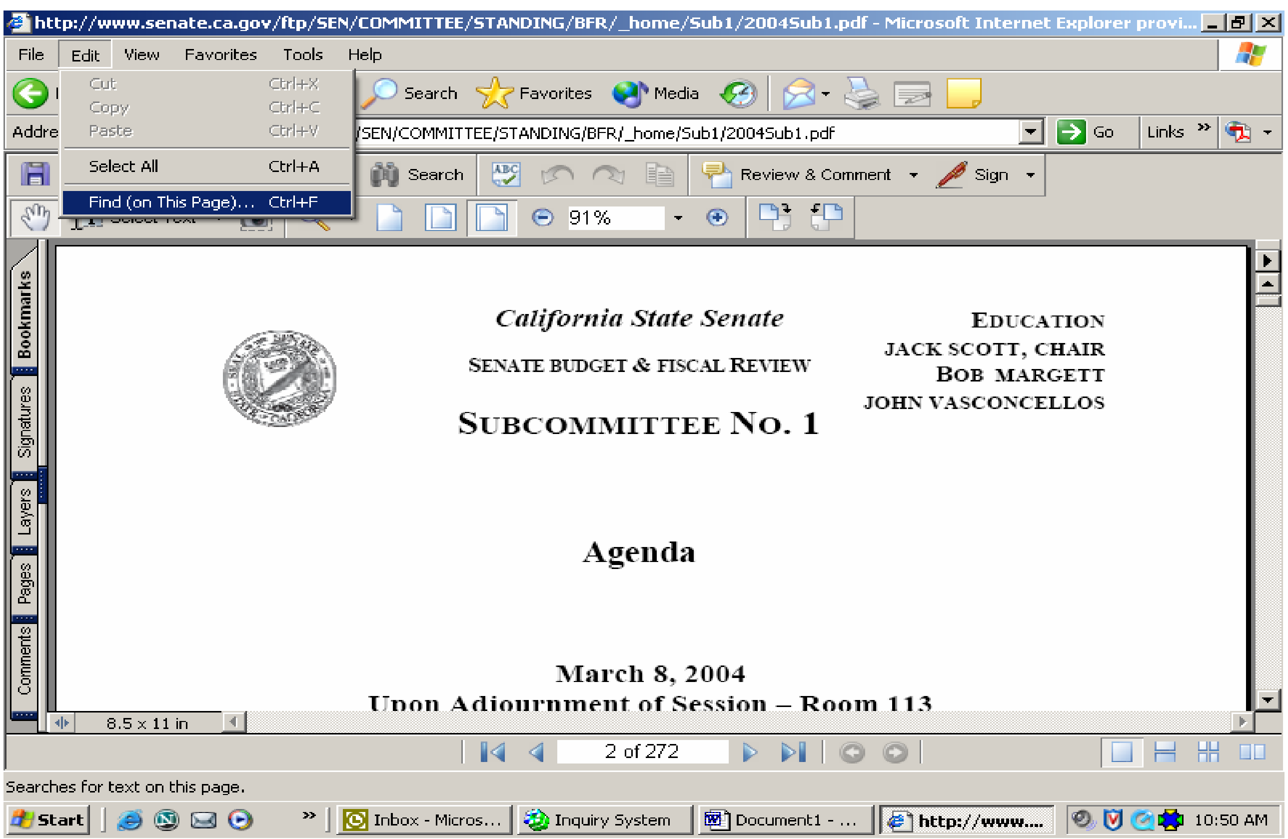

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Jerry Hill

Thursday, March 21, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Mark Ibele

Agenda

State Finance and Administration

Overview of State Fiscal Offices and Functions

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-651-1505. Requests should be made one week in advance whenever possible.

Overview of State Fiscal Offices and Functions

Legislative Analyst's Office

Presentation from the Legislative Analyst's Office on the California's state fiscal offices and their related activities. These departments and offices comprise:

Tax Agencies
Franchise Tax Board
State Board of Equalization
Employment Development Department

Fiscal Control Departments
Department of Finance
State Controller's Office

Banking, Treasury, and Credit Management
State Treasurer's Office

Independent Auditor
California State Auditor

Proposed Vote Only Calendar:

0968 California Tax Credit Allocation Committee

Department Summary: The California Tax Credit Allocation Committee (CTCAC) allocates federal and state tax credits used to create and maintain affordable rental housing for low-income households in the state by forming partnerships with developers, investors and public agencies. CTCAC works with public and private entities to assist with project development and monitors project compliance. CTCAC coordinates its functions with state and local housing fund providers and with private fund investors in the provision and maintenance of affordable housing. CTCAC consists of seven members from state and local governments, with the State Treasurer serving as chair. Other members are the Governor or Director of Finance, State Controller, Director of the Department of Housing and Community Development, Executive Director of the California Housing Finance Agency, and two representatives from local government.

Budget Summary: The CTCAC budget calls for $6.3 million and 40 positions for 2013-14. This represents a slight increase from the 2012-13 funding level of $6.0 million and 39 positions. CTCAC is funded through fees generated by the issuance of debt and reimbursements, with no General Fund support.

Item Proposed for Vote Only:

1. **Budget Proposal (Governor's Budget BCP#1):** The Governor's Budget proposes an augmentation of one position for the allocation unit to carry out core functions and administer federal and state mandates associated with the Low Income Housing Tax Credit Program. The request is in response to an increase in the number of competitive applications for the program. Although applications fluctuate from year to year, prior to 2011, they averaged around 100 whereas as now they approximate 175-200 annually. Project review frequency is established through federal law and regulations.

   Staff Comment: Staff has no concerns with this proposal.

   Staff Recommendation: Approve the request for the additional position.

   <u>Vote:</u>

0971 California Alternative Energy and Advanced Transportation Financing Authority

Department Summary: The California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) was established in 1980 to promote prompt and efficient development of energy sources that are renewable or technologies that more efficiently utilize and conserve scarce energy resources than conventional technologies. The intent of the legislation establishing the Authority was to promote energy sources designed to reduce the degradation of the environment. The Authority later was expanded to include development and commercialization of advanced transportation technologies. More recent legislation added advanced manufacturing to the list of eligible projects. CAEATFA consists of five members and is chaired by the State Treasurer.

Budget Overview: The CAEATFA budget calls for $6.7 million and 9 positions for 2013-14. This represents a slight decrease from the 2012-13 funding level of $7.1 million; the position number will remain constant. CAEATFA is funded through special funds and reimbursements, with no General Fund support.

Item Proposed for Vote Only:

1. **Budget Proposal (Governor's Budget BCP#1):** The Governor's Budget calls for one, three-year, limited-term position to address the workload associated with implementing SB 1128, which expanded the types of eligible projects under CAEATFA's existing authority to provide a sales and use tax exclusion. The legislation allows the sales and use tax exclusion to extend beyond equipment and machinery used to produce advanced transportation and alternative source energy, and include advanced manufacturing. The definition of advanced manufacturing is broad and complex and will further be refined during program development. The proposal also includes a request for budget bill language (BBL) that provides for extending the repayment date of the loan to CAEAFTA from the Renewable Resources Trust Fund to June 30, 2016. The extension of the loan is necessary to allow for the program to establish a fee structure and generate fee revenue to repay the loan. The loan was made in 2011-12 and carries interest equal to the Pooled Money Investment Account (PMIA) rate.

   Staff Comment: Staff has no concerns with the proposal.

   Staff Recommendation: Approve the request for one, three-year, limited-term position and proposed BBL providing for an extension of the existing loan repayment date.

   <u>Vote:</u>

0860 / 7730 Board of Equalization / Franchise Tax Board

Departments and Budgets Overview: Descriptions of Board of Equalization (BOE) and Franchise Tax Board (FTB) and their budgets are provided under Discussion / Vote items.

Item Proposed for Vote Only:

1. **Budget Change (Staff Issue):** Prior to the current budget year, California was a member of the Multistate Tax Commission (MTC), a multistate organization that provides information on state tax issues, facilitates cooperation in compliance and enforcement efforts, provides model legislation, and coordinates litigation efforts affecting states. SB 1015, adopted as part of the 2012 Budget Act, repealed all provisions related to the Multistate Tax Compact (which addressed the apportionment of income of multistate companies), among other provisions. The repeal of the Multistate Tax Compact ended California's participation as a voting member of the executive committee of the MTC. California's dues as a member of the MTC were roughly $540,000, evenly split between BOE and FTB.

   Staff Comment: California's membership (and dues obligations) ended as of the effective date of SB 1015. These funds have been reapplied, according to both tax agencies, to other activities. Given that both agencies reverted significant resources in 2011-12 and the funds freed-up through the deactivation of the state's MTC membership were never redirected by legislative action, the committee may want to consider having resources for this activity removed from the current year budget and in the 2013-14 budget and ongoing. If the state reactivates its membership, the agencies could request an augmentation

   Staff Recommendation: Approve action to reduce current year budgets for BOE and FTB by $270,000 for each agency, and reduce the 2013-14 budget and ongoing by an equivalent amount.

   <u>Vote:</u>

9600 Bond Extinguishment

Item Description: The Constitution authorizes the Legislature, at any time after the approval by the voters of a law authorizing the issuance of bonded indebtedness, to reduce the amount of the indebtedness authorized by the law to an amount not less than the amount contracted at the time of the reduction. Existing law authorizes departments of the state to issue certain securities for facilities in the Capital Area Plan.

Item Proposed for Vote Only:

1. **Bond Extinguishment and Bonding Authority Reduction (Budget Trailer Bill):** The Governor's Budget proposes trailer bill language that would reduce the amount of bonded indebtedness authorized under the Public Education Bond Act of 1996 by $12.9 million. The budget trailer bill would also repeal the authority of the Director of General Services and the Public Works Board to issue up to $391 million in financing securities for facilities in the Capital Area Plan.

   Staff Comment: Staff has no concerns with this proposal.

   Staff Recommendation: Approve placeholder trailer bill language.

   Vote:

Proposed Discussion / Vote Calendar:

9600 General Obligation Bonds and Commercial Paper

Item Overview: Expenditure of bond proceeds is reflected in the budgets of individual departments, with the payment of bond debt service consolidated in Item 9600 in the Governor's Budget. It is the repayment of bond debt that is reflected as a General Fund expense. Some bond costs are offset by special funds or federal funds. Other bonds are 'self-liquidating,' or have their own dedicated revenue source for debt service. For example the Economic Recovery Bonds (ERBs) receive a quarter-cent of the sales tax as a component of the 'triple flip' enacted as part of the 2004 budget package.

Budget Overview: The Governor's Budget includes $5.1 billion in General Fund costs for General Obligation (GO) bond debt service and related costs, or a total of $6.5 billion when the debt service costs of the ERBs are included. In addition to this amount, $1.1 billion in debt costs are scheduled to be funded from special funds. Finally, federal bond subsidies, through the Build America Bonds (BABs) program, will provide $352 million in 2013-14 providing for a reduction in General Fund expenses. The Governor's proposed budget includes $98.5 billion in General Fund available resources (not including carry-over balances), so the net General Fund bond debt service as a percentage of General Fund resources is about 5.0 percent.

Governor's Budget for GO Bond Debt
(Dollars in Millions)

Category	2011-12 Actual Cost	2012-13 Estimated Cost	2013-14 Forecasted Cost
General Fund cost	$4,390	$4,292	$5,071
Other funds cost	894	765	1,082
Federal subsidy (Build America Bond Program)	300	352	352
Total Debt Service	**$5,584**	**$5,409**	**$6,505**
Economic Recovery Bonds (ERBs, not included above because indirect GF cost)	$1,025	$1,399	$1,543

The ERBs are not included directly in General Fund costs for bond debt service. As noted above, repayment of those bonds is financed from a quarter cent sales tax that was temporarily redirected from local government. Local government revenue is backfilled through a diversion of property tax revenues and an increase from the state General Fund in Proposition 98 education funding. The Governor's Budget reflects special fund expenditures of $1.5 billion for ERB debt service in 2013-14, and the Proposition 98 budget reflects increased General Fund expenditures of $1.5 billion.

Background: The state uses GO bonds to borrow funds for spending—primarily for infrastructure and other capital investments. Bonds must be approved by voters and bond proceeds are either continuously appropriated (immediately available for expenditure) or require an appropriation from the Legislature. All bond debt service is continuously appropriated and, therefore, not scheduled in the annual budget bill. According to the State Treasurer's Office, the state has $79.6 billion in outstanding GO bond debt (including self-liquidating bonds such as the ERBs). Another $33.2 billion in bonds is authorized, but remain unissued. In most instances, bonds are sold at different lengths of maturity such that repayment is spread over about 30 years. The chart below indicates the authorized but unissued reservoir of bonds.

General Obligation Bonds Authorized and Not Issued
(Dollars in Millions)

Authorized Bond Program	Unissued Amount
Prop 1B of 2006: Transportation	$10,275
Prop 1A of 2008: High-Speed Rail	9,449
Prop 55 of 2004 & Prop 1D of 2006: Education Facilities	2,442
Prop 84 of 2006: Safe Drinking Water	2,957
Prop 71 of 2004: Stem Cell Research	1,767
Prop 1E of 2006: Disaster Prep and Flood Prevention	1,819
Prop 46 of 2002 & Prop 1C of 2006: Housing	1,259
All other	3,240
Total	**$33,208**

The state generally goes to market to sell GO bonds twice annually—once in the spring and once in the fall. Bond structures are often tailored to meet market demand and investor appetite. This tailoring includes adjusting variables such as fixed and variable rates, call features and premiums, and various security enhancements. Bonds are sold in amounts necessary to meet expenditure needs plus an additional cash cushion to account for flexibility regarding how fast projects will expend funds and uncertainty about the timing of the next bond sale.

Paying GO bond debt is a significant General Fund expense; however, the use of bonds to accelerate capital projects is a commonly-used practice of government entities. State and federal tax exemptions for interest income received by investors ensure that GO bond debt is a low-cost financing alternative. To the extent bond costs do not exceed a government's long-term ability to fund other commitments, bonds allow the public to enjoy the benefits of infrastructure investment more quickly than would otherwise be the case. The LAO indicates that the state's debt service requirements will climb steadily over the next several years to about $7.3 billion in

2017-18. As a percent of General Fund revenues, however, debt service should remain at about the 6.0 percent level.

Voters approved over $40 billion in new bonds on the 2006 ballot, just prior to the national recession. The bonds have allowed the state to invest in infrastructure while the need for economic stimulus is most acute, borrowing costs are low, and construction procurement is favorable. Despite the benefits of bonds, they come with the cost of many years of debt service. A $1.0 billion bond generates annual bond debt costs of about $65 million over a 30-year period. That bond cost crowds out alternative expenditures over the life of the bond. The Legislature can prioritize or limit bond funding through the budget process as overall expenditures are prioritized. This question may be particularly acute as the economy begins to recover and interest costs climb as result of increased demand for capital.

Items Proposed for Discussion / Vote:

1. **Bond Sale and Cash Plan for 2013-14 (Governor's Budget Proposal):** The budget plan includes an assumption that $3.7 billion in GO bonds will be sold in the spring of 2013, and that $2.0 billion more will be sold in the fall of 2013. Among these are the planned sales for transportation and related capital facilities and for various education facility bonds. Subsequent to the Governor's Budget, the spring issuance was reduced to $2.7 billion. The issuances will comprise both bond originations and refinancings.

   Detail: As the state's cash situation deteriorated with the most recent recession, the Administration changed the methodology for managing bond cash. Prior to the recession, reserve cash funded project costs in advance of bond sales, and then bond sales replenished cash reserves. When reserve cash declined, the state had to instead sell bonds in advance of expenditures. Due to project expenditures occurring slower than anticipated at the time of bond sales, large bond cash balances developed—about $9.7 billion as of December 2011. Last year, the Administration implemented a plan to utilize commercial paper to aid cashflow, and reduce the need to carry large bond cash balances. Progress has been made to reduce bond cash, and the cash reserves have dropped to about $6.0 billion currently. At budget hearings, the Administration could be asked to discuss their management of bond proceeds, forecasts of project expenditures and the optimal level of cash balances. Cash balances are shown in the table below.

General Obligation Current Cash Proceeds
(Dollars in Millions)

Authorized Bond Program	Bond Proceed Cash November 2012
Prop 1B of 2006: Transportation	$1,026
Prop 1E of 2006: Disaster Prep and Flood Prevention	1,187
Prop 84 of 2006: Safe Drinking Water	951
Prop 1C of 2006: Housing	633
Prop 1D of 2006: Public Education Facilities	611
Prop 50 of 2002: Water Security	458
Prop 13 of 1996: Clean Water and Watershed	223
All others	916
Total	**$6,005**

Staff Comment and Questions: While funding for bond debt service is continuously appropriated, a broader discussion on GO bonds may be useful to understand the Administration's priorities and help inform future discussion on individual bonds and expenditure plans. The Administration should be prepared to discuss their overall plan for GO bonds in 2013-14. Individual bonds will be discussed in more detail by subject matter in this subcommittee and other subcommittees as hearings progress this spring.

Questions: *(1) Is bond cash sufficient to fund all bond projects appropriated by the Legislature, or are some projects on hold due to insufficient bond cash or other reasons? (2) Are cash expenditure projections for bond projects being met? If not, can planned 2013 bond sales be adjusted to reduce the General Fund debt service cost in 2012-13? (3) Does the Administration support appropriations for unissued bonds, or does the Administration want to curtail any bond programs to preserve General Fund resources? (4) The Treasurer recently indicated that bond refinancings have saved the state $200 million; have these savings been incorporated in the budget?*

Staff Recommendation: Informational item. Bring the issue back at a future time if the Administration substantially revises their bond plan as part of the May Revision.

2. **Infrastructure Financing and Debt Service Capacity (Governor's Budget Proposal):** The Governor's Budget proposes bond sales in the spring and fall of 2013. The issuance of authorized bonds on a consistent basis over the next few years would keep debt service requirements in the range of 6-7 percent of General Fund revenues. Beginning in 2015-16, debt service requirements as a percent of General Fund revenues would begin to drop without additional bond issuances. However, significant infrastructure needs are apparent throughout the

state which must be addressed through additional bond authorizations, on a pay-as-you-go basis, or some alternative means of financing.

Detail: The state's capital needs related to new infrastructure and maintenance are significant, and the state has struggled to keep up with the backlog of projects through the bond program. On the transportation side alone—a significant proportion of the total—the California Transportation Commission (CTC) has identified $538 billion in in total infrastructure needs, including $172 billion in highway and intercity rail needs. A transportation workgroup is expected to explore long-term funding options, including pay-as-you-go, as a means of financing needed projects. Over the last decade, pay-as-you-go provides about one-third of infrastructure spending.

In addition, the Administration will release the 2013 Five-Year Infrastructure Plan later this year. The plan is expected to lay out the Administration's infrastructure priorities for the next five years for major state infrastructure programs, including high-speed rail and other transportation projects, resource programs, higher education, and K-12 education. Given the state's increased debt burden and General Fund constraints, the plan will examine agencies' reported needs assessments, analyze the use of General Fund-backed debt, and explore alternatives to the reliance on voter-authorized GO bonds. The Legislature could balance the various options according to a matrix of considerations including financing costs, ease of implementation, project flexibility and assumed risk.

Staff Comment and Questions: The Administration should be prepared to discuss the affordability of the state GO bond plan and the ability of the state's General Fund to continue at the current level—or any future increased level—of debt service requirements given other demands on the General Fund. This additional debt could include the discussed water bond. It should also discuss the status of the infrastructure plan and the different types of financing options that are being considered. Finally, sequestration has occurred and there will be an impact of federal debt service subsidies through the Build America Bonds (BABs) program, the impact of which should be addressed by the administration or the Treasurer's Office.

> *<u>Questions:</u> (1) What is the status of the infrastructure plan? (2) Can the Administration address the options for funding that might be considered under the plan? (3) What affect, if any, will sequestration—or other upcoming potentially negative federal events—have on the state's debt service plans?*

Staff Recommendation: Informational item.

9620 Cash Management and Budgetary Loans

Item Overview: This budget item appropriates funds to pay interest costs on General Fund borrowing used to overcome cash flow imbalances during the fiscal year. Because receipts and disbursements occur unevenly throughout the fiscal year, the General Fund borrows in most years, even though each budget is balanced when enacted, and funds are repaid within the fiscal year. Interest is paid on both internal borrowing, such as short-term loans from special funds, and for external borrowing, such as Revenue Anticipation Notes (RANs). This item additionally pays interest costs for budgetary borrowing by the General Fund from special funds. Budgetary borrowing is across fiscal years and is scored as a budget solution, whereas cashflow borrowing is not counted as a budget solution, but conducted in order to maintain adequate cash reserves.

Budget Overview: This item appropriates funds for interest costs associated with cashflow and budgetary borrowing. The budget includes $150 million General Fund for the interest costs associated with two cashflow borrowing methods—$100 million for the RAN and $50 million for internal borrowing costs. The proposed amounts are conservative and based on budgeting sufficient funds to cover the uncertainty in interest rates and other factors. In addition, the budget includes $31.5 million in interest costs associated with the repayment of internal budgetary borrowing from special funds.

Items Proposed for Discussion / Vote:

1. **Cashflow Borrowing (Governor's Budget Proposal).** The Governor's Budget proposes both internal and external cashflow borrowing. Generally, internal sources are assessed first, and external borrowing is used to supplement internal sources. In order to supplement the state's internal borrowing within the budget year, the Administration has proposed a RAN initially sized at $7.0 billion. This provides an additional cashflow cushion to the existing availability of internal resources. Without the external borrowing, there would be insufficient cash reserves and other funds during the months of October, November, December and March. In addition, there would be only a narrow 'cushion' during several other months in the fiscal year.

   Background and Detail: Given that the state receives revenues on an uneven basis throughout the year, the state's cash position varies, with the typical low points occurring in July, October and November. Maintaining an adequate cash balance allows the state to pay its bills in a timely fashion. For the current year, the state issued Series A and B RANs in August, sized together at $10 billion. The RANs are payable in May and June and carry an expected interest cost of $48 million. With regard to internal borrowing, last year, an additional eight special funds were made eligible for cash borrowing, which provided about $865 million of new borrowable resources. The state also established a new cashflow tool in the form of the Voluntary Investment Program (VIP). This program provided an additional means to assure cashflow continuity by establishing a new account for voluntary participation by local governments, but it was not required in the current year. Another cash management tool of the state is the State Agency Investment Fund (SAIF) which attracts deposits from entities not otherwise required to deposit funds with the state. During the current year, there were deposits totaling approximately $1.7 billion combined from University of California (UC) and the California State University (CSU) systems.

An additional tool in managing cash is deferrals of payments within the fiscal year to higher education, K-12 education, local governments, and other entities. In recent years, flexible deferrals have been enacted in statutes that allow specified deferrals if necessary to maintain a prudent balance for bond debt and other priority payments. For the current year, there were deferrals allowed for K-12 education, higher education and local government payments. The fiscal impact of these deferrals varies from entity to entity depending upon their own cash positions. Fortunately, given the improvement in the cash status, no new education or other payment deferrals are incorporated in the budget.

Based on the cashflow statements of the Administration, the cash low-points will occur in July, October and November, when unused borrowable cash resources are estimated to be $3.7 billion, $4.3 billion and $4.0 billion respectively. By way of comparison, and reflective of the uneven flow of receipts and disbursements, the cash and borrowable resources in June of this year are estimated to be $11.0 billion.

Staff Comment and Questions: Maintaining an emphasis on cashflow borrowing from internal sources is sound fiscal policy that reduces the need for more expensive external borrowing. The Administration's proposal appears to be a suitable approach to cashflow management and the anticipated reduction in the size of external borrowing will reduce the state's interest costs. Nevertheless, the reduction in borrowing does result in a significant decline in the cash cushion during some months compared to the current year. The committee may want to receive additional details from the Administration regarding cashflow borrowing. The Administration should be prepared to address the cost of external borrowing, the timing of the issuance, and the adequacy of cashflow coverage.

Questions: *(1) Current cashflow analysis in the budget year shows smaller margins in certain months than the current year; are the margins adequate? (2) What are the options for the state should the margins narrow further?*

Staff Recommendation: Informational item.

2. **Budgetary Borrowing Repayment Plan (Governor's Budget Proposal):** The Governor proposes to pay down $4.2 billion of the remaining $27.8 billion "wall of debt" in 2013-14. In addition, the Governor's multi-year budget plan proposes to

almost fully repay "wall of debt" obligations by the end of 2016-17. The amount remaining at the end of that period would be unpaid education and local government mandate costs, deferred Medi-Cal costs, and deferred state payroll costs, totaling approximately $4.3 billion. Assuming this plan is adhered to, the 2017-18 budget and ongoing budgets would be largely free of these debt pressures and expenditures would be more in line with annual revenues.

The amount of special-fund loans proposed for repayment in the Governor's Budget is $561 million, plus total interest costs of $31.5 million. The Administration indicates repayment of these loans is necessary to support 2013-14 activities of those departments that are paid for with the associated special fund resources. Interest is required on most special fund loans and is paid when the principal is repaid. Funds proposed to be repaid are listed in the table below.

Governor's Proposal for Repayment of Special Fund Loans
(Dollars in Millions)

Affected Department and Special Fund	Principal Amount
Justice—National Mortgage Special Deposit Fund	$100.0
Consumer Affairs—Real Estate Appraisers Regulation Fund	8.1
General Services—Public School Planning, Design and Construction Review Revolving Fund	15.0
Transportation—State Highway Account, State Transportation Fund	50.0
Energy Commission—Renewable Resource Trust Fund	20.0
Resources—California Beverage Container Recycling Fund	89.4
Resources—Glass Processing Fee Account	39.0
Resources—PET Processing Fee Account, California Beverage Container Recycling Fund	27.0
Agriculture—Department of Food and Agriculture Fund	15.0
Public Utilities Commission—Utilities Reimbursement Account	25.0
Public Utilities Commission—California High Cost Fund B Administrative Committee Fund	75.0
Public Utilities Commission—California Advanced Services Fund	75.0
Other Departments, Funds and Accounts	22.9
Total	**$561.4**

Background and Detail: Through budget actions over the last decade, the state has borrowed from special funds and deferred various payments in order to close budget deficits. By the close of 2010-11, the Department of Finance (DOF) indicates a total of $34.7 billion in loans and deferrals had accumulated and remained unpaid. This amount largely represents the debt overhang from prior year budgets adopted under the previous Administration. By 2012, this amount had been whittled down to $33.0 billion and by the end of the current year, is expected to be reduced further to $27.8 billion. Special fund loans constitute $4.1 billion of the remaining $27.8 billion "wall of debt" at the end of this year. The repayment of loans from special funds is discretionary. As long as the borrowing does not interfere with the activities that the special fund supports, the repayment of these loans is on a flexible schedule.

Some obligations included in the "wall of debt" have required repayment in specified years due to constitutional requirements or to scheduled bond debt service. Examples of rigid remittance requirements are a payment of $1.9 billion scheduled for June 2013 for 'Proposition 1A' local-government borrowing and annual Economic Recovery Bond (ERB) payments of approximately $1.5 billion through 2016-17. Other debt payments are more flexible, for example school payment deferrals and special fund loans can be repaid over time as the budget situation allows. The Administration indicates that the plan for paying off the wall of debt corresponds to the period that the temporary taxes are in place.

Staff Comment and Questions: Generally, decisions about special fund loans will be made in the budget subcommittees by subject-matter area, although the 9620 Budget Item should be made to conform. A high-level staff review of the proposed loan repayments and fund condition statement suggests some of the loans proposed for repayment could be deferred for additional budget savings in 2013-14, if necessary. Alternatively, some fund repayments could be adjusted such that loan repayments from other funds, such as transportation, could be accelerated. Some departments may have deferred capital projects or maintenance that can be accelerated by early loan repayments. Other departments may not have spending pressures, and funds from repaid loans may result in surplus reserves over a period of many years.

The committee may want to hold final determination on loan repayments until the May Revision when final revenue forecasts are known. The Administration should be prepared to discuss their overall plan for special fund loan repayment for the remainder of 2012-13 and for 2013-14.

> *<u>Questions:</u> (1) How did the Administration determine which loans should be repaid and which should be deferred? (2) When a decision was made to repay a certain special fund, how was the repayment amount determined? (3) Given significant "wall of debt" progress in other areas of the budget, why does the Administration propose to repay special funds loans in 2012-13 and 2013-14 beyond the level that appears necessary for certain special funds?*

Staff Recommendations: Informational item.

8860 Department of Finance

Department Overview: The Department of Finance (DOF) is the state's fiscal control agency and acts as the Governor's chief fiscal policy arm.

Budget Overview: The Governor Budget proposes expenditures of $69.2 million and 492.8 positions compared to expenditures of $68.7 million and 486.2 positions in the current year.

Item Proposed for Discussion / Vote:

1. **Direct Transfer Authority for Cost of Department of Finance Services (Budget Trailer bill):** The Governor's Budget proposes trailer bill language that would facilitate and expedite the ability of DOF's Office of State Audits and Evaluations (OSEA) to carry out financial, performance and compliance audits and evaluations, as well as special products. The proposed trailer bill would eliminate the requirement that DOF execute an interagency agreement for each project approved by the Department of General Services (DGS), and instead allow for so-called direct transfer authority to DOF.

   Background: OSEA conducts numerous important audits and studies throughout the years. Some of the more recent ones have involved former redevelopment agencies and their successor agencies, the Department of Parks and Recreation, the California Public Utilities Commission, Cal Fire, and various special funds. The activities are reimbursable, as required under statute, and OSEA charges the agencies and departments for direct and indirect costs of the services provided. Currently, the interagency agreement must be completed before OSEA begins work, which can add to delays in starting the project.

   Staff Comment and Questions: DOF notes that the process for entering into an interagency agreement can be lengthy—sometimes several weeks or months can elapse before one is in place. Collecting amounts owed following the activity is also cumbersome and administratively burdensome. Under the proposed language, OSEA would still agree on a scope of work with the agency or department and DOF indicates that it would work with legislative staff in scoping audits requested by the Legislature. OSEA has been called upon with increasing frequency in recent years, often for studies that need to be completed quickly.

   <u>*Questions:*</u> *(1) Given that DGS is being eliminated as a participant in the OSEA activities, should there be another control point for the process? (2) Is there a need to formalize the process in terms of scoping or notification regarding the selected project?*

   Staff Recommendation: Approve placeholder trailer bill language.

   <u>Vote:</u>

Control Section 35.5 General Fund Revenues Accrual Methods

Item Overview: Budget Control Section 35.5 defines total resources available to the General Fund for a fiscal year before any transfer to the Budget Stabilization Account for purposes of Paragraph (1) of subdivision (f) of Section 10, and subdivision (g) of Section 12, of Article IV of the California Constitution.

Item Proposed for Discussion / Vote:

1. **Net Final Payment Accrual Methodology (Governor's Proposed Budget Trailer Bill).** The Governor's Budget proposes making permanent the accrual method adopted as a part of the 2012 Budget Act. Specifically, the Administration proposes that the Legislature enact a budget trailer bill to codify permanently the use of this new accrual method. The proposed trailer bill would direct DOF to use the estimated net final payment accrual methodology for tax revenues accrued under any *initiative* measure enacted on or after January 1, 2012. In effect, the measure would require use of the "estimated net final payment accrual methodology" for initiative measures passed in 2012 or thereafter, including Propositions 30 and 39. This is consistent with how DOF treats revenue accruals in the Governor's Budget. The new accrual method for Propositions 30 and 39 and subsequent initiative tax changes means, for example, that each calendar year's Proposition 30 collections will be attributed in part to the fiscal year that ends on June 30 of that calendar year with the rest attributed to the fiscal year beginning on July 1 of that calendar year. For instance, a portion of tax year 2013 Proposition 30 revenues would be accrued to the 2012-13 fiscal year as the first fiscal year for 2013 tax collections, with the rest accrued to 2013-14 as the second fiscal year for 2013 tax collections.

   Background: In past years, in an effort to address budgetary stress, the state has shifted accrual methodologies for certain revenues, resulting in changes as to how revenues are attributed across fiscal years. The state's accrual methodology was originally adopted in 1966; however, in 2008, these rules were changed by shifting tax revenues that would otherwise have been attributed to 2009-10 to 2008-09, instead. Last year, as part of the Budget Act of 2012, Control Section 35.5 (e) directed that a significant portion of revenues derived from new tax laws enacted in 2012, including from Propositions 30 and 39, be accrued to 2011-12 instead of 2012-13 (even though the measures were passed after the conclusion of 2011-12). This approach is referred to by the administration as "net final payment accrual methodology." Accrual method changes, such as this one, do not change the amount of revenue collected or assumed to be collected by the state, but instead change the fiscal years to which revenue is attributed in the state's budgetary-legal basis accounting system.

   LAO Perspective: The LAO has recommended against the adoption of the proposed budget trailer bill and cited several factors, including added complexity of the state's budgeting system, especially Proposition 98 calculations, and increased chances of large forecasting errors. Nevertheless, the LAO recommends that, given the significant budgetary changes that would be required to undo the net final payment accrual method immediately, the Legislature authorize this accrual method in Control Section 35.5 in each annual budget act until a replacement accrual method is adopted. The office also has specific suggestions regarding adoption of an alternative accrual methodology.

Staff Comment: The Administration's proposal does not appear to treat revenues on a consistent basis with respect to accrual methodology, and has, as a means of delineation, employed a somewhat arbitrary reliance on the origin of the tax law change. In addition, as the LAO notes, the proposal complicates forecasting and revenue estimates and Proposition 98 calculations. These aspects are particularly problematic with respect to budgetary considerations subject to legislative deliberations. Leaving in place existing accrual methodology for the budget year, while embarking on a broader approach to accrual methods, would seem an appropriate approach. The committee should ask that the Administration present its trailer bill proposal and ask LAO to comment on the merits and drawbacks.

Staff Recommendation: Do not adopt the net final payment accrual methodology in the Administration's proposed trailer bill; adopt budget bill (BBL) language to allow for final payment accrual methodology until a suitable permanent approach is determined.

Vote:

7730 Franchise Tax Board

Department Overview: The Franchise Tax Board (FTB) is one of the state's two major tax collection agencies and administers the personal income tax and the corporation tax programs, the largest and third-largest contributors to the state's revenue, respectively. The department also performs some non-tax collection activities, such as the collection of court-ordered payments, delinquent vehicle license fees, and political reform audits. The FTB is governed by a three-member board, consisting of the Director of Finance, the Chair of the Board of Equalization, and the State Controller. An executive officer, appointed by the board, manages the daily functions of the department.

Budget Overview: The Governor's Budget proposes expenditures of $750.2 million ($719.1 million General Fund) and 5,771 positions for FTB. This represents a continuation of substantial increase in support for the agency compared to the 2009-10 fiscal year. Expenditures grew from $533.1 million in 2009-10 due primarily to reinstating some of the budget reductions from earlier years as well as new programs. The budget reinstatements were made to reverse negative revenue impacts of the prior Administration's statewide cuts and furloughs, which included the state's tax collection agencies. In addition, the budget calls for augmentations for specific tax compliance programs and technology improvements related to the department's revenue collection activities.

Items Proposed for Discussion / Vote:

1. **Departmental Reorganization (Informational Item):** Last year, as a component of the Governor's initiative to make government more efficient, the current budget includes two significant changes that will affect the department's way of doing business. First, it called for consolidating the activities of the Employment Development Department (EDD) that relate to tax collection (primarily personal income tax withholding and payroll tax administration) with FTB activities into a new California Department of Revenue (CDR). In general, this could make sense in an organizational context as well as increase the level of information exchanged among the various programs. Some concerns relate to the potential of impairment of activities during the consolidation and the ease with which activities of EDD can be split off from other functions that are not part of the consolidation.

   The second major change is to include this new CDR in the newly-proposed Government Operations Agency (GOA). The GOA would combine activities related to procurement, information technology, human resources and administration and include General Services, Human Resources, Technology, Office of Administrative Law, the Public Employees Retirement System, State Teachers Retirement System, State Personal Board, Government Claims Board, and DOR.

Staff Comment: The major reorganization is effective July 1, 2013 as part of the Governor's Reorganization Plan #2. The committee members may inquire of the department or DOF the procedures to be used for the consolidation and reorganization and the timeline for the process relating to the proposed CDR. In addition, the department should be prepared to discuss the advantages that may be realized in the reorganization. For example, the Governor's Budget incorporates an additional $3.8 million in tax collections by FTB and EDD as part of additional data sharing resulting from increased cooperation. The committee could inquire as to other opportunities either with EDD or the Board of Equalization (BOE), the state's other major tax collection agency.

Staff Recommendation: Informational item.

2. **Tax Gap Related Policies (Informational Item):** The tax gap is defined as the difference between what taxpayers should pay according to law and what is actually remitted. The tax gap is the result of non-compliance with the state's tax laws, either through intentional disregard or unintentional means. The presence of the tax gap puts an additional strain and burden on compliant taxpayers since, if all individuals and businesses complied, taxes for compliant taxpayers could decline and still result in generating the same amount of revenue for the state. The FTB estimates the current annual tax gap to be $10 billion ($8 billion personal income tax and $2 billion corporation tax)—or roughly 15 percent of total taxes that should be collected from these sources.

   FTB pursues various programs to narrow the tax gap. Some of these programs focus on taxpayer education and seek additional compliance from those who may not be aware of certain tax requirements. Other measures relate to enforcement efforts to improve compliance among individuals and businesses that chose not to comply with the state's tax laws. These measures result in additional revenue for the state that would otherwise not be received. Equally central to the core value of good tax collection practices is that such efforts make the tax system fairer to everyone by distributing the burden according to adopted laws.

   In general, the efforts and programs of FTB are designed to address the following components of the tax gap:

   - Non-filers—Entities that simply avoid filing required income tax forms.
   - Under-reporters/Over-reporters—Entities that under-report the amount of income or over-report income deductions or tax credits.
   - Non-Payers—Entities that file but do not remit tax owed.

   Tax enforcement and compliance has become increasingly driven by information, data, and technology over the last couple of decades. The FTB processes more than 15 million personal income tax returns and one-million business enterprise returns annually. Given the volume and complexity of tax returns, filings and programs, it has become imperative that tax agencies remain current in information technology in order to access and exchange information. FTB's operations are heavily reliant on effective storage and use of data from a variety of sources, in order to maintain adequate compliance and enforcement activities. The FTB has made significant progress in this area, and this continues to be a focus of its activities (see discussion under Enterprise Data to Revenue issue). These efforts can also have a positive impact on reducing the tax gap.

Staff Comment: The department should provide background information to the committee regarding the status of tax gap efforts. This should include results from discreet programs as well as general successes in narrowing the tax gap through increased data sharing and advances in technological capabilities. The LAO should provide comments regarding the department's efforts in this regard and any additional measures that the department could take to improve compliance.

Staff Recommendation: Informational item.

3. **Section 1031—Like-Kind Exchanges (Staff Issue):** California's income laws provide for "like-kind exchanges," which allow the owner of qualified business or investment property (such as a building or equipment) to sell the property and purchases other similar property. When the newly-acquired property is sold, the deferred gain on the original property is then subject to taxation. In this manner, the program acts as a means to defer the gain on the sale of property. Qualified property does not include property used for personal purposes (e.g., home or family car), property sold by a business (e.g., inventories), specifically excluded property (such as securities), and certain other types of property. California conforms to federal law with respect to this program.

   Program Detail: There are significant policy and revenue implications of the program. The like-kind exchange program facilitates exchanges of business assets and allows owners of exchanged property to keep the full value of exchanged property invested in their businesses. Without the program, some otherwise productive transactions might not be undertaken in order to avoid having any resulting gains subject to taxation. Thus, the program could facilitate a more efficient use of productive assets by allowing such exchanges to occur *ex tax*. By allowing investors to retain the lower basis in the property, the tax gains deferral in like-kind exchanges can increase the revenue loss of the "step-up" provision of the estate tax. The step-up provision allows the basis of inherited property to increase for tax purposes to its fair market value at the time of death of the original owner. In addition, if the property owner exchanges California property for non-California property, California may never tax the full amount of the gain on the California property because of the inability to ensure income tax compliance with respect to any gain on a sale by a non-resident. Like any other deferral, to the extent taxes are finally imposed, no consideration is given regarding the loss of the use of revenues between the time of the transaction and the date the taxes are paid.

Alternative Approaches: The loss of revenues due to compliance issues associated with out-of-state, like-kind exchanges is substantial. FTB indicates that if the like-kind exchange were limited to in-state exchanges, the revenue gain would be $110 million to $130 million annually. However, some analysts have raised the prospect that limiting like-kind exchanges to in-state properties may raise constitutional issues, in that it may result in disparate treatment of in-state and out-of-state businesses activity and interfere with interstate commerce.

Alternative means by which to address the tax avoidance associated with out-of-state like-kind exchanges have been suggested, including:

- **Holding Period.** Require a holding period on purchased or exchanged property. This would restrict flipping of investment property and reduce the attractiveness of tax avoidance.
- **Reporting Requirement.** Establish an annual reporting requirement for taxpayers who engaged in a like-kind exchange. Similar annual reporting is required of insurance companies regarding the transfer of certain assets, and reporting is required by some states.
- **Deposit Methods.** Institute withholding of capital gains taxes for like-kind exchanges. Alternatively, require the posting of a bond or allowing the state to establish a property lien.
- **Data Collection.** Pursue information and enforcement of like-kind exchanges with federal and state governments to track the event and location of capital gains realizations.

LAO Perspective: In prior years, the LAO has urged the elimination of the like-kind exchange either in whole or in part. As part of its review of the 2008-09 budget, LAO called for limiting the like-kind exchange to in-state properties only. Subsequently, as part of its 2009-10 budget analysis series, LAO recommended a total elimination of the like-kind exchange.

Staff Comment and Questions: This issue is not a proposal of FTB or the Administration. There is an active market of brokers putting together parties interested in like-kind exchanges in order to avoid or defer taxation. For example, see the listing for the “Professional Trade Association for Qualified Intermediaries under IRC Section 1031”, under the umbrella of the Federation of Exchange Accommodators. The like-kind exchange can happen repeatedly and need not be on a one-for-one basis; like-kind exchange of property only partially used for business is also allowed, although in this case only the gain related to the business portion of the property would be deferred. If California were to alter its treatment, depending on the approach, it could be out of conformity with federal law and potentially add substantial additional record keeping requirements for business. Separate property sales and purchase records would need to be maintained for state and federal purposes. FTB staff and LAO should comment on the policy and legal implications of either full elimination or partial elimination of like-kind exchanges, or other means of ensuring compliance. In particular, they should comment on advantages and disadvantages of alternatives to address non-compliance resulting from this program, including the holding period and reporting options identified above.

<u>Questions:</u> (1) What is the most efficacious approach California could pursue to stem the revenue loss from in-kind exchanges? (2) Is this approach potentially in conflict with Constitutional protections with respect to interstate commerce? (3) How would you assess the value of the reporting requirement--what is the likely compliance with this and what would be the enforcement options?

Staff Recommendation: Hold open and direct staff to pursue various options for tax compliance with respect to in-kind exchanges, including measures designed to collect the correct amount of tax related for out-of-state in-kind exchanges.

<u>Vote:</u>

4. **Civil Proceedings—Limit on Attorney Fees (Budget Trailer Bill):** The Governor's Budget proposes in a budget trailer bill to limit the means through which attorneys may be compensated in suits against the state involving taxation. The statutory change would affect taxes administered by both the FTB and the BOE. Under the bill, the provisions in the tax laws applicable to personal income tax, corporate franchise tax, and sales and use taxes, regarding prevailing party and reasonable litigation costs would be the exclusive means by which litigation costs and attorneys' fees may be awarded against the FTB and the BOE. These provisions would generally be extended to property taxation and other taxes and fees administered by BOE. The provisions would limit fees to $160 per hour (adjusted on the basis of changes in the California Consumer Price Index) unless the court determines that a special factor justifies a higher rate.

   Background: Current state law provides two methods for determining attorney's fees in tax related cases: the Revenue & Taxation Code (R&TC) which caps attorney's fees at an hourly rate, and the Code of Civil Procedure which uses a multiplier to determine attorney's fees. The proposed change in statute would place the state in virtual conformity with the federal government by limiting fees to those determined under the R&TC. Current federal law provides similar provisions to the state R&TC for capping attorney's fees for parties that prevail against the Internal Revenue Service (IRS). The Administration notes that over $2 million in fees have been paid on four cases over the last 10 years under the Code of Civil Procedure.

LAO Perspective: LAO notes that the proposal may foreclose the option of highly qualified tax counsel based on hourly fee limitation. In addition, it notes that the change may have an effect on limiting suits which have a legitimate public purpose.

Staff Comment and Questions: The proposal would not limit, in any way, the ability of taxpayers a taxpayer's right to file a claim for refund for any tax and only regulates the way they pay unrelated third parties seeking refunds on their behalf. In addition, the provisions would not disallow contingency fee structures, but rather address the fees that could be paid under such plans. The proposal apparently addresses a drafting error from 1983 when the state intended to conform to federal law requiring all attorneys' fees related to tax cases to be awarded under the R&TC with an hourly cap versus under the Code of Civil Procedure. Nevertheless, the fee limit could serve to discourage suits that may have a substantial public purpose in clarifying or correcting existing law and regulation.

> <u>*Questions:*</u> *(1) How was the $160 hourly fee limit determined? (2) Is this below the standard for quality tax counsel, and if so, should the fee limit be increased? (2) What might be the special circumstances under which this fee could be increased by the courts? (3) Is this the means by which suits that have a public purpose would still be able to be brought?*

Staff Recommendation: Hold open and direct staff to work with Administration in potential refinements to the proposed trailer bill.

<u>Vote:</u>

5. **Enterprise Data to Revenue Project (Governor's Budget BCP#1).** FTB processes more than 15 million personal income tax returns and one million business enterprise returns annually. Its operations are heavily reliant on effective storage and use of data from a variety of sources. This request is for a third year of funding for its Enterprise Data to Revenue (EDR) Project, which will address the agency's return processing and utilization of data and connect various systems. The request calls for $152.1 million General Fund and 184 permanent positions in 2013-14. The request includes conversion of 26 positions associated with the project from limited-term to permanent. In addition, the proposal includes a placeholder for the department's project needs in 2014-15 of $87.6 million and 36 positions. Of the $152.1 million in 2013-14, $133.5 million is for a vendor payment (for 2014-15, the vendor payment is $68.5 million). EDR is a fixed-price, benefits-funded project in that timing of the vendor payment is contingent on the state receiving additional revenues attributable to the project. Because of flexibility inherent in the contract structure, FTB is requesting encumbrance and expenditure authority for a portion of the 2013-14 vendor payment until 2014-15.

Anticipated revenue attributable to EDR is $261.6 million in 2013-14 and $684.6 million in 2014-15.

Detail of Project: EDR will replace several older FTB information technology systems and streamline other existing systems. Over the long term, the project is expected to generate and safeguard significant state revenues in the high hundreds of millions of dollars. As a result of certain components coming on-line, the project and related activities generated $7.5 million in revenues in 2009-10, $25.4 million in 2010-11, and $115.7 million in 2011-12. The amounts projected for each of these years were $3.8 million, $13.7 million and $65.3 million, respectively. Total cost of the project through 2017-18 is estimated to be $689.9, with approximately $398.9 million payable as a vendor payment. Total revenue generated by the EDR project over this period is expected to be roughly $4.7 billion, for a benefit cost ratio of 6.8:1.

The continuation of the EDR project is expected to fund the technology-intensive portion of the project. FTB indicates that the initial revenues generated by the EDR project were primarily from adding staff to process the current backlog of business entity returns and begin collection correspondence in order to accelerate revenue. Beginning in 2011-12, substantial revenues were generated by the EDR project proper.

Main Goals: The EDR Project has three major goals. First, it seeks to capture all tax return data in an electronic form. Second, the project will integrate the various existing "siloed" tax databases at FTB into a data warehouse. Third, the project will enable FTB to add third-party data (for example, county assessor data) to its data warehouse. The FTB asserts that the EDR Project will allow it to substantially improve detection of underpayment and fraud in order to collect taxes from those who are not paying the full amount that they owe. In addition, FTB indicates that the project will enable it to improve service and give taxpayers better access to their tax records.

Project Components: The project includes the following improvements to FTB's systems that process personal income tax and business entity tax returns:

- An underpayment modeling process that would be integrated with the Accounts Receivable Collections System and Taxpayer Information System.
- An enterprise data warehouse with data search and analysis tools.
- A taxpayer records folder that is accessible to the taxpayer and allows taxpayers and FTB staff to access the information.
- Re–engineering of existing business processes—including imaging of tax returns, data capture, fraud and underpayment detection, tax return validation, filing enforcement, and other audit processes—and integration of these enhanced business processes with FTB's existing tax systems.
- Improved business services at FTB such as address verification, issuance of notices, and a single internal password sign-on for its IT systems.

Benefits-Funded Approach: FTB indicates that it plans to finance the EDR Project using a benefit-funded approach. Contractor payment for system development and implementation will be conditioned on generating additional revenue that will more than cover the cost. This approach is intended to protect the state and also give the contractors a strong incentive to develop the project in a manner that produces significant revenue quickly. The FTB has used this approach previously. FTB's benefit-funded approach makes use of revenue gains from reducing the business entity backlog to more than offset costs in 2009-10 through 2012-13. Although these gains could be accomplished regardless of whether project development goes forward, it makes sense to move forward now because cleaning up the backlog is a necessary condition to efficient project development. In subsequent years, the estimates in the project's Feasibility Study Report (FSR) indicate large increases in annual revenue gains that would be more directly attributable to the IT project. From 2011-12 through 2015-16, annual revenue gains increase from $115.7 million to $1.1 billion, while IT project implementation costs increase from $37.0 million in 2011-12 to a peak of $147.6 million in 2013-14 and then decline to $54.3 million by 2015-16. The method of financing EDR is similar to that used by the Employment Development Department for certain technology projects.

Staff Comment: The net benefit of this project (as estimated in the FSR) ramps up quickly. As noted above, the project began to produce significant net revenues starting in 2011-12. The FTB has among the best track records in California state government for the successful development and implementation of major information technology projects. FTB projects have experienced some delays and cost increases in certain phases, although these problems generally have not prevented successful completion of project phases. Generally, the project has come on-line faster than anticipated. Existing Supplemental Report Language requires FTB to report to the Legislature when revenue, costs, scope or schedule variances exceed 10 percent. The committee may ask the LAO and the California Technology Agency (CTA) to comment on the project.

Staff Recommendation: Hold open.

<u>Vote:</u>

6. **Central Processing Unit Capacity Increase (Governor’s Budget BCP#2):** The FTB is requesting one-time funding of $3.6 million in 2013-14 and $700,000 on an ongoing basis beginning in 2013-14 to increase processing capability, memory storage and software upgrades on FTB’s mainframe computing system to meet workload growth projections through 2014-15. The request is pursuant to a feasibility study report and approved by the State and Consumer Services Agency and California Technology Agency (CTA).

Background: FTB is responsible for maintaining the mainframe environment so the EDR system can be implemented. The department indicates that workload growth projection will exceed the CPU capacity in 2013-14, with demanded needs of 104 percent. Industry standards recommend operating at 90 percent of capacity. As a result, backlog of required reports and data operations are likely to occur with increased response times and a reduction in services. In terms of workload increases, these have reportedly been across the board over the last few years. For example, for personal income tax (PIT) and corporation tax (CT) programs, the workload measure in million instructions per second (MIPS) has grown from 988 in 2008-09 to a projected 1,381 in 2013-14—an increase of 40 percent over the four years.

Staff Comment: The proposal is a necessary investment in department technology, especially in view of additional data demands that will be placed on the CPU by the EDR system. The committee may want to ask the department about the expectations of the how long the investment will satisfy increasing data and information technology demands in the state.

Staff Recommendation: Approve the budget request.

<u>Vote:</u>

0860 Board of Equalization

Department Overview: The State Board of Equalization (BOE) is comprised of five members—four members each elected specifically to the board on a district basis and the State Controller. The BOE administers the sales and use tax (including all state and local components), oversees the local administration of the property tax, and collects a variety of excise and special taxes (including the gasoline tax, insurance tax, and cigarette and tobacco products taxes) and various fees (including the underground storage tank fee, e-waste recycling fee, and fire prevention fee). The BOE establishes the values of state-assessed property, including inter-county pipelines, railroads, and regulated telephone, electricity, and gas utilities. The BOE also hears taxpayer appeals of FTB decisions on personal income and corporation taxes.

Budget Overview: The Governor's budget proposes resource support of $555.9 million ($313.5 million General Fund), and 4,847 positions for the BOE in fiscal year 2013-14. The budget proposes a total funding increase of $28.7 million (5.4 percent), and a General Fund support increase of $16.3 million (5.5 percent), compared with spending estimates for the current year. Proposed staffing in the budget would increase by 135 positions (2.8 percent) from the current-year estimate.

Items Proposed for Discussion / Vote:

1. **Enhancement of E-Services (Governor’s Budget BCP#1):** The Governor’s Budget proposes $950,000 ($690,000 General Fund) and 4.0 limited-term positions in 2013-14 and 2014-15 to make enhancements to the e-registration system. The additional staff and resources will pay for enhancements to allow taxpayers to register online with more ease and make account maintenance adjustments that are currently handled by BOE staff.

   Background: Additional funding for the department’s electronic services expansion has allowed for implementation of a new registration system, electronic filing, and online requests for extensions, relief of penalty and declarations of timely mailing. The BOE expects the savings resulting from the new system to be $13.42 million by the end of 2013-14. Savings from the system for 2008-09 through 2013-14 were or are expected to be redirected. The next step in the electronic services process is to allow taxpayers to make changes to their accounts on-line, including changes in business location, mailing address, business name, officer information, e-mail addresses, and phone numbers.

   Staff Comment and Questions: The advantages of electronic services can accrue to taxpayers by increasing convenience as well as reducing costs. BOE indicates that significant savings have occurred through it electronic services efforts, totaling $53.6 million over the five year period ending 2013-14. This is largely through a reduction in staffing resources that are necessary for administration. The committee may inquire as to whether additional reductions in the department's real estate footprint should not also occur. As part of the proposal, BOE notes that the accounts receivable inventory continues to be high and that the redirection of resources could generate an additional $12.9 million in 2013-14 and $17.5 million annually thereafter. This could be accomplished through the redirection of 24.5 positions. This would reportedly have an impact on the identification of future audit leads.

<u>Questions:</u> (1) To what were the savings derived from the electronic services expansion redirected? Were all these savings diverted to revenue producing activities? (2) Could the savings from the project be diverted to the accounts receivable inventory? (3) Can the state expect to realize savings on the real estate side from increased e-services? (4) Are there expected to be any changes (plus or minus) in the district satellite offices as a result of expanded electronic services, or has this been discussed?

Staff Recommendation: Approve resources for two-year limited-term positions to perform electronic services modifications and redirect 24.5 positions to focus on accounts receivable activities in 2013-14 and realize an additional $12.9 million in revenue. Adopt budget bill language (BBL) requiring the department to report to the fiscal committees of the Legislature on the impact of the redirection on audit leads by March 1, 2014, in conjunction with budget hearings.

<u>Vote:</u>

2. **Fuel Tax Swap Refund Workload (Governor's Budget BCP#2).** The Governor's Budget proposes resources for continued processing of workload associated with the fuel tax swap that replaced the sales tax on gasoline with an excise tax calibrated to result in an equivalent amount of revenue. The proposal would convert two tax auditor positions from limited-term to permanent and reclassify two tax technician positions to tax auditor positions. The positions are engaged in refund claims made under the diesel fuel tax whose workload has been affected by the fuel tax swap.

   Background: The fuel tax swap eliminated the sales tax on gasoline and increased the excise tax by an amount that each year will generate an equivalent amount of revenue. The fuel tax swap also increased the sales tax on diesel fuel to provide additional funding for mass transportation (which had been eliminated by virtue of the elimination of the sales tax on gasoline). The mechanism requires ongoing monitoring, reconciliation and refund operations to maintain revenue neutrality and ensure consumer protections.

   Staff Comment: Staff has no concerns with the proposal.

   Staff Recommendation: Approve budget request for workload associated with fuel tax swap.

<u>Vote:</u>

3. **Joint Operations Center Ensuring Fuel Tax Compliance (Governor's Budget BCP#3):** This proposal represents a request to continue BOE's participation in a program that relates to compliance with California's fuel tax law and the collection of program revenues. The proposal continues the agency's participation in the Joint Operations Center (JOC) project for national fuel compliance, which is intended to reduce fuel tax evasion for the participating states. The program provides staff, data and expertise from participating states and the federal government to identify under-reporting, non-reporting and trends in tax evasion.

   Background and Detail: The proposal calls for the permanent funding of two business tax specialists that are currently limited-term and expire at the end of 2012-13. The source of annual funding is $300,000 from Federal Highway Administration funds. JOC has established a National Data Center and is in the process of integrating California data into the national database. In 2009, BOE began the process of analysis and investigation of leads being generated by the data center. In the ensuing years, JOC put its operations into effect and is receiving and combining data from state, federal and private party sources. Analytical tools are being used to identify anomalies, inconsistencies and omissions in the data, and generate leads for JOC audit teams to pursue. Audit teams are currently combining state and federal resources to conduct joint audits and investigations.

   Staff Comment and Questions: BOE is committed through a memorandum of understanding to two full-time staff positions. The operations are of direct benefit to the state and, indirectly, through apportionment of federal dollars collected through the program.

   <u>Questions:</u> (1) Was BOE's JOC participation affected in any manner by the limited-term nature of the funded positions?

   Staff Recommendation: Approve positions as three-year, limited-term positions.

   <u>Vote:</u>

4. **Narrowing the Tax Gap (Informational Issue):** The tax gap is defined as the difference between the amount of tax lawfully owed and the amount actually collected. Both BOE and FTB have estimated tax gap amounts over the last few years. BOE estimates the current gap for taxes that it administers at approximately $2.3 billion in lost revenues annually due to noncompliance, with General Fund reductions well in excess of about $1.0 billion annually. The major components of the tax gap are: (1) use tax liabilities of businesses and individual

consumers; (2) tax evasion by non-filers; and (3) under-reporting and nonpayment by registered taxpayers.

BOE has a number of programs—largely through the sales and use tax program—that are aimed at reducing the size of the tax gap. Some of these are designed to increase voluntary compliance and focus on education and outreach efforts to inform consumers and businesses regarding their tax collection and remittance obligations. In other cases, tax gap efforts are focused more on the compliance and enforcement activities, such as the Statewide Compliance and Outreach Program. BOE has a number of additional tax gap initiatives currently in place. These programs include more effective use of software applications, utilizing North American Industry Classification System (NAICS) codes, investigating misuse of resale certificates, and conducting special audits of auto auctions and gas stations. These programs are generally outlined in BOE's report to the Legislature on compliance and audit activities provided in December of each year. In addition, this report is to include information regarding BOE's Enhancing Tax Compliance Program. Current tax gap activities and revenue impacts are listed below:

Board of Equalization Tax Gap Initiatives
(Dollars in Millions)

Tax Gap Program	2011-12 Estimated Revenue	2011-12 Actual Revenue
US Customs	$14.4	$9.4
Agriculture Station Inspection	31.9	36.0
AB4X 18 Qualified Purchaser	36.7	51.3
Statewide Compliance and Outreach	34.5	84.0
Instate Service	37.4	37.9
Tax Gap II	NA	NA
Out of State 1032 Audits	11.0	34.3
Enhancing Tax Compliance	58.1	132.4

BOE has had a tax gap strategic plan in place since 2007. In bringing the components of the plan into operation, BOE has initiated a number of specific programs—including those outlined above. BOE staff should describe for the committee the results of its tax gap initiatives to date, the overall success of the program, and any impact of budget reductions on strategic planning for its Tax Gap initiatives, including the impact of the personal leave program.

Staff Comment: The department should outline its current approach to narrowing the tax gap, and in particular, its progress in coordinating with other state agencies—as well as other states—in these activities. The committee may want to pursue questions relating to audit selection and any new tax gap programs that are currently being designed or pursued, including those identified above.

Staff Recommendation: Informational item.

5. **Clarifying and Reconciling the "Triple Flip" (Budget Trailer Bill):** The Governor's Budget proposes budget trailer bill language that clarifies existing statutory language regarding the so-called "triple flip,' which provided for the simultaneous reduction of local sales taxes and increase in property taxes to local governments in order to provide for a dedicated payment stream for the Economic Recovery Bonds (ERBs).

   Background: As part of the previous Administration's proposed budget "workout," the state issued voter-approved ERBs in the amount of $15 billion. In order to establish security on the bonds, legislation provided for a dedicated sales tax funded by a shift of ¼ cent local sales tax to the state. Local governments were compensated on a dollar-for-dollar basis by an increase in property taxes from Educational Revenue Augmentation Fund (ERAF) resources that would otherwise have gone to K-12 education. Local education, in turn, is made whole by an increase in the state minimum funding guarantee under Proposition 98. The "triple flip" is in place until the bonds are retired (estimated to be 2016), after which point, the ¼ cent sales tax will revert to local governments, property tax shifts from ERAF to local governments will cease, and the General Fund payments to local education will decline by an amount equal to the reinstated property tax revenues.

   Detail: Sales taxes are distributed to local governments three months after collection, which amounts are the basis of the ERAF property tax shift to compensate local governments for the ¼ cent sales tax reduction. Thus, during a fiscal year, the amounts actually distributed to local governments correspond to a period of time that includes one-quarter of the prior fiscal year and three-quarters of the current fiscal year. The original legislation was designed to hold local governments harmless during the period the bonds are outstanding. However, because of the three month lag period between the collection of the sales tax and distribution to local governments, local governments (under the current language) will come up short in the amount of one-quarter's worth of revenue. This is because, when the "triple flip" ends, the prior quarter's revenue is to be allocated to local governments as a final shift. But under the timing of distribution, this distribution actually would correspond to the amount collected in the prior quarter, *minus one*. Because this lag was not incorporated in the original language, the Administration proposes language that, after the ERBs are paid-off, would compensate local governments for the final two quarters of sales tax from the special ¼ cent sales tax.

   Staff Comment: There is no disagreement that the intent of the "triple flip" was to hold local governments harmless, and it is apparent that the current language is flawed in this regard. The Administration has proposed language that attempts to address this flaw, and the LAO has indicated that there may be further clarity that could be added to the proposed language. The language also needs to clarify the timing of sales tax shifts such that the total state and local sales tax remains constant and the restatement of the local ¼ sales tax does not overlap with the state's ¼ cent sales tax.

Staff Recommendation: Approve placeholder trailer bill language and direct staff to work with the Administration in refining language to achieve stated purposes and intent.

Vote:

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Jerry Hill

Thursday, March 21, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Mark Ibele

Agenda Actions

State Finance and Administration

Overview of State Fiscal Offices and Functions

<u>Informational Item.</u>

Proposed Vote-Only Calendar:

<u>Adopted Vote-Only Calendar (2-0).</u>

Proposed Discussion / Vote Calendar:

<u>Financial Management</u>

<u>Items 1 and 2: Informational Items.</u>

<u>Items 1 and 2: Informational Items.</u>

<u>Item1: Adopted TBL Regarding Direct Transfer Authority (2-0).</u>

Item 1: Adopted BBL Allowing Net Final Payment Accrual Methodology for 2013-14 to Allow for Development of Permanent Accrual Approach.

Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Jerry Hill

Thursday, March 21, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Mark Ibele

Agenda Actions

State Finance and Administration

Overview of State Fiscal Offices and Functions

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Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Lois Wolk
Senator Tom Berryhill

Thursday, April 4, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

Item Number and Title

0515	Business, Consumer Services and Housing Agency
0511	Government Operations Agency
1110	Department of Consumer Affairs
1110/1111	Department of Consumer Affairs Boards and Bureaus
1701	Department of Business Oversight
8940	California Military Department

(See Table of Contents on page 2 for a More Specific Listing of Issues)

AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 2)

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only:

	Issue	2013-14 Amount	Fund Source	Staff Recommendation
	Department of Consumer Affairs(1110)			
1	California State Board of Pharmacy	$164,000	Special Fund	APPROVE
2	Board of Accountancy	-$48,000	Special Fund	APPROVE
3	Court Reporters Board	$44,000	Special Fund	APPROVE
4	Dental Hygiene Committee	$72,000	Special Fund	APPROVE
5	Physical Therapy Board	3.0 PY’s	Internal Redirect	APPROVE
6	Board for Professional Engineers, Land Surveyors, and Geologists	1.0 PY	Internal Redirect (results in $15,000 in savings)	APPROVE
7	Bureau for Private Post-Secondary Education	$81,000	Special Fund	APPROVE

Vote:

Issues Proposed for Vote Only – Issue Descriptions

California Department of Consumer Affairs

Issue 1 – California State Board of Pharmacy

Governor's Budget Request: The Governor's 2013-14 budget is requesting one Pharmacy Inspector position and $164,000 in order to comply with provisions of SB 1095 (Chapter 454, Statutes of 2012).

Background: This is a request to fund additional workload requirements that will be assumed by the California State Board of Pharmacy due to additional entities that may seek licensure or renewal.

An Ambulatory Surgical Center (ASC) is a clinic that is not part of a hospital and that provides ambulatory surgical care for patients that remain less than 24 hours. SB 1095 (Chapter 454, Statutes of 2012), expanded the term clinic to include accredited or Medicare certified Ambulatory Surgical Centers. Due to a 2007 court ruling (*Capen v. Shewry*), a large number ASCs have fallen into a jurisdictional "gray-area"; the California Department of Public Health (CPDH) no longer issues licenses to ASCs and the California Medical Board, the entity deemed by the California Court of Appeals to be the appropriate regulator, does not have the statutory authority to regulate the drugs stored in these facilities. The ASCs that fall into the jurisdictional "gray-area" are those owned by physicians, which the Pharmacy Board estimates may be 90 percent of the ASCs in the state. As physician-owned clinics, the California Court of Appeals determined that they do not qualify as surgical clinics within the meaning of Health and Safety Code 1204(b)(1). SB 1095 clarified that the Board of Pharmacy is the state regulator of a clinic setting that is not licensed by the CDPH and where the Medical Board has no jurisdiction over the drug supply. Beginning January 1, 2013, physician-owned clinics will now be able to obtain licensure with the Board of Pharmacy. Obtaining licensure will ensure that the clinics are capable of legally purchasing drugs at wholesale prices and/or maintaining a commingled drug stock.

The California State Board of Pharmacy oversees all aspects of the practice of Pharmacy in California: the practitioner (pharmacist), the practice site (pharmacy), and the product (drugs and devices). The Board has projected that the expanded definition of clinic will increase the number of its currently licensed population by 450 clinics. Currently, the licensing fee for a clinic is $400 and the renewal fee is $250. The cost of an additional Pharmacy Inspector will be nearly offset by the continued revenue from renewals and licensing of clinics.

Issue 2 – California Board of Accountancy

Governor's Budget Request: The Governor's 2013-14 budget requests that one Office Assistant position be eliminated and that the California Board of Accountancy's (CBA) budget authority be reduced by $48,000, as well. The reduction is a result of SB 1405 (Chapter 411, Statutes of 2012), which eliminated the notification and fee requirement of out-of-state certified public accountants that practice in the state.

Background: SB 1405 (Chapter 411, Statutes of 2012) revised the practice privilege statutes for the practice of accountancy to allow out-of-state licensees to practice in California with no notice or fee paid to the CBA. Removing the requirement for a notice or fee to be paid to the CBA will reduce the clerical workload of the board, which is reflected in the request to eliminate 1.0 Office Assistant position. However, the CBA does recognize that there will be an ongoing need for some clerical functions, primarily related to communications as it relates to practice privilege, which will be absorbed by the CBA's Licensing Division.

Issue 3 – Court Reporters Board

Governor's Budget Request: The Governor's 2013-14 Budget requests the position authority to hire a half-time (0.5) two-year limited-term staff services analyst. Additionally, the Court Reporters Board is requesting $44,000 in FY 2013-14, and $35,000 in FY 2014-15 to administer the extension of the Pro Per Pilot Project of the Transcript Reimbursement Fund (TRF).

Background: SB 1236 (Chapter 322, Statutes of 2012) is an extension of legislation passed in 2011 that provided low-income pro per litigants with limited access to the Transcript Reimbursement Fund. Pro per applicants in qualifying civil cases can apply to have their court or deposition transcripts paid for through the Transcript Reimbursement Fund. SB 1236 extends the Board's Pro Per Pilot Project to January 1, 2017. The amount for each case is limited to $1,500. According to the Board, estimates originally assumed that requests for reimbursement against the TRF would be approximately 10-15 percent and the workload increase would be absorbable. However, the requests for reimbursement have exceeded 60 percent and have created a workload that can no longer be absorbed by the existing Board staff.

The Transcript Reimbursement Fund was established in 1981 and is funded through the Certified Shorthand Reporters annual license renewal fees. In accordance with Business and Professions Code § 8030.2, $300,000 is transferred from the Court Reporters Fund to the Transcript Reimbursement Fund at the beginning of each fiscal year.

Issue 4 – Dental Hygiene Committee of California

Governor's Budget Request: The Governor's 2013-14 Budget requests one office technician and $72,000 in 2013-14 and $65,000 ongoing to implement the provisions included in SB 1202 (Chapter 331, Statutes of 2012).

Background: SB 1202 (Chapter 331, Statutes of 2012) provides additional program functions in registered dental hygiene licensing, dental hygiene school, and curriculum review. The approved measure broadened the current authorities afforded to the committee, and, according to the committee have created an additional workload requirement that cannot be absorbed by staff. The committee projects that they will see an increased number of applications for various special permits, in addition to a higher level of inquiries that will need to be addressed.

Issue 5 – Physical Therapy Board

Governor's Budget Request: The Governor's 2013-14 Budget requests position authority for three additional positions (one Office Technician and two Staff Services Analysts) in Fiscal Year (FY) 2013-14 and ongoing.

Background: The Physical Therapy Board (Board) is requesting position authority for a total of three positions for FY 2013-14 and ongoing. The positions will be within the Board's Enforcement and Licensing units. The Board's two core functions, licensing and enforcement, were authorized 14.3 positions in the Current Year Budget.

Resource History

Program Budget	FY 2010-11	FY 2011-12	FY 2012-13
Authorized Expenditures	$2,791	$3,404	$3,321
Revenues	$3,205	$3,119	$3,185
Personnel Years	16.5	15.4	14.3
Vacancies	5.9	0.4	0.0

It is the Board's intent to redirect resources currently used to support temporary staff members that have been performing duties that are best suited for permanent staff. Currently, the specified positions review applications (Applications and Licensing) and assign inquiries to a specific enforcement analyst for processing (Enforcement). The Board cites the Continuing Competency Audits that became effective on October 31, 2010, as a need for increased response and enforcement related resources. The Board has been faced with a steadily increasing investigative workload leading to a larger number of cases to remain pending. The increasing backlogs hinder the Board's future communications with complainants, investigators, expert consultants and the Attorney General regarding case status. Additionally, the Licensing Division has been faced with an increasing work load, creating a backlog for applicants to the Physical Therapy Board.

Issue 6 – Board for Professional Engineers, Land Surveyors, and Geologists

Governor's Budget Request: The Governor's 2013-14 Budget requests one position in Fiscal Year 2013-14 and ongoing to serve as a senior registrar for the Geology and Geophysicists program.

Background: In 2009, the Board for Professional Engineers, Land Surveyors and Geologists (Board) assumed the responsibilities of the Geologists and Geophysicists Board. The Geology program is now part of the Board and is allocated five staff. According to the Board the additional staff member is necessary to provide technical review of applications, respond to technical questions from the public, applicants, licensees, and other governmental agencies. The new senior registrar will be designated as the head of the Geology Program within the Board for Professional Engineers, Land Surveyors, and Geologists. Currently, the Geology Program relies heavily on technical experts to assist with the review of exams, applications, and development of the exams. The Board estimates that it assumed over $150,000 in technical expert-related expenses. According to the Board, hiring one senior registrar with experience and licensure as a professional geologist will relieve the Board of the technical expert-related costs, and will allow the Board to reduce their Budget Authority by $15,000 in Fiscal Year 2013-14 and ongoing.

Issue 7 – Bureau for Private Postsecondary Education

Governor's Budget Request: The Governor's 2013-14 Budget requests one one-year limited-term position and $81,000 in Fiscal Year 2013-14 in order to comply with provisions of AB 2296 (Block, Chapter 585, Statutes of 2012) that require the Bureau of Private Postsecondary Education to research measures and standards for gainful employment and implement regulations by July 1, 2014.

Background: The Bureau is responsible for the oversight of California's private postsecondary educational institutions. Currently, there are approximately 1,500 institutions regulated by the Bureau. Many of the institutions governed by the Bureau are vocational institutions offering skills training for entry-level positions in a variety of industries and trades. Existing law requires institutions to disclose to prospective students information regarding the institution's graduation, placement, licensure examination passage, and salary rates. AB 2296 expands the requirements to be met by private postsecondary educational institutions subject to state oversight under the California Private Postsecondary Education Act (CPPEA) by expanding disclosures related to unaccredited programs; expanding disclosure requirements for all regulated institutions; establishing more stringent criteria for determining gainful employment and calculating job placement rates; and, increasing institutional documentation and reporting requirements around completion rates, job placement/license exam passage rates, and salary/wage information for graduates.

1110/11 CALIFORNIA DEPARTMENT OF CONSUMER AFFAIRS

Department Overview: The Department of Consumer Affair's (DCA) Boards and Bureaus provide exams and licensing, enforcement, complaint mediation, education for consumers, and information on privacy concerns. DCA Boards and Bureaus establish minimal competency standards for more than 250 professions involving 3.0 million professionals. The Department of Consumer Affairs (DCA) consists of 36 regulatory boards, bureaus, committees, commissions, and programs, all of which regulate more than 100 businesses and 200 industries and professions, including doctors, contractors, private security companies, and beauty salons.

The boards and commissions are semi-autonomous regulatory bodies with the authority to set their own priorities and policies. Members of the boards and commission are appointed by the Governor and the Legislature.

Budget Overview: The Department's Boards are budgeted under organizational code 1110, and the total proposed budget for the Boards is $289.42 million (non-General Fund) and 1,538.2 Personnel Years for Fiscal Year 2013-14.

The Bureaus are budgeted under organizational code 1111, and the total proposed budget is $283.01 million (non-General Fund) and 1,750.0 Personnel Years for Fiscal Year 2013-14.

DCA Boards and Bureaus

(dollars in thousands)

		Positions		Expenditures	
		2012-13	2013-14	2012-13	2013-14
1	Board of Accountancy	84.8	80.8	$ 11,434	$ 11,870
2	Architects Board	30.4	30.4	$ 4,802	$ 5,007
3	Athletic Commission	13.7	9.1	$ 1,407	$ 1,422
4	Board of Behavioral Science	42.6	43.4	$ 8,090	$ 7,898
5	Chiropractic Examiners	--	19.4	$ ----	$ 3,860
6	Barbering and Cosmetology	96.2	92.2	$ 19,909	$ 20,511
7	Contractors State Licensing	401.6	401.6	$ 59,008	$ 61,872
8	Dental Board	74.5	74.1	$ 13,555	$ 14,090
9	Dental Hygiene Committee	7.2	8.2	$ 1,409	$ 1,529
10	Guide Dogs for the Blind	1.5	1.5	$ 196	$ 197
11	Medical Board	282.3	282.3	$ 56,673	$ 57,598
12	Acupuncture Board	8.0	8.0	$ 2,774	$ 2,820
13	Physical Therapy Board	14.3	16.4	$ 3,286	$ 3,259
14	Physician Assistant Committee	4.6	4.5	$ 1,461	$ 1,441
15	Podiatric Medicine	5.2	5.2	$ 1,176	$ 1,402
16	Psychology	17.5	17.3	$ 4,440	$ 4,523
17	Respiratory Care Board	16.4	16.4	$ 3,189	$ 3,269
18	Speech-Language Hearing Aid	8.6	8.6	$ 1,896	$ 1,933
19	Occupational Therapy	8.3	7.7	$ 1,372	$ 1,444
20	Board of Optometry	10.5	10.4	$ 1,699	$ 1,847
21	Osteopathic Medical Board	8.5	8.4	$ 1,805	$ 1,851
22	Naturopathic Medicine Committee	1.0	1.0	$ 171	$ 165
22	Board of Pharmacy	80.2	81.1	$ 15,057	$ 16,091
23	Engineers and Land Surveyors	63.7	64.7	$ 10,604	$ 11,262
24	Registered Nursing	132.0	130.8	$ 30,999	$ 30,520
25	Court Reporters Board	4.5	5.0	$ 1,097	$ 1,221
26	Structural Pest Control Board	--	29.9	$ ----	$ 4,898
27	Veterinary Medical Board	12.8	12.8	$ 2,819	$ 2,972
28	Vocational Nursing	68.7	67.9	$ 12,656	$ 12,484
29	Arbitration Certification Program	8.0	8.0	$ 1,118	$ 1,153
30	Security and Investigative	50.4	49.9	$ 12,296	$ 13,199
31	Private Postsecondary Education	57.0	58.0	$ 10,147	$ 10,715
32	Electronic and Appliance Repair, Home Furnishings, and Thermal Insulation	41.9	41.9	$ 7,073	$ 7,571
33	Automotive Repair	594.8	594.8	$ 181,862	$ 191,883
34	Telephone Medical Advice Services Bureau	1.0	1.0	$ 153	$ 173
35	Cemetery and Funeral	21.5	21.5	$ 4,163	$ 4,456
36	Real Estate Appraisers	--	32.8	-----	$ 5,441
37	Department of Real Estate	--	334.7	------	$ 47,801
38	Professional Fiduciaries	1.7	1.7	$ 403	$ 440

Issues Proposed for Discussion / Vote

Issue 1 – Performance-Based Budgeting

Governor's Budget: The Governor's 2013-14 Budget draws upon the performance-based budgeting approach and highlights a multi-year plan that has been developed by the Department of Consumer Affairs (DCA) and the Department of Finance (DOF) to modify programs within the DCA to achieve more efficiency and transparency. This plan stems from an Executive Order, issued by Governor Brown in 2011, which directed the DOF to modify the state budget process in order increase efficiency and focus on accomplishing program-related goals.

Background: Performance-based budgeting is an approach that creates incentives for agencies to produce measurable results that lead to defensible spending levels. Although the interest in this form of budgeting has waxed and waned over the past several decades, the most recent period of budget stress has generated increasing interest among state legislators and the executive branch. A performance-based budgeting approach provides for budget allocations based on defined performance measures and allows for adjustments based on these pre-established metrics. The procedures can also facilitate examining internal allocations within budgets.

The DCA will assess enforcement needs based on the following criteria:

- **Intake Cycle Time** - *Average number of days from receipt of the complaint to the date the complaint was assigned for investigation;*

- **Investigation Cases** - *Average number of days from receipt of the complaint to closure of the investigation process. Does not include cases resulting in formal discipline.*

- **Formal Discipline Cases** - *Average cycle time to complete the entire enforcement process for those cases closed by the Attorney General's office after referral by the program. This measure does not include declined, withdrawn or dismissed cases.*

Staff Comment: This is an informational item.

Issue 2 – Governor's Reorganization Plan Number Two: Funding Support for Business, Consumer Services, and Housing Agency

Governor's Budget Request: The Governor's budget includes a request for $2.824 million ($106,000 General Fund) in expenditure authority and 15.0 positions beginning in 2013-14 for the Business, Consumer Services and Housing Agency.

Background: The Business, Consumer Services and Housing Agency (Agency) was created as part of the Governor's Reorganization Plan Number 2 of 2012 (GRP2). Pursuant to GRP2, the State and Consumer Services Agency and the Business, Transportation and Housing Agency are eliminated effective June 30, 2013. This request establishes funding and position support for the new Agency, which is structured similarly to the two agencies that are being eliminated.

Prior to GRP2, some agencies regulating businesses were part of the Business, Transportation and Housing Agency; some licensing entities were part of the State and Consumer Services Agency; and others overseeing businesses and professionals were scattered throughout government. Under GRP2 these entities have now been consolidated into the Business, Consumer Services, and Housing Agency which includes the following Departments:

Department of Consumer Affairs (DCA): Previously under the State and Consumer Services Agency, the DCA oversaw licensing and enforcement of more than 200 professional licensing categories and over 2.5 million individuals. GRP2 restructured the DCA to include four additional entities within DCA: the Bureaus of Real Estate and Real Estate Appraisers, the Structural Pest Control Board, and the Board of Chiropractic Examiners.

The Department of Housing and Community Development: Previously housed under the Business, Transportation and Housing Agency, the Department of Housing and Community Development assists the state's residents with affordable housing options, administering several general obligation bond programs, and financing options. Under GRP2, the California Housing Finance Authority will be located within the Department of Housing and Community Development.

The Department of Business Oversight: GRP2 created a new department comprised of the Department of Corporations and the Department of Financial Institutions that will have regulatory responsibility for financial entities such as securities brokers and dealers, financial planners, mortgage lenders unaffiliated with banks, state-chartered banks, credit unions, and money transmitters.

The Department of Fair Employment and Housing: The Department of Fair Employment and Housing is responsible for protecting the people of California from unlawful discrimination in employment, housing, and public accommodations, and from the perpetration of acts of hate violence. The Department's jurisdiction extends to individuals, private or public entities, housing providers, and business establishments within the state.

The Seismic Safety Commission: The mission of the commission is to lower earthquake risk to life and property of Californians. The Commission works with federal, state, and local agencies as well as the private sector on a variety of activities that guide and stimulate earthquake risk reduction and management.

The California Horse Racing Board: The California Horse Racing Board regulates parimutuel wagering for the protection of the public and promotes the horse racing and breeding industries.

The Department of Alcohol and Beverage Control: The department is vested with the exclusive power to license and regulate persons and businesses engaged in the manufacture, importation, distribution and sale of alcoholic beverages in the State of California.

The Alcoholic Beverage Control Appeals Board: The Alcoholic Beverage Control Appeals Board provides a forum of appeal to persons who are dissatisfied with the Department of Alcohol Beverage Control's decisions to order penalties or issue, deny, condition, transfer, suspend, and revoke any alcoholic beverage license.

Funding to support the Agency is proposed to come from departments and entities housed under the Agency's umbrella as adjusted by GRP2. Funding support from the departments under the Agency is primarily a mix of reimbursements and direct special fund appropriations. Direct General Fund appropriations were provided for the share of the Agency costs to be borne by the Department of Fair Employment and Housing and the Seismic Safety Commission.

Departmental Contributions to Support the Business, Consumer Services and Housing Agency

Department	2013-14	2014-15	Positions
Department of Consumer Affairs	$1,828,000	$1,767,000	3300
Seismic Safety Commission	$4,000	$3,000	7
Department of Fair Employment and Housing	$102,000	$99,000	185
Housing and Community Development	$298,000	$289,000	539
Alcoholic Beverage Control	$237,000	$229,000	428
California Horse Racing Board	$34,000	$33,000	61
Department of Business Oversight	$321,000	$310,000	579
Total Expenditures	**$2,824,000**	**$2,730,000**	**----**

Staff Recommendation: Approve as budgeted

Vote:

Issue 3 – BreEZe System

Governor's Budget Request: The Governor's budget includes a request for $7.67 million dollars in additional funding for continued support of the Department of Consumer Affairs, Consumer and Client Services Division's automated licensing and enforcement system. This request also includes a request for $4.188 million in additional funding for all boards and bureaus to fund credit card processing fees on behalf of users of credit card payments through the BreEZe project. The total project cost for 2013-14 will be $11.995 million.

Background: The Department of Consumer Affairs is the umbrella agency for 37 business and professional licensing entitites (collectively referred to as boards and bureaus) that regulate over 2.7 million businesses and professionals in over 250 license categories.

The BreEZe project began with the approval of the Feasibility Study Report on November 30, 2009. In Fiscal Year 2010-11, the Department of Consumer Affairs gained approval of a Budget Change Proposal to redirect funding from the existing iLicensing Project, plus augment budgets for the BreEZe project to support the procurement and implementation of an integrated licensing and enforcement system, in support of the Department of Consumer Affair's Consumer Protection Enforcement Inititiative. Additionally, in Fiscal Year 2011-12, the department gained approval to appropriate $1.2 million on a one-time basis, to the BreEZe project. BreEZe is designed to bring all of the Department of Consumer Affairs' Boards and Bureaus into an integrated licensing and enforcement system.

More specifically, the BreEZe project includes the purchase and implementation of a commercially integrated enterprise enforcement case management and licensing system that can be fitted specifically for DCA's needs. DCA is funded entirely by business and professional licensing fees and receives no General Fund appropriations.

BreEZe Costs	**Budget Year 2013-14**
DCA Boards	$5,944
DCA Bureaus	$1,823
Total	**$7,767**

Credit Card Convenience Fees: This Budget Change Proposal also includes a request for additional funding for all boards and bureaus to fund credit card processing fees on behalf of users of credit card payments through the BreEZe system. The BreEZe system will interface with a third-party payment processor which will provide DCA with the ability to accept electronic payments, while meeting compliance with Payment Card Industry Security Standards, via the third-party payment processor. The department is requesting $4.18 million dollars to support credit card processing fees on behalf of users of credit card payments through the BreEZe system. The $4.18 million for processing fees is included in the overall cost of the request.

Credit Card Convenience Fee	**Budget Year 2013-14**
DCA Boards	$3,564
DCA Bureaus	$624
Total	**$4,188**

Staff Comment: According to the most recent update to the Special Project Report (SPR), a number of defects occurred while conducting User Acceptance Testing. The reported defects that occurred during the User Acceptance Testing have caused a delay in the originally proposed timeline. The 2009 Feasibility Study Report estimated a project go-live date of July 2012, and the most recent update to the SPR noted that the vendor, Accenture has proposed a go-live date of May 2013. Overall project costs have not increased for BreEZe and, according to the updated February 1 SPR, are estimated to be $45 million. There are nine boards and one committee included in the first phase of the rollout; Medical Board of California, Board of Registered Nursing, Board of Barbering and Cosmetology, Physician Assistant Board, Board of Psychology, Naturopathic Medicine Committee, Osteopathic Medical Board of California, Respiratory Care Board, Board of Podiatric Medicine and the Board of Behavioral Sciences.

Due to the delay, an updated Special Project Report will need to be submitted. At this time it is unclear whether or not the cost of the program will increase. However, it is certain that there will be significant delays to the project's originally proposed timeline. At this time, staff would recommend that the item be held open until the updated SPR, has been submitted by the Technology Agency and has been reviewed by committee staff.

Staff Recommendation: Hold Item Open

Vote:

Issue 4 – Dental Hygiene Committee

Governor's Budget Request: The Governor's 2013-14 Budget requests to eliminate its legislative licensing appropriation in the amount of $264,000 and increase their main budget act appropriation by $264,000 to combine both their budget act and legislative appropriation into one budget act appropriation.

Background: This Budget Change Proposal is a technical request. Both accounts are managed by the same committee and there is no longer any need for two separate items of appropriation. Prior to 2008, dental hygienists were regulated by the Committee on Dental Auxiliaries (COMDA), which also regulated dental assistants. COMDA had one fund and one budget act appropriation. AB 539 (Chapter 294, Statutes of 2004) created a separate annual appropriation out of the COMDA fund specifically for licensing functions related to hygienists. SB 853 (Chapter 31, Statutes of 2008) removed the COMDA fund from statute, but it did not address the separate appropriation specifically for hygienists. Subsequent clean-up legislation addressed the issue of an appropriation being made against an account that no longer exists. However, the appropriation remains a legislative appropriation against the committee's fund rather than an appropriation annually made through the budget act.

The Department of Consumer Affairs has requested that the following provision be added to the budget act under item ***1110-001-3140***:

Provisions:

> *2. Of the amount appropriated in this item, $264,000 is in lieu of the appropriation provided for operating expenses necessary to manage the Dental Hygiene licensing examination pursuant to Section 109 of Chapter 307, of the Statutes of 2009.*

Staff Recommendation: Include provisional budget bill language in the Budget Act.

Vote:

Issue 5 – California State Athletic Commission

Governor's Budget Request: The Governor's budget includes a request for an $814,000 budget reduction for the California State Athletic Commission in Fiscal 2013-14 and ongoing.

Background: The commission is responsible for licensing fighters, promoters, managers, seconds, matchmakers, referees, judges, timekeepers, and approves physicians. The Commission protects consumers by ensuring that bouts are fair and competitive while protecting the health and safety of participants.

During Fiscal Year 2011-12 the commission neared insolvency, which was only avoided because of the severe cuts taken by the commission to end the year with 0.1 months ($23,000) in the reserve. During that time the following actions were taken:

- Laying off all temporary staff
- Declaring lay off of two permanent full-time staff
- Reducing staffing levels at regulated events
- Reducing staff and Commission member travel

According to the Commission; restructuring expenditures will allow the commission to build up a reserve of 2.9 months by the end of 2013-14.

Staff Comment: The reduction in budget authority represents nearly a 35 percent reduction in in spending for Fiscal Year 2013-14, compared to the current fiscal year. While the commission and the Department of Consumer Affairs, have both noted that the reduction in spending will be temporary in order to allow the commission to rebuild its reserves, it is still unknown, what, if any, measures will be taken to ensure future solvency of the commission's primary fund source. The Department of Consumer Affairs and the commission have committed to conducting a thorough review of the Athletic Commission's policies and procedures. The commission is currently operating under very austere conditions that are not sustainable for a very long period.

As noted by the Bureau of State Audits, revenues were well below the annual projections and expenditures far exceeded the actual revenue stream. This will lead to a structural deficit that will cause additional action to be taken in the future if the commission does not restructure their revenue and spending projections, payment structure to inspectors, and utilize resources in a more judicious manner.

Staff Recommendation: Approve as budgeted with Supplemental Reporting Language to include:

- The number of inspectors in the state and what type of event each inspector is capable of regulating.
- The number of Athletic Commission staff required for each type of event.
- The amount required to provide training to athletic inspectors over the last three years.

Vote:

Issue 6 – Governor's Reorganization Plan No. 2 – Department of Real Estate and Office of Real Estate Appraisers

Governor's Budget Request: The Governor's budget is requesting to transfer the budget and position authority from the Department of Real Estate and Office of Real Estate Appraisers to the newly-established bureaus with the Department of Consumer Affairs.

Background: Pursuant to the Governor's Reorganization Plan No. 2, the Department of Consumer Affairs is requesting to transfer the budget and position authority from the Department of Real Estate and the Office of Real Estate Appraisers to the Department of Consumer Affairs effective July 1, 2013. This reorganization requires the functions, authority and resources of the Department of Real Estate and Office of Real Estate Appraisers to be transferred to the Department of Consumer Affairs. Effective July 1, 2013 all positions and allocated resources will be transferred to the newly-established Bureau of Real Estate and the Bureau of Real Estate Appraisers within the Department of Consumer Affairs, eight positions have been identified for consolidation and are estimated to result in $1.25 million in savings annually.

Staff Recommendation: Approve as budgeted.

Vote:

0511 GOVERNMENT OPERATIONS AGENCY

Department Overview: The Government Operations Agency was created as part of the Governor's Reorganization Plan Number 2 of 2012 (GRP2). GRP2, which took effect July 3, 2012, sought to better align departments and other entities with similar purposes. The agency brings together the major components of state administration, including procurement, information technology, and human resources.

The following departments are included under the agency:

Department of General Services: The Department of General Services provides centralized services to state agencies as it pertains to the management of state-owned and leased real estate, approval of architectural designs for local schools and other state buildings, printing services, procurement of commodities, services, and equipment for state agencies, and management of the state's vehicle fleet.

Department of Human Resources (CalHR): CalHR is responsible for managing the state's personnel functions and represents the Governor as the "employer" in all matters concering state employer-employee relations. CalHR is responsible for issues related to recruitment, selection, salaries, benefits, and position classification and provides a variety of training and consultation services to state departments and local agencies.

Department of Technology: The Department of Technology retains statewide authority to centralize and unify the state's information technology (IT) projects. Aligning it with other administrative service programs will enhance its ability to develop, launch, manage and monitor large IT projects. The director of the department remains subject to Senate confirmation, and is still recognized as the state's chief information officer.

Office of Administrative Law: The Office of Administrative Law is responsible for reviewing administrative regulations proposed by over 200 state regulatory agencies for compliance with standards set forth in California's Administrative Procedure Act, for transmitting these regulations to the Secretary of State, and for publishing regulations in the California Code of Regulations.

Public Employees Retirement System (PERS): The PERS administers retirement benefits for over 1.6 million active employees and retirees of the state and local agencies in California. PERS also provides health benefits for nearly 1.3 million active and retired state, local government, and school employees.

State Teachers Retirement System (STRS): The primary responsibility of STRS is to provide retirement-related benefits and services to over 850,000 active and retired educators in public schools from pre-kindergarten through the community college system.

State Personnel Board (SPB): The five-member SPB is responsible for the state's civil service system. SPB ensures that the civil service system is free of political patronage and that employment decisions are merit-based. Members of SPB are appointed by the Governor for a ten-year term, as required by the California Constitution.

Franchise Tax Board (FTB): The mission of the FTB is to collect the proper amount of tax revenue and operate other programs, as defined in statute.

Victims Compensation and Government Claims Board (Board): The Board provides responsive financial compensation to remedy the financial burdens of victims of crime through a stable Restitution Fund, and for those with claims against the State, an opportunity to resolve those claims or proceed with other remedies.

Funding to support the agency is proposed to come from the departments and other entities under the agency's umbrella. Fund support for the agency is comprised of direct appropriations from the General Fund ($1.336 million General Fund) and reimbursements from the respective departments within the agency. The reimbursement funding formula utilized to support the agency is based on the number of personnel at each entity.

Departmental Contributions to Support the Government Operations Agency

Department	2013-14	2014-15	Positions
Department of General Services	$863,000	$785,000	3623
Victims Compensation and Government Claims	$64,000	$59,000	270
CalHR	$58,000	$52,000	242
Department of Technology	$296,000	$269,000	1242
State Personnel Board	$17,000	$15,000	70
State Teachers Retirement System	$215,000	$196,000	904
Public Employees Retirement System	$580,000	$528,000	2435
Office of Administrative Law	$5,000	$4,000	20
Franchise Tax Board	$1,331,000	$1,210,000	5587
Total Expenditures	**$3,429,000**	**$3,118,000**	**----**

Governor's Budget Request: The Governor's 2013-14 Budget requests funding support for the Government Operations Agency. Specifically, the Governor's Budget is requesting expenditure authority of $3.429 million ($1.336 million General Fund) and 17.0 positions beginning in 2013-14 for the Government Operations Agency.

Staff Recommendation: Approve as budgeted.

Vote:

1701 DEPARTMENT OF BUSINESS OVERSIGHT

Department Overview: Effective July 1, 2013, pursuant to the Governor's Reorganization Plan No. 2 of 2012, the Department of Financial Institutions and the Department of Corporations are merging to create this Department.

Budget Overview: The Governor's 2013-14 Budget includes a request for $79.52 million in order to support the newly-created Department of Business Oversight. Additionally, the request includes positional authority of 582.0 personnel years.

Issue 1 – Governor's Reorganization Plan No. 2

Governor's Budget Request: The Governor's 2013-14 Budget requests the transfer of all budget authority from the Department of Financial Institutions (Org Code 2150) and the Department of Corporations (Org Code 2180) to the newly-created Department of Business Oversight (Org Code 1701), effective July 1, 2013.

Background: Pursuant to the enactment of the Governor's Reorganization Plan No. 2 (GRP2), on July 1, 2013, the Department of Corporations and the Department of Financial Institutions will reorganize to create the Department of Business Oversight (DBO). The DBO will be created by transferring day-to-day staff operations of the Department of Corporations and Department of Financial Institutions into one consolidated department. GRP2 will not impact the mission of each respective department; the Department of Corporations will continue to support a fair and secure financial marketplace for the state's residents and the Department of Financial Institution's will continue to protect and serve the state's citizens through the effective regulation and supervision of financial institutions licensed by the Department of Financial Institutions.

Staff Recommendation: Approve as budgeted.

Vote:

Issue 2 - Implementation of the Homeowner Bill of Rights

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for six positions within the Department of Corporations Lender-Fiduciary Program and $911,000 (State Corporations Fund) to implement and enforce provisions of the Homeowner Bill of Rights in California SB 900 and AB 278 (Chapter 87, Statutes of 2012 & Chapter 86 Statutes of 2012).

Background: In accordance with the California Finance Lenders Law (CFLL), the Department of Corporations is responsible for the licensing and regulation of consumer finance lenders, mortgage brokers, and mortgage loan originators. The Department is also responsible for the regulation of mortgage bankers, mortgage servicers, and mortgage loan originators under the California Residential Mortgage Lending Act (CRMLA). The Department estimates that nearly 35 percent of the residential mortgage loans in the state are serviced by a licensee under either the California Residential Mortgage Lending Act or the California Finance Lenders Law.

SB 900 and AB 278 modified several components of California's non-judicial foreclosure process to require various procedural requirements before a residential mortgage loan servicer can proceed with a foreclosure. According to the Department of Corporations, the additional resources have been requested to meet the increased workload associated with the reforms of regulatory examinations, and the resources will also serve to provide an adequate level of industry regulation and consumer protection in the state.

The foreclosure legislation set forth different requirements for companies with more than 175 foreclosures per year and with companies that have less than 175 foreclosures per year. According to the department, there were 61 mortgage servicers licensed under CFLL and 80 licensed under the CRMLA. The foreclosure legislation resulted in an increase in the need for examinations. Five of the six requested positions are proposed to be utilized to address the increased workload requirements stemming from the foreclosure legislation. The sixth position will be one staff counsel who will assist in interpreting regulatory notices, rulemaking, and conduct external outreach, as needed.

Staff Recommendation: Approve as budgeted.

Vote:

Issue 3 - Hard Money Lending

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for two positions and $281,000 to implement and enforce SB 978 (Chapter 669, Statutes of 2012).

Background: The intent of SB 978 (Chapter 669, Statutes of 2012) was to address abuses that have been identified in some instances of "hard money" lending. Hard money lending is the term used to describe the practice of nontraditional lending to persons that are unable to obtain conventional loans. The changes made in SB 978 are intended to increase real estate investor protections and would require the Department of Corporations to focus greater scrutiny on the activities of those who solicit investors in connection with real estate investments, which are most often the form of collateral utilized in a hard money loan.

According to the Department, the two positions requested will be utilized to examine the securities issuers to whom the department currently issues permits. The Department will also now be required to issue an annual report related to the data collected from persons to whom it issues permits.

Staff Recommendation: Approve as budgeted.

Vote:

8940 CALIFORNIA MILITARY DEPARTMENT

Department Overview: The California Military Department is responsible for the command, leadership, and management of the California Army and Air National Guard and five other related programs. The purpose of the California National Guard is to provide military service supporting this state and the nation. The three missions of the California National Guard are to provide: 1) mission ready forces to the federal government as directed by the President; 2) emergency public safety to civilian authorities as directed by the Governor; and, 3) support to the community as approved by a proper authority. The California Military Department is organized in accordance with federal departments of the Army and the Air Force staffing procedures.

Budget Overview: The Governor's Budget proposes $153.45 million ($44.9 million General Fund) and 812.7 personnel years. This reflects a decrease of $3.9 million and an increase of five positions as compared to the 2012-13 budget.

Fund Source	2011-12	2012-13	2013-14 (proposed)
General Fund	$42,902	$44,004	$44,918
Federal Trust Fund	$72,651	$94,265	$97,695
Reimbursements	$8,552	$17,668	$9,068
Mental Health Services Fund	$539	$561	$1,351
Other Funds	$91	$422	$424
Total Expenditures	**$122,090**	**$140,323**	**$130,773**
Personnel Years	**683.2**	**807.7**	**812.7**

The Military Department also receives Federal Fund support. These funds are not allocated by the state or deposited in the State Treasury and are not included in program or statewide totals. All of the other federal funds are received from the Federal Government for the support of the federal component of the California National Guard.

Federal Funds – California Military Department

	2011-12	2012-13	2013-14
Expenditures	$911,643	$770,484	$786,665
Personnel Years	4,109.9	4,109.9	4,109.9

Issue 1 - Behavioral Health Crisis Action Team

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for five positions to hire needed behavioral health officers. The Military Department is also requesting an $815,000 increase in expenditure authority to fund the behavioral health officer positions.

Background: Currently, the Military Department employs three permanent positions and two temporary positions to provide behavioral health services to the 21,262 members of the California National Guard. The Military Department is requesting to convert the two temporary positions to permanent status and hire an additional three licensed behavioral health staff. This will provide the Military Department with a total of eight licensed behavioral health staff. The Military Department estimates that the additional licensed staff will be able to provide a 75 percent increase in the Military Department's behavioral health capability statewide.

Staff Comment: According to the Military Department, there were 20 suicides or suicide attempts during the 2012 calendar year. There is clearly a need for additional resources, particularly in the more rural communities in the state, where the Military Department has proposed providing coverage.

Staff Recommendation: Approve as budgeted.

Vote:

Issue 2 – State Active Duty Employee Compensation Increase

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for a $1.2 million ($526,000 General Fund) augmentation to cover the estimated State Active Duty (SAD) employee compensation increases to be granted effective January 1, 2013.

Background: The California Military Department (CMD) is authorized to have 808 positions. The positions are both civil service (271) and State Active Duty (537) positions. The SAD employees are active members of the National Guard or State Military Reserve and carry out various administrative, training, security, and other functions within the CMD. Funding for the State Active Duty employees is provided by a mixture of both Federal and State funds.

In accordance with state law, the salary ranges for SAD employees are set equivalent to the federal pay ranges for active duty military personnel. The annual budgets for most state agencies assume that, on average, their employees receive salaries in the middle of their salary ranges, since agencies will generally have a mix of newer and more senior employees within each classification. According to the Legislative Analyst's Office (LAO), this is not how the CMD has calculated pay for State Active Duty. The LAO has found that SAD employees at CMD earn salaries at the top of the available salary range rather than the more typical midrange. According to the Administration, this is because most SAD employees are believed to be more senior with salaries at or near the upper limit for their ranks. However, based on research conducted by the LAO of actual CMD expenditures for SAD positions in 2011-12, SAD employees, on average, actually receive salaries somewhat below the middle step for their rank. Consequently, the proposed budget for CMD includes more than is necessary to fund its authorized SAD positions. The LAO estimates that the CMD has projected their budget to be about $1.3 million higher in the budget year because of the discrepancy in their pay calculations.

LAO Recommendation. Reduce CMD's budget in 2013-14 to reflect the middle salary range of SAD employees, consistent with CMD's actual expenditures and the practice in most state departments. Reduce CMD's budget by $600,000 in General Fund and $700,000 in federal funds.

Staff Comment: The Military Department has conveyed that the proposed employee compensation increases could be absorbed internally for the Budget Year. This will provide the Military Department with an opportunity to reassess salary ranges at a more appropriate mid-classification salary range in the event that a pay raise is needed in subsequent budgets.

Staff Recommendation: Deny without prejudice.

Vote:

Issue 3 – Federal Trust Fund Authority Increase

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for a $17 million baseline increase to the Military Department's Federal Trust Fund Authority.

Background: The Military Department maintains an agreement with the National Guard Bureau that allows for state reimbursement for activities the federal government sees as required to support the federal mission of the California National Guard including; maintaining armories, logistical facilities, and training site management. The Military Department is forecasting to receive $52.6 in federal funds for the facilities program, however, the current Federal Trust Fund Authority for this program is $35.62 million. Recent changes at the United States Property and Fiscal Office necessitate the use of the state's contracting process, resulting in the department's request for the augmentation in federal fund authority.

Staff Recommendation: Approve as budgeted

Vote:

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Lois Wolk
Senator Tom Berryhill

Thursday, April 4, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

OUTCOMES

Item Number and Title

0515	Business, Consumer Services and Housing Agency
0511	Government Operations Agency
1110	Department of Consumer Affairs
1110/1111	Department of Consumer Affairs Boards and Bureaus
1701	Department of Business Oversight
8940	California Military Department

(See Table of Contents on page 2 for a More Specific Listing of Issues)

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-651-1505. Requests should be made one week in advance whenever possible.

AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 2)

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only:

	Issue	2013-14 Amount	Fund Source	Staff Recommendation
	Department of Consumer Affairs(1110)			
1	California State Board of Pharmacy	$164,000	Special Fund	APPROVE
2	Board of Accountancy	-$48,000	Special Fund	APPROVE
3	Court Reporters Board	$44,000	Special Fund	APPROVE
4	Dental Hygiene Committee	$72,000	Special Fund	APPROVE
5	Physical Therapy Board	3.0 PY's	Internal Redirect	APPROVE
6	Board for Professional Engineers, Land Surveyors, and Geologists	1.0 PY	Internal Redirect (results in $15,000 in savings)	APPROVE
7	Bureau for Private Post-Secondary Education	$81,000	Special Fund	APPROVE

Vote:

Issues Proposed for Vote Only – Issue Descriptions

California Department of Consumer Affairs

.

Issue 1 – California State Board of Pharmacy

Governor's Budget Request: The Governor's 2013-14 budget is requesting one Pharmacy Inspector position and $164,000 in order to comply with provisions of SB 1095 (Chapter 454, Statutes of 2012).

Background: This is a request to fund additional workload requirements that will be assumed by the California State Board of Pharmacy due to additional entities that may seek licensure or renewal.

An Ambulatory Surgical Center (ASC) is a clinic that is not part of a hospital and that provides ambulatory surgical care for patients that remain less than 24 hours. SB 1095 (Chapter 454, Statutes of 2012), expanded the term clinic to include accredited or Medicare certified Ambulatory Surgical Centers. Due to a 2007 court ruling (*Capen v. Shewry*), a large number ASCs have fallen into a jurisdictional "gray-area"; the California Department of Public Health (CPDH) no longer issues licenses to ASCs and the California Medical Board, the entity deemed by the California Court of Appeals to be the appropriate regulator, does not have the statutory authority to regulate the drugs stored in these facilities. The ASCs that fall into the jurisdictional "gray-area" are those owned by physicians, which the Pharmacy Board estimates may be 90 percent of the ASCs in the state. As physician-owned clinics, the California Court of Appeals determined that they do not qualify as surgical clinics within the meaning of Health and Safety Code 1204(b)(1). SB 1095 clarified that the Board of Pharmacy is the state regulator of a clinic setting that is not licensed by the CDPH and where the Medical Board has no jurisdiction over the drug supply. Beginning January 1, 2013, physician-owned clinics will now be able to obtain licensure with the Board of Pharmacy. Obtaining licensure will ensure that the clinics are capable of legally purchasing drugs at wholesale prices and/or maintaining a commingled drug stock.

The California State Board of Pharmacy oversees all aspects of the practice of Pharmacy in California: the practitioner (pharmacist), the practice site (pharmacy), and the product (drugs and devices). The Board has projected that the expanded definition of clinic will increase the number of its currently licensed population by 450 clinics. Currently, the licensing fee for a clinic is $400 and the renewal fee is $250. The cost of an additional Pharmacy Inspector will be nearly offset by the continued revenue from renewals and licensing of clinics.

Issue 2 – California Board of Accountancy

Governor's Budget Request: The Governor's 2013-14 budget requests that one Office Assistant position be eliminated and that the California Board of Accountancy's (CBA) budget authority be reduced by $48,000, as well. The reduction is a result of SB 1405 (Chapter 411, Statutes of 2012), which eliminated the notification and fee requirement of out-of-state certified public accountants that practice in the state.

Background: SB 1405 (Chapter 411, Statutes of 2012) revised the practice privilege statutes for the practice of accountancy to allow out-of-state licensees to practice in California with no notice or fee paid to the CBA. Removing the requirement for a notice or fee to be paid to the CBA will reduce the clerical workload of the board, which is reflected in the request to eliminate 1.0 Office Assistant position. However, the CBA does recognize that there will be an ongoing need for some clerical functions, primarily related to communications as it relates to practice privilege, which will be absorbed by the CBA's Licensing Division.

Issue 3 – Court Reporters Board

Governor's Budget Request: The Governor's 2013-14 Budget requests the position authority to hire a half-time (0.5) two-year limited-term staff services analyst. Additionally, the Court Reporters Board is requesting $44,000 in FY 2013-14, and $35,000 in FY 2014-15 to administer the extension of the Pro Per Pilot Project of the Transcript Reimbursement Fund (TRF).

Background: SB 1236 (Chapter 322, Statutes of 2012) is an extension of legislation passed in 2011 that provided low-income pro per litigants with limited access to the Transcript Reimbursement Fund. Pro per applicants in qualifying civil cases can apply to have their court or deposition transcripts paid for through the Transcript Reimbursement Fund. SB 1236 extends the Board's Pro Per Pilot Project to January 1, 2017. The amount for each case is limited to $1,500. According to the Board, estimates originally assumed that requests for reimbursement against the TRF would be approximately 10-15 percent and the workload increase would be absorbable. However, the requests for reimbursement have exceeded 60 percent and have created a workload that can no longer be absorbed by the existing Board staff.

The Transcript Reimbursement Fund was established in 1981 and is funded through the Certified Shorthand Reporters annual license renewal fees. In accordance with Business and Professions Code § 8030.2, $300,000 is transferred from the Court Reporters Fund to the Transcript Reimbursement Fund at the beginning of each fiscal year.

Issue 4 – Dental Hygiene Committee of California

Governor's Budget Request: The Governor's 2013-14 Budget requests one office technician and $72,000 in 2013-14 and $65,000 ongoing to implement the provisions included in SB 1202 (Chapter 331, Statutes of 2012).

Background: SB 1202 (Chapter 331, Statutes of 2012) provides additional program functions in registered dental hygiene licensing, dental hygiene school, and curriculum review. The approved measure broadened the current authorities afforded to the committee, and, according to the committee have created an additional workload requirement that cannot be absorbed by staff. The committee projects that they will see an increased number of applications for various special permits, in addition to a higher level of inquiries that will need to be addressed.

Issue 5 – Physical Therapy Board

Governor's Budget Request: The Governor's 2013-14 Budget requests position authority for three additional positions (one Office Technician and two Staff Services Analysts) in Fiscal Year (FY) 2013-14 and ongoing.

Background: The Physical Therapy Board (Board) is requesting position authority for a total of three positions for FY 2013-14 and ongoing. The positions will be within the Board's Enforcement and Licensing units. The Board's two core functions, licensing and enforcement, were authorized 14.3 positions in the Current Year Budget.

Resource History

Program Budget	FY 2010-11	FY 2011-12	FY 2012-13
Authorized Expenditures	$2,791	$3,404	$3,321
Revenues	$3,205	$3,119	$3,185
Personnel Years	16.5	15.4	14.3
Vacancies	5.9	0.4	0.0

It is the Board's intent to redirect resources currently used to support temporary staff members that have been performing duties that are best suited for permanent staff. Currently, the specified positions review applications (Applications and Licensing) and assign inquiries to a specific enforcement analyst for processing (Enforcement). The Board cites the Continuing Competency Audits that became effective on October 31, 2010, as a need for increased response and enforcement related resources. The Board has been faced with a steadily increasing investigative workload leading to a larger number of cases to remain pending. The increasing backlogs hinder the Board's future communications with complainants, investigators, expert consultants and the Attorney General regarding case status. Additionally, the Licensing Division has been faced with an increasing work load, creating a backlog for applicants to the Physical Therapy Board.

Vote 2-0

Issue 6 – Board for Professional Engineers, Land Surveyors, and Geologists

Governor's Budget Request: The Governor's 2013-14 Budget requests one position in Fiscal Year 2013-14 and ongoing to serve as a senior registrar for the Geology and Geophysicists program.

Background: In 2009, the Board for Professional Engineers, Land Surveyors and Geologists (Board) assumed the responsibilities of the Geologists and Geophysicists Board. The Geology program is now part of the Board and is allocated five staff. According to the Board the additional staff member is necessary to provide technical review of applications, respond to technical questions from the public, applicants, licensees, and other governmental agencies. The new senior registrar will be designated as the head of the Geology Program within the Board for Professional Engineers, Land Surveyors, and Geologists. Currently, the Geology

Program relies heavily on technical experts to assist with the review of exams, applications, and development of the exams. The Board estimates that it assumed over $150,000 in technical expert-related expenses. According to the Board, hiring one senior registrar with experience and licensure as a professional geologist will relieve the Board of the technical expert-related costs, and will allow the Board to reduce their Budget Authority by $15,000 in Fiscal Year 2013-14 and ongoing.

Issue 7 – Bureau for Private Postsecondary Education

Governor's Budget Request: The Governor's 2013-14 Budget requests one one-year limited-term position and $81,000 in Fiscal Year 2013-14 in order to comply with provisions of AB 2296 (Block, Chapter 585, Statutes of 2012) that require the Bureau of Private Postsecondary Education to research measures and standards for gainful employment and implement regulations by July 1, 2014.

Background: The Bureau is responsible for the oversight of California's private postsecondary educational institutions. Currently, there are approximately 1,500 institutions regulated by the Bureau. Many of the institutions governed by the Bureau are vocational institutions offering skills training for entry-level positions in a variety of industries and trades. Existing law requires institutions to disclose to prospective students information regarding the institution's graduation, placement, licensure examination passage, and salary rates. AB 2296 expands the requirements to be met by private postsecondary educational institutions subject to state oversight under the California Private Postsecondary Education Act (CPPEA) by expanding disclosures related to unaccredited programs; expanding disclosure requirements for all regulated institutions; establishing more stringent criteria for determining gainful employment and calculating job placement rates; and, increasing institutional documentation and reporting requirements around completion rates, job placement/license exam passage rates, and salary/wage information for graduates.

Items held open

Issues Proposed for Discussion / Vote

Issue 1 – Performance-Based Budgeting

Governor's Budget: The Governor's 2013-14 Budget draws upon the performance-based budgeting approach and highlights a multi-year plan that has been developed by the Department of Consumer Affairs (DCA) and the Department of Finance (DOF) to modify programs within the DCA to achieve more efficiency and transparency. This plan stems from an Executive Order, issued by Governor Brown in 2011, which directed the DOF to modify the state budget process in order increase efficiency and focus on accomplishing program-related goals.

Background: Performance-based budgeting is an approach that creates incentives for agencies to produce measurable results that lead to defensible spending levels. Although the interest in this form of budgeting has waxed and waned over the past several decades, the most recent period of budget stress has generated increasing interest among state legislators and the executive branch. A performance-based budgeting approach provides for budget allocations based on defined performance measures and allows for adjustments based on these pre-established metrics. The procedures can also facilitate examining internal allocations within budgets.

The DCA will assess enforcement needs based on the following criteria:

- **Intake Cycle Time** - *Average number of days from receipt of the complaint to the date the complaint was assigned for investigation;*

- **Investigation Cases** - *Average number of days from receipt of the complaint to closure of the investigation process. Does not include cases resulting in formal discipline.*

- **Formal Discipline Cases** - *Average cycle time to complete the entire enforcement process for those cases closed by the Attorney General's office after referral by the program. This measure does not include declined, withdrawn or dismissed cases.*

Staff Comment: **This is an informational item.**

Issue 2 – Governor's Reorganization Plan Number Two: Funding Support for Business, Consumer Services, and Housing Agency

Governor's Budget Request: The Governor's budget includes a request for $2.824 million ($106,000 General Fund) in expenditure authority and 15.0 positions beginning in 2013-14 for the Business, Consumer Services and Housing Agency.

Background: The Business, Consumer Services and Housing Agency (Agency) was created as part of the Governor's Reorganization Plan Number 2 of 2012 (GRP2). Pursuant to GRP2, the State and Consumer Services Agency and the Business, Transportation and Housing Agency are eliminated effective June 30, 2013. This request establishes funding and position support for the new Agency, which is structured similarly to the two agencies that are being eliminated.

Prior to GRP2, some agencies regulating businesses were part of the Business, Transportation and Housing Agency; some licensing entities were part of the State and Consumer Services Agency; and others overseeing businesses and professionals were scattered throughout government. Under GRP2 these entities have now been consolidated into the Business, Consumer Services, and Housing Agency which includes the following Departments:

Department of Consumer Affairs (DCA): Previously under the State and Consumer Services Agency, the DCA oversaw licensing and enforcement of more than 200 professional licensing categories and over 2.5 million individuals. GRP2 restructured the DCA to include four additional entities within DCA: the Bureaus of Real Estate and Real Estate Appraisers, the Structural Pest Control Board, and the Board of Chiropractic Examiners.

The Department of Housing and Community Development: Previously housed under the Business, Transportation and Housing Agency, the Department of Housing and Community Development assists the state's residents with affordable housing options, administering several general obligation bond programs, and financing options. Under GRP2, the California Housing Finance Authority will be located within the Department of Housing and Community Development.

The Department of Business Oversight: GRP2 created a new department comprised of the Department of Corporations and the Department of Financial Institutions that will have regulatory responsibility for financial entities such as securities brokers and dealers, financial planners, mortgage lenders unaffiliated with banks, state-chartered banks, credit unions, and money transmitters.

The Department of Fair Employment and Housing: The Department of Fair Employment and Housing is responsible for protecting the people of California from unlawful discrimination in employment, housing, and public accommodations, and from the perpetration of acts of hate violence. The Department's jurisdiction extends to individuals, private or public entities, housing providers, and business establishments within the state.

The Seismic Safety Commission: The mission of the commission is to lower earthquake risk to life and property of Californians. The Commission works with federal, state, and local agencies as well as the private sector on a variety of activities that guide and stimulate earthquake risk reduction and management.

The California Horse Racing Board: The California Horse Racing Board regulates parimutuel wagering for the protection of the public and promotes the horse racing and breeding industries.

The Department of Alcohol and Beverage Control: The department is vested with the exclusive power to license and regulate persons and businesses engaged in the manufacture, importation, distribution and sale of alcoholic beverages in the State of California.

The Alcoholic Beverage Control Appeals Board: The Alcoholic Beverage Control Appeals Board provides a forum of appeal to persons who are dissatisfied with the Department of Alcohol Beverage Control's decisions to order penalties or issue, deny, condition, transfer, suspend, and revoke any alcoholic beverage license.

Funding to support the Agency is proposed to come from departments and entities housed under the Agency's umbrella as adjusted by GRP2. Funding support from the departments under the Agency is primarily a mix of reimbursements and direct special fund appropriations. Direct General Fund appropriations were provided for the share of the Agency costs to be borne by the Department of Fair Employment and Housing and the Seismic Safety Commission.

Departmental Contributions to Support the Business, Consumer Services and Housing Agency

Department	2013-14	2014-15	Positions
Department of Consumer Affairs	$1,828,000	$1,767,000	3300
Seismic Safety Commission	$4,000	$3,000	7
Department of Fair Employment and Housing	$102,000	$99,000	185
Housing and Community Development	$298,000	$289,000	539
Alcoholic Beverage Control	$237,000	$229,000	428
California Horse Racing Board	$34,000	$33,000	61
Department of Business Oversight	$321,000	$310,000	579
Total Expenditures	**$2,824,000**	**$2,730,000**	**----**

Staff Recommendation: Approve as budgeted

Vote: **Item approved 2-0**

Issue 3 – BreEZe System

Governor's Budget Request: The Governor's budget includes a request for $7.67 million dollars in additional funding for continued support of the Department of Consumer Affairs, Consumer and Client Services Division's automated licensing and enforcement system. This request also includes a request for $4.188 million in additional funding for all boards and bureaus to fund credit card processing fees on behalf of users of credit card payments through the BreEZe project. The total project cost for 2013-14 will be $11.995 million.

Background: The Department of Consumer Affairs is the umbrella agency for 37 business and professional licensing entitites (collectively referred to as boards and bureaus) that regulate over 2.7 million businesses and professionals in over 250 license categories.

The BreEZe project began with the approval of the Feasibility Study Report on November 30, 2009. In Fiscal Year 2010-11, the Department of Consumer Affairs gained approval of a Budget Change Proposal to redirect funding from the existing iLicensing Project, plus augment budgets for the BreEZe project to support the procurement and implementation of an integrated licensing and enforcement system, in support of the Department of Consumer Affair's Consumer Protection Enforcement Inititiative. Additionally, in Fiscal Year 2011-12, the department gained approval to appropriate $1.2 million on a one-time basis, to the BreEZe project. BreEZe is designed to bring all of the Department of Consumer Affairs' Boards and Bureaus into an integrated licensing and enforcement system.

More specifically, the BreEZe project includes the purchase and implementation of a commercially integrated enterprise enforcement case management and licensing system that can be fitted specifically for DCA's needs. DCA is funded entirely by business and professional licensing fees and receives no General Fund appropriations.

BreEZe Costs	Budget Year 2013-14
DCA Boards	$5,944
DCA Bureaus	$1,823
Total	**$7,767**

Credit Card Convenience Fees: This Budget Change Proposal also includes a request for additional funding for all boards and bureaus to fund credit card processing fees on behalf of users of credit card payments through the BreEZe system. The BreEZe system will interface with a third-party payment processor which will provide DCA with the ability to accept electronic payments, while meeting compliance with Payment Card Industry Security Standards, via the third-party payment processor. The department is requesting $4.18 million dollars to support credit card processing fees on behalf of users of credit card payments through the BreEZe system. The $4.18 million for processing fees is included in the overall cost of the request.

Credit Card Convenience Fee	Budget Year 2013-14
DCA Boards	$3,564
DCA Bureaus	$624
Total	**$4,188**

Staff Comment: According to the most recent update to the Special Project Report (SPR), a number of defects occurred while conducting User Acceptance Testing. The reported defects that occurred during the User Acceptance Testing have caused a delay in the originally proposed timeline. The 2009 Feasibility Study Report estimated a project go-live date of July 2012, and the most recent update to the SPR noted that the vendor, Accenture has proposed a go-live date of May 2013. Overall project costs have not increased for BreEZe and, according to the updated February 1 SPR, are estimated to be $45 million. There are nine boards and one committee included in the first phase of the rollout; Medical Board of California, Board of Registered Nursing, Board of Barbering and Cosmetology, Physician Assistant Board, Board of Psychology, Naturopathic Medicine Committee, Osteopathic Medical Board of California, Respiratory Care Board, Board of Podiatric Medicine and the Board of Behavioral Sciences. Due to the delay, an updated Special Project Report will need to be submitted. At this time it is unclear whether or not the cost of the program will increase. However, it is certain that there will be significant delays to the project's originally proposed timeline. At this time, staff would recommend that the item be held open until the updated SPR, has been submitted by the Technology Agency and has been reviewed by committee staff.

Staff Recommendation: Hold Item Open

Vote: **Item held open**

Issue 4 – Dental Hygiene Committee

Governor's Budget Request: The Governor's 2013-14 Budget requests to eliminate its legislative licensing appropriation in the amount of $264,000 and increase their main budget act appropriation by $264,000 to combine both their budget act and legislative appropriation into one budget act appropriation.

Background: This Budget Change Proposal is a technical request. Both accounts are managed by the same committee and there is no longer any need for two separate items of appropriation. Prior to 2008, dental hygienists were regulated by the Committee on Dental Auxiliaries (COMDA), which also regulated dental assistants. COMDA had one fund and one budget act appropriation. AB 539 (Chapter 294, Statutes of 2004) created a separate annual appropriation out of the COMDA fund specifically for licensing functions related to hygienists. SB 853 (Chapter 31, Statutes of 2008) removed the COMDA fund from statute, but it did not address the separate appropriation specifically for hygienists. Subsequent clean-up legislation addressed the issue of an appropriation being made against an account that no longer exists. However, the appropriation remains a legislative appropriation against the committee's fund rather than an appropriation annually made through the budget act.

The Department of Consumer Affairs has requested that the following provision be added to the budget act under item ***1110-001-3140***:

Provisions:

> *2. Of the amount appropriated in this item, $264,000 is in lieu of the appropriation provided for operating expenses necessary to manage the Dental Hygiene licensing examination pursuant to Section 109 of Chapter 307, of the Statutes of 2009.*

Staff Recommendation: Include provisional budget bill language in the Budget Act.

Vote: **Budget Language Adopted 2-0**

Issue 5 – California State Athletic Commission

Governor's Budget Request: The Governor's budget includes a request for an $814,000 budget reduction for the California State Athletic Commission in Fiscal 2013-14 and ongoing.

Background: The commission is responsible for licensing fighters, promoters, managers, seconds, matchmakers, referees, judges, timekeepers, and approves physicians. The Commission protects consumers by ensuring that bouts are fair and competitive while protecting the health and safety of participants.

During Fiscal Year 2011-12 the commission neared insolvency, which was only avoided because of the severe cuts taken by the commission to end the year with 0.1 months ($23,000) in the reserve. During that time the following actions were taken:

- Laying off all temporary staff
- Declaring lay off of two permanent full-time staff
- Reducing staffing levels at regulated events
- Reducing staff and Commission member travel

According to the Commission; restructuring expenditures will allow the commission to build up a reserve of 2.9 months by the end of 2013-14.

Staff Comment: The reduction in budget authority represents nearly a 35 percent reduction in in spending for Fiscal Year 2013-14, compared to the current fiscal year. While the commission and the Department of Consumer Affairs, have both noted that the reduction in spending will be temporary in order to allow the commission to rebuild its reserves, it is still unknown, what, if any, measures will be taken to ensure future solvency of the commission's primary fund source. The Department of Consumer Affairs and the commission have committed to conducting a thorough review of the Athletic Commission's policies and procedures. The commission is currently operating under very austere conditions that are not sustainable for a very long period.

As noted by the Bureau of State Audits, revenues were well below the annual projections and expenditures far exceeded the actual revenue stream. This will lead to a structural deficit that will cause additional action to be taken in the future if the commission does not restructure their revenue and spending projections, payment structure to inspectors, and utilize resources in a more judicious manner.

Staff Recommendation: Approve as budgeted with Supplemental Reporting Language to include:

- The number of inspectors in the state and what type of event each inspector is capable of regulating.
- The number of Athletic Commission staff required for each type of event.
- The amount required to provide training to athletic inspectors over the last three years.
- **Include Long-term Solvency Plan due to Legislature in February 2014**

Vote: **SRL, including Sen. Berryhill's request that a long-term solvency plan be presented to the Legislature in 2014, adopted 2-0**

Issue 6 – Governor's Reorganization Plan No. 2 – Department of Real Estate and Office of Real Estate Appraisers

Governor's Budget Request: The Governor's budget is requesting to transfer the budget and position authority from the Department of Real Estate and Office of Real Estate Appraisers to the newly-established bureaus with the Department of Consumer Affairs.

Background: Pursuant to the Governor's Reorganization Plan No. 2, the Department of Consumer Affairs is requesting to transfer the budget and position authority from the Department of Real Estate and the Office of Real Estate Appraisers to the Department of Consumer Affairs effective July 1, 2013. This reorganization requires the functions, authority and resources of the Department of Real Estate and Office of Real Estate Appraisers to be transferred to the Department of Consumer Affairs. Effective July 1, 2013 all positions and allocated resources will be transferred to the newly-established Bureau of Real Estate and the Bureau of Real Estate Appraisers within the Department of Consumer Affairs, eight positions have been identified for consolidation and are estimated to result in $1.25 million in savings annually.

Staff Recommendation: Approve as budgeted.

Vote: **Approved as budgeted 2-0**

0511 GOVERNMENT OPERATIONS AGENCY

Department Overview: The Government Operations Agency was created as part of the Governor's Reorganization Plan Number 2 of 2012 (GRP2). GRP2, which took effect July 3, 2012, sought to better align departments and other entities with similar purposes. The agency brings together the major components of state administration, including procurement, information technology, and human resources.

The following departments are included under the agency:

Department of General Services: The Department of General Services provides centralized services to state agencies as it pertains to the management of state-owned and leased real estate, approval of architectural designs for local schools and other state buildings, printing services, procurement of commodities, services, and equipment for state agencies, and management of the state's vehicle fleet.

Department of Human Resources (CalHR): CalHR is responsible for managing the state's personnel functions and represents the Governor as the "employer" in all matters concering state employer-employee relations. CalHR is responsible for issues related to recruitment, selection, salaries, benefits, and position classification and provides a variety of training and consultation services to state departments and local agencies.

Department of Technology: The Department of Technology retains statewide authority to centralize and unify the state's information technology (IT) projects. Aligning it with other administrative service programs will enhance its ability to develop, launch, manage and monitor large IT projects. The director of the department remains subject to Senate confirmation, and is still recognized as the state's chief information officer.

Office of Administrative Law: The Office of Administrative Law is responsible for reviewing administrative regulations proposed by over 200 state regulatory agencies for compliance with standards set forth in California's Administrative Procedure Act, for transmitting these regulations to the Secretary of State, and for publishing regulations in the California Code of Regulations.

Public Employees Retirement System (PERS): The PERS administers retirement benefits for over 1.6 million active employees and retirees of the state and local agencies in California. PERS also provides health benefits for nearly 1.3 million active and retired state, local government, and school employees.

State Teachers Retirement System (STRS): The primary responsibility of STRS is to provide retirement-related benefits and services to over 850,000 active and retired educators in public schools from pre-kindergarten through the community college system.

State Personnel Board (SPB): The five-member SPB is responsible for the state's civil service system. SPB ensures that the civil service system is free of political patronage and that employment decisions are merit-based. Members of SPB are appointed by the Governor for a ten-year term, as required by the California Constitution.

Franchise Tax Board (FTB): The mission of the FTB is to collect the proper amount of tax revenue and operate other programs, as defined in statute.

Victims Compensation and Government Claims Board (Board): The Board provides responsive financial compensation to remedy the financial burdens of victims of crime through a stable Restitution Fund, and for those with claims against the State, an opportunity to resolve those claims or proceed with other remedies.

Funding to support the agency is proposed to come from the departments and other entities under the agency's umbrella. Fund support for the agency is comprised of direct appropriations from the General Fund ($1.336 million General Fund) and reimbursements from the respective departments within the agency. The reimbursement funding formula utilized to support the agency is based on the number of personnel at each entity.

Departmental Contributions to Support the Government Operations Agency

Department	2013-14	2014-15	Positions
Department of General Services	$863,000	$785,000	3623
Victims Compensation and Government Claims	$64,000	$59,000	270
CalHR	$58,000	$52,000	242
Department of Technology	$296,000	$269,000	1242
State Personnel Board	$17,000	$15,000	70
State Teachers Retirement System	$215,000	$196,000	904
Public Employees Retirement System	$580,000	$528,000	2435

Office of Administrative Law	$5,000	$4,000	20
Franchise Tax Board	$1,331,000	$1,210,000	5587
Total Expenditures	**$3,429,000**	**$3,118,000**	**----**

Governor's Budget Request: The Governor's 2013-14 Budget requests funding support for the Government Operations Agency. Specifically, the Governor's Budget is requesting expenditure authority of $3.429 million ($1.336 million General Fund) and 17.0 positions beginning in 2013-14 for the Government Operations Agency.

Staff Recommendation: Approve as budgeted.

Vote: **Approved as budgeted 2-0**

1701 DEPARTMENT OF BUSINESS OVERSIGHT

Department Overview: Effective July 1, 2013, pursuant to the Governor's Reorganization Plan No. 2 of 2012, the Department of Financial Institutions and the Department of Corporations are merging to create this Department.

Budget Overview: The Governor's 2013-14 Budget includes a request for $79.52 million in order to support the newly-created Department of Business Oversight. Additionally, the request includes positional authority of 582.0 personnel years.

Issue 1 – Governor's Reorganization Plan No. 2

Governor's Budget Request: The Governor's 2013-14 Budget requests the transfer of all budget authority from the Department of Financial Institutions (Org Code 2150) and the Department of Corporations (Org Code 2180) to the newly-created Department of Business Oversight (Org Code 1701), effective July 1, 2013.

Background: Pursuant to the enactment of the Governor's Reorganization Plan No. 2 (GRP2), on July 1, 2013, the Department of Corporations and the Department of Financial Institutions will reorganize to create the Department of Business Oversight (DBO). The DBO will be created by transferring day-to-day staff operations of the Department of Corporations and Department of Financial Institutions into one consolidated department. GRP2 will not impact the mission of each respective department; the Department of Corporations will continue to support a fair and secure financial marketplace for the state's residents and the Department of Financial Institution's will continue to protect and serve the state's citizens through the effective regulation and supervision of financial institutions licensed by the Department of Financial Institutions.

Staff Recommendation: Approve as budgeted.

Vote: **Approved as budgeted 2-0**

Issue 2 - Implementation of the Homeowner Bill of Rights

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for six positions within the Department of Corporations Lender-Fiduciary Program and $911,000 (State Corporations Fund) to implement and enforce provisions of the Homeowner Bill of Rights in California SB 900 and AB 278 (Chapter 87, Statutes of 2012 & Chapter 86 Statutes of 2012).

Background: In accordance with the California Finance Lenders Law (CFLL), the Department of Corporations is responsible for the licensing and regulation of consumer finance lenders, mortgage brokers, and mortgage loan originators. The Department is also responsible for the regulation of mortgage bankers, mortgage servicers, and mortgage loan originators under the California Residential Mortgage Lending Act (CRMLA). The Department estimates that nearly 35 percent of the residential mortgage loans in the state are serviced by a licensee under either the California Residential Mortgage Lending Act or the California Finance Lenders Law.

SB 900 and AB 278 modified several components of California's non-judicial foreclosure process to require various procedural requirements before a residential mortgage loan servicer can proceed with a foreclosure. According to the Department of Corporations, the additional resources have been requested to meet the increased workload associated with the reforms of regulatory examinations, and the resources will also serve to provide an adequate level of industry regulation and consumer protection in the state.

The foreclosure legislation set forth different requirements for companies with more than 175 foreclosures per year and with companies that have less than 175 foreclosures per year. According to the department, there were 61 mortgage servicers licensed under CFLL and 80 licensed under the CRMLA. The foreclosure legislation resulted in an increase in the need for examinations. Five of the six requested positions are proposed to be utilized to address the increased workload requirements stemming from the foreclosure legislation. The sixth position will be one staff counsel who will assist in interpreting regulatory notices, rulemaking, and conduct external outreach, as needed.

Staff Recommendation: Approve as budgeted.

Vote: **Item held open**

Issue 3 - Hard Money Lending

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for two positions and $281,000 to implement and enforce SB 978 (Chapter 669, Statutes of 2012).

Background: The intent of SB 978 (Chapter 669, Statutes of 2012) was to address abuses that have been identified in some instances of "hard money" lending. Hard money lending is the term used to describe the practice of nontraditional lending to persons that are unable to obtain conventional loans. The changes made in SB 978 are intended to increase real estate investor protections and would require the Department of Corporations to focus greater scrutiny on the activities of those who solicit investors in connection with real estate investments, which are most often the form of collateral utilized in a hard money loan.

According to the Department, the two positions requested will be utilized to examine the securities issuers to whom the department currently issues permits. The Department will also now be required to issue an annual report related to the data collected from persons to whom it issues permits.

Staff Recommendation: Approve as budgeted.

Vote: **Approved as Budgeted 2-0**

8940 CALIFORNIA MILITARY DEPARTMENT

Department Overview: The California Military Department is responsible for the command, leadership, and management of the California Army and Air National Guard and five other related programs. The purpose of the California National Guard is to provide military service supporting this state and the nation. The three missions of the California National Guard are to provide: 1) mission ready forces to the federal government as directed by the President; 2) emergency public safety to civilian authorities as directed by the Governor; and, 3) support to the community as approved by a proper authority. The California Military Department is organized in accordance with federal departments of the Army and the Air Force staffing procedures.

Budget Overview: The Governor's Budget proposes $153.45 million ($44.9 million General Fund) and 812.7 personnel years. This reflects a decrease of $3.9 million and an increase of five positions as compared to the 2012-13 budget.

Fund Source	2011-12	2012-13	2013-14 (proposed)
General Fund	$42,902	$44,004	$44,918
Federal Trust Fund	$72,651	$94,265	$97,695
Reimbursements	$8,552	$17,668	$9,068
Mental Health Services Fund	$539	$561	$1,351
Other Funds	$91	$422	$424
Total Expenditures	**$122,090**	**$140,323**	**$130,773**
Personnel Years	**683.2**	**807.7**	**812.7**

The Military Department also receives Federal Fund support. These funds are not allocated by the state or deposited in the State Treasury and are not included in program or statewide totals.

All of the other federal funds are received from the Federal Government for the support of the federal component of the California National Guard.

Federal Funds – California Military Department

	2011-12	2012-13	2013-14
Expenditures	$911,643	$770,484	$786,665
Personnel Years	4,109.9	4,109.9	4,109.9

Issue 1 - Behavioral Health Crisis Action Team

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for five positions to hire needed behavioral health officers. The Military Department is also requesting an $815,000 increase in expenditure authority to fund the behavioral health officer positions.

Background: Currently, the Military Department employs three permanent positions and two temporary positions to provide behavioral health services to the 21,262 members of the California National Guard. The Military Department is requesting to convert the two temporary positions to permanent status and hire an additional three licensed behavioral health staff. This will provide the Military Department with a total of eight licensed behavioral health staff. The Military Department estimates that the additional licensed staff will be able to provide a 75 percent increase in the Military Department's behavioral health capability statewide.

Staff Comment: According to the Military Department, there were 20 suicides or suicide attempts during the 2012 calendar year. There is clearly a need for additional resources, particularly in the more rural communities in the state, where the Military Department has proposed providing coverage.

Staff Recommendation: Approve as budgeted.

Vote: **Item held open**

Issue 2 – State Active Duty Employee Compensation Increase

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for a $1.2 million ($526,000 General Fund) augmentation to cover the estimated State Active Duty (SAD) employee compensation increases to be granted effective January 1, 2013.

Background: The California Military Department (CMD) is authorized to have 808 positions. The positions are both civil service (271) and State Active Duty (537) positions. The SAD employees are active members of the National Guard or State Military Reserve and carry out various administrative, training, security, and other functions within the CMD. Funding for the State Active Duty employees is provided by a mixture of both Federal and State funds.

In accordance with state law, the salary ranges for SAD employees are set equivalent to the federal pay ranges for active duty military personnel. The annual budgets for most state agencies assume that, on average, their employees receive salaries in the middle of their salary ranges, since agencies will generally have a mix of newer and more senior employees within each classification. According to the Legislative Analyst's Office (LAO), this is not how the CMD has calculated pay for State Active Duty. The LAO has found that SAD employees at CMD earn salaries at the top of the available salary range rather than the more typical midrange. According to the Administration, this is because most SAD employees are believed to be more senior with salaries at or near the upper limit for their ranks. However, based on research conducted by the LAO of actual CMD expenditures for SAD positions in 2011-12, SAD employees, on average, actually receive salaries somewhat below the middle step for their rank. Consequently, the proposed budget for CMD includes more than is necessary to fund its authorized SAD positions. The LAO estimates that the CMD has projected their budget to be about $1.3 million higher in the budget year because of the discrepancy in their pay calculations.

LAO Recommendation. Reduce CMD's budget in 2013-14 to reflect the middle salary range of SAD employees, consistent with CMD's actual expenditures and the practice in most state departments. Reduce CMD's budget by $600,000 in General Fund and $700,000 in federal funds.

Staff Comment: The Military Department has conveyed that the proposed employee compensation increases could be absorbed internally for the Budget Year. This will provide the Military Department with an opportunity to reassess salary ranges at a more appropriate mid-classification salary range in the event that a pay raise is needed in subsequent budgets.

Staff Recommendation: Deny without prejudice.

Vote: **Staff recommendation to deny without prejudice adopted 2-0**

Issue 3 – Federal Trust Fund Authority Increase

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for a $17 million baseline increase to the Military Department's Federal Trust Fund Authority.

Background: The Military Department maintains an agreement with the National Guard Bureau that allows for state reimbursement for activities the federal government sees as required to support the federal mission of the California National Guard including; maintaining armories, logistical facilities, and training site management. The Military Department is forecasting to receive $52.6 in federal funds for the facilities program, however, the current Federal Trust Fund Authority for this program is $35.62 million. Recent changes at the United States Property and Fiscal Office necessitate the use of the state's contracting process, resulting in the department's request for the augmentation in federal fund authority.

Staff Recommendation: Approve as budgeted

Vote: Approved as budgeted 2-0

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Lois Wolk
Senator Tom Berryhill

Thursday, April 11, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

Item Number and Title

0690	Office of Emergency Services
1690	Seismic Safety Commission
8620	Fair Political Practices Commission
8820	Commission on the Status of Women and Girls
8940	California Department of Veterans Affairs

(See Table of Contents on page 2 for a More Specific Listing of Issues)

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-651-1505. Requests should be made one week in advance whenever possible.

AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 4)

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only:

	Issue	2013-14 Amount	Fund Source	Staff Recommendation
	Office of Emergency Services(0690)			
1	Antiterrorism Fund	$500,000/Trailer Bill Language	Special Fund	APPROVE
2	California Disaster Assistance Act	-$10.0 Million	General Fund	APPROVE
	Fair Political Practices Commission (8620)			
3	Technical Assistance Division	$151,000	Reimbursements	APPROVE
	California Department of Veterans Affairs (8940)			
4	State Veterans Cemeteries Federal Funding	$153,000	Federal Trust Fund	APPROVE
5	County Enterprising Standard Licensing Fee	$96,000	Special Fund	APPROVE
6	Yountville Veterans Home Cemetery Renovation	$2.9 million	Federal Trust Fund	APPROVE
7	Yountville Steam System Renovation	$4.095 million	Federal Trust Fund	APPROVE
8	Yountville Chilled Water System Distribution Renovation	$3.665 million	Federal Trust Fund	APPROVE
	Department of Consumer Affairs (1110)			
9	Board for Professional Engineers, Land Surveyors, and Geologists	1.0 PY	Internal Redirect (results in $15,000 in savings)	APPROVE
10	Bureau for Private Post-Secondary Education	$81,000	Special Fund	APPROVE

Issues Proposed for Vote Only – Issue Descriptions

Office of Emergency Services

Issue 1 –Antiterrorism Fund

Governor's Budget Request: The Governor's 2013-14 budget is requesting a reduction of $500,000 in General Fund contribution to the California Specialized Training Institute, and a corresponding permanent increase of $500,000 in Antiterrorism Fund support to the California Specialized Training Institute. This request includes trailer bill language specifying that administrative costs associated with funding local antiterrorism efforts are capped at five percent.

Background: The 2012-13 Budget allocated $750,000 General Fund towards the California Specialized Training Institute. General Fund costs are usually associated with salaries and wages that cannot be paid for with grant funding. This shift would reduce General Fund support for the California Specialized Training Institute to $250,000.

Existing law authorizes the Department of Motor Vehicles, in conjunction with the California Highway Patrol, to issue memorial license plates. The revenue from fees garnered from the issuance, renewal, transfer, and substitution of the memorial license plates is deposited into the Antiterrorism Fund. The Antiterrorism Fund is stable and has the capacity to absorb costs associated with training local entities on antiterrorism related activities at the California Specialized Training Institute.

Issue 2 – California Disaster Assistance Act

Governor's Budget Request: The Governor's 2013-14 budget is requesting a reduction of $10.0 million in General Fund support to the California Disaster Assistance Act (CDAA).

Background: The Governor's 2013-14 Budget includes a request of $39.1 millionfor the Office of Emergency Services to support CDAA. The funds are utilized to pay the matching portion of either a state or federally declared local disaster. The state pays 75 percent of local project costs when a disaster proclamation is made by the Governor, and pays roughly 18 percent in the event of a federal disaster proclamation. This reduction should not negatively impact the CDAA program.

Fair Political Practices Commission

Issue 3 – Technical Assistance Division

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for 1.7 Personnel Years and $151,000 provided to the Fair Political Practices Commission on a one-year limited-term basis to implement the provisions of AB 2062 (Chapter 500, Statutes of 2012).

Background: Beginning January 1, 2013 a state agency, upon Fair Political Practices Commission (FPPC) approval, is permitted to electronically file Statements of Economic Interest (Form 700). Approval stems from review of a pilot project that began in 2009. A small number of governmental entities, with the advisement of the FPPC, began electronically filing, and the reports were shared with the Legislative Analyst's Office (LAO).

Included in the report was a number of recommendations: (1) the Legislature should allow participating entities to continue electronic filing on an ongoing basis; (2) the Legislature should consider giving all governments the option to establish an electronic filing system; and (3) the Legislature should authorize the FPPC to establish any guidelines and specifications to be followed by the government entities when developing and using the electronic filing systems.

The 1.7 positions that are requested will be paid with fee revenue. According to the FPPC, there are over 700 cities, 200 state agencies, 58 counties, and thousands of school and special districts in the state. Analysis conducted by the Senate Appropriations Committee found that only a fraction of those entities would need to pay the required $1,000 filing fee in order for the FPPC to fund the requested positions.

California Department of Veterans Affairs

Issue 4 – State Veterans Cemeteries' Federal Funding

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for an increase of $153,000 in Federal Trust Fund Authority and two positions to augment staffing at Northern California Cemetery and Yountville Veterans Home Cemetery.

Background: According to the California Department of Veterans Affairs (CDVA), federal funding provided by the U.S. Department of Veterans Affairs (USDVA) will increase from the current level of $178,000 to $331,000 in 2013-14. The increase in funding can be largely attributed to the increased burial allowance provided by USDVA. CDVA will utilize the additional funding to provide each cemetery with an additional groundskeeper.

Issue 5 – County Enterprise Standard Licensing Fees

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for an increase of $96,000 in the Veterans Service Office Fund appropriation. The increased funding will be utilized on maintenance fees for the County Veteran Service Offices (CVSO's) enterprise standard case management software.

Background: The Budget Act of 2010 included authority and one-time funding to use Veteran Service Office Funds (VSOF) to implement standardized statewide veteran claims management software. Currently, there is a $3,500 maintenance fee assessed on each of the 56 counties with CVSO operations. However, of the $654,000 budget authority provided to CDVA, only $100,000 is dedicated to maintenance and support of the software. CDVA has requested that the shortfall be addressed with a budget authority augmentation of $96,000. The fund condition of the VSOF will remain stable if the augmentation is authorized.

Issue 6 – Yountville Veterans Home: Veterans Cemetery

April Finance Letter Request: The Administration, via a Spring Finance Letter, has requested a reversion of unencumbered funds from the 2012 Budget Act. Additionally, the Administration has requested an appropriation of $2.9 million in Federal Trust Fund Authority in Budget Year 2013.-14.

Background: The 2012 Budget Act included an appropriation in item 8955-490 of Federal Trust Fund to support the construction phase of the Veterans Homes California – Yountville Cemetery renovation project. However, the construction phase of the project is not set to begin until January 2014 due to the project's current status with the U.S. Department of Veterans Affairs. The Budget Authority provided in the 2012 Budget Act will have expired prior to federal funds becoming available. The objective of this renovation project is to bring the cemetery in compliance with U.S. Department of Veterans Affairs National Cemetery Administration standards. Much of the infrastructure at the cemetery will need to be repaired or replaced. CDVA has submitted an application for federal assistance and, once the renovation is complete, will be able to maintain the cemetery with existing resources.

Issue 7 – Yountville Steam System Renovation

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for $4.095 million in Federal Trust Fund authority for the construction phase of the Veterans Homes California – Yountville steam system renovation.

Background: The Yountville Home's primary source of heat for buildings and hot water is steam. The steam lines currently in place are insulated with asbestos containing material and are quickly deteriorating beyond repair. Additionally, the current steam distribution system in place is antiquated and does not maximize energy efficiency measures. The total cost of this project is $7.482 million and will be funded with a combination of federal funds ($4.095 million) and lease revenue bonds ($3.387 million).

Issue 8 – Yountville Chilled Water Distribution System Renovation

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for $3.665 million in Federal Trust Fund authority for the construction phase of the Veterans Homes California – Yountville chilled water distribution system renovation.

Background: The intent of the chilled water distribution system renovation project is to correct system deficiencies and ensure that the Yountville home has the necessary capacity to maintain a proper temperature throughout the home per California Department of Public Health Services guidelines. The total estimated project cost is estimated to be $6.398 million and will be funded by The Veterans Home Bond ($497,000), Lease Revenue Bonds ($2.236 million) and Federal Trust Fund ($3.665 million).

California Department of Consumer Affairs

Issue 9 – Board for Professional Engineers, Land Surveyors, and Geologists

Governor's Budget Request: The Governor's 2013-14 Budget requests one position in Fiscal Year 2013-14 and ongoing to serve as a senior registrar for the Geology and Geophysicists program.

Background: In 2009, the Board for Professional Engineers, Land Surveyor's, and Geologists (Board) assumed the responsibilities of the Geologists and Geophysicists Board. The Geology program is now part of the Board and is allocated five staff. According to the Board, the additional staff member is necessary to provide technical review of applications and respond to technical questions from the public, applicants, licensees, and other governmental agencies. The new senior registrar will be designated as the head of the Geology Program within the Board for Professional Engineers, Land Surveyors, and Geologists. Currently, the Geology Program relies heavily on technical experts to assist with the review of exams, applications, and development of the exams. The Board estimates that it assumed over $150,000 in technical expert-related expenses. According to the Board, hiring one senior registrar with experience and licensure as a professional geologist will relieve the Board of the technical expert-related costs, and will allow the Board to reduce their Budget Authority by $15,000 in Fiscal Year 2013-14 and ongoing.

Issue 10 – Bureau for Private Postsecondary Education

Governor's Budget Request: The Governor's 2013-14 Budget requests one one-year limited-term position and $81,000 in Fiscal Year 2013-14 in order to comply with provisions of AB 2296 (Block, Chapter 585, Statutes of 2012) that require the Bureau of Private Postsecondary Education (Bureau) to research measures and standards for gainful employment and implement regulations by July 1, 2014.

Background: The Bureau is responsible for the oversight of California's private postsecondary educational institutions. Currently, there are approximately 1,500 institutions regulated by the Bureau. Many of the institutions governed by the Bureau are vocational institutions offering skills training for entry-level positions in a variety of industries and trades. Existing law requires institutions to disclose to prospective students information regarding the institution's graduation, placement, licensure examination passage, and salary rates. AB 2296 expands the requirements to be met by private postsecondary educational institutions subject to state oversight under the California Private Postsecondary Education Act (CPPEA) by expanding disclosures related to unaccredited programs; expanding disclosure requirements for all regulated institutions; establishing more stringent criteria for determining gainful employment and calculating job placement rates; and, increasing institutional documentation and reporting requirements around completion rates, job placement/license exam passage rates, and salary/wage information for graduates.

Issues Proposed for Discussion / Vote

0690 OFFICE OF EMERGENCY SERVICES

Department Overview: Pursuant to the Governor's Reorganization Plan Number 2 of 2012 (GRP2) the California Emergency Management agency has been re-named the Office of Emergency Services (OES).

The principal objective of the Office of Emergency Services (OES) is to reduce vulnerability to hazards and crimes through emergency management and criminal justice. OES coordinates emergency activities to save lives and reduce property loss during disasters and to expedite recovery from the effects of disasters. On a day-to-day basis, the OES provides leadership, assistance, and support to state and local agencies in planning and preparing for the most effective use of federal, state, local, and private sector resources in emergencies. This emergency planning is based upon a system of mutual aid whereby a jurisdiction relies first on its own resources, and then requests assistance from its neighbors. The OES's plans and programs are coordinated with those of the federal government, other states, and state and local agencies within California.

During an emergency, the OES functions as the Governor's immediate staff to coordinate the state's responsibilities under the Emergency Services Act and applicable federal statutes. It also acts as the conduit for federal assistance through natural disaster grants and federal agency support.

Additionally, the OES is responsible for the development and coordination of a comprehensive state strategy related to all hazards that includes prevention, preparedness, and response and recovery.

Budget Overview: The January Governor's Budget provides OES with 538.1 positions and $1.24 billion ($103.01 million General Fund).This reflects a decrease of $14 million ($9 million General Fund) and 4.5 positions compared to the 2012-13 budget.

Issue 1 – Transfer of the Public Safety Communications Office

Spring Finance Letter: The Administration has requested the transfer of $2.4 million State Emergency Telephone Number Account (SETNA), $71.6 million Technology Services Revolving Fund, and 374 positions from the Department of Technology to the OES for State Operations. Additionally, this request includes a request for the transfer of $110.6 million SETNA and $1.9 million Federal Trust Fund authority from the Department of Technology to the OES for Local Assistance.

Background: In 2005, the Office of Network Services was transferred from the Department of General Services to the Department of Technology Services. In an effort to unify all emergency services, the 9-1-1 Emergency Communications and the Radio Communications were transferred in 2009 to the Office of Chief Information Officer (OCIO) and renamed the Public Safety Communications Office (PSCO).

Currently, the PSCO is comprised of two funding sources. The Radio Communications Division is an internal service fund and is finance from revenues received from customer agencies for communication services provided by the office. The 9-1-1 Emergency Communications program is funded by the SETNA, providing both State Operations and Local Assistance funding. Revenue from SETNA is derived from surcharges on intrastate telephone communications services. The surcharge is capped, by statute, at 0.75 percent of charges for intrastate services and is currently set at the statutory minimum of 0.50 percent. PSCO currently occupies a five building campus on Seqioua Pacific Boulevard in Sacramento, and the administrative staff are located at the Prospect Green Campus in Rancho Cordova.

The PSCO is comprised of 50 offices throughout the state. PSCO has the responsibility of administering the state's 9-1-1 emergency communications program serving 462 police, fire, and paramedic dispatch centers located within California's 58 counties. PSCO is currently planning the Next Generation of 9-1-1 services.

If adopted, the following will occur as a result of the reorganization:

- All positions, including support staff, within the Department of Technology's Public Safety Communications Office will be transferred to the OES. This will result in a total of 374 positions transferring. 329 positions from the Public Safety Communications Office, 36 positions from the Office of Administration, and nine positions from the IT services division.

- All employees transferring from the Department of Technology to the OES will retain their civil service status, and their personnel records will be transferred from the Department of Technology to the OES.

- Public Safety Communications staff associated with this transfer will not be relocated from their current worksite.

- The 36 administrative positions will consist of a combination of filled and vacant positions. Specifically, there eleven administrative staff who will continue to work at the Sequoia Pacific Campus or their existing field work sites. OES has identified existing open space at their Mather Offices that can be utilized by the 25 admin staff. The Administration does not anticipate any costs associated with employee relocation. Administrative staff moves will occur starting July 1, 2013, and will be set based on when IT systems can be established at OES that support the staff workload. The employee transfer is expected to be complete by July 1, 2014.

- Beginning with the 2013-14 Budget Act, all items associated with the support of the Public Safety Communications Office will be transferred to the OES.

- Statutory authority granted to the PSCO will not change, and the Administration has submitted draft Trailer Bill Language that will reflect the change in statute.

Staff Comment: Earlier this year, the Senate Energy, Utilities and Communications Committee held a hearing to address the status of the state's Public Safety Networks. During this hearing much concern was expressed over the state not meeting milestones associated with Next-Generation 911 (NextGen911). Also, during this hearing, and, in subsequent conversations, the Technology Department staff have committed to working with the Legislature to identify a clear path forward to developing a NextGen911 platform for the state. Prior to adopting the technical budget action associated with this request it is advisable that appropriate staff from the OES offer the same commitment to the Legislature. Specifically, it is important that there is a commitment that this budget authority transfer and related employee transfer will not inhibit the state's capability to develop a NextGen911 platform.

Staff Recommendation: Approve as budgeted and adopt trailer bill language. Adopt conforming Budget Change Proposal submitted by the Technology Department.

Vote:

1690 SEISMIC SAFETY COMMISSION

Department Overview: The Alfred E. Alquist Seismic Safety Commission is tasked with lowering earthquake risk to life and property of Californians. The commission coordinates with federal, state, and local agencies as well as the private sector on a variety of risk reduction and management-related activities.

There are twenty appointed commissioners who provide policy guidance, topical expertise, and private sector perspective. The Commission is responsible for (1) advising the Governor, Legislature, school districts, and the citizens of California on seismic safety policies and issues, (2) maintaining and encouraging the implementation of the five-year California Earthquake Loss Reduction Plan, (3) reviewing the adequacy of earthquake-related safety policies and programs, (4) using existing knowledge and conducting studies, where necessary, to develop and publish information to improve the performance of structures in California, (5) preparing and disseminating guides to the public identifying earthquake weaknesses and other issues related to residential and commercial buildings, and (6) fostering the development and use of new and emerging earthquake monitoring and prevention-related technologies.

Budget Overview: The Seismic Safety Commission is authorized 6.5 Personnel Years and $3.2 million ($1.9 General Fund). This reflects a $1.3 million increase over the 2012-13 budget. The $1.3 million increase stems from the increased use of the California Research and Assistance Fund (CRAF). In 2007, the Commission received approximately $6 million from the CRAF, and the Department of Finance extended the CRAF special deposit fund for an additional three years in 2011.

Issue 1 – Seismic Safety Account

Governor's Budget Request: The Governor's 2013-14 Budget includes Trailer bill language that will create the Seismic Safety Account within the Insurance Fund. The Seismic Safety Account would be funded through Insurance Assessments and moneys in the account would be made available upon appropriation of the Legislature.

Background: The Governor's 2013-14 budget includes a $1.2 million loan to the Insurance Fund from the General Fund. The loan to the Insurance Fund from the General Fund will be repaid by June 30, 2016 through fees collected by the Department of Insurance.

Beginning in FY 2001-02, funding support for the Seismic Safety Commission (commission) was shifted from the General Fund to the Insurance Fund. The commission was supported in the Insurance Fund by utilizing a fee authorized by Section 12975.9 of the Insurance Code. The authority to collect the fee expired on June 30, 2012.

Staff Comment: The proposed trailer bill would create a special account (Seismic Safety Account) within the Insurance Fund. Funds within the special account would be appropriated to the commission, and to the Department of Insurance to support the administrative management of the account. Funding for the account would be drawn from an assessment drawn from each person who owns property, commercial or residential, that is covered by a property insurance policy. The bill would require the Department of Insurance to calculate the annual assessment, which is not to exceed $0.15 per property exposure. The insurer, upon receipt of an invoice from the department, would be required to transmit payment directly to the special account. The assessment could then be collected from the insured, unless the insurer has determined it to be more cost-effective to pay on the insured's behalf.

This measure has been identified as a tax on the insured, not the insurer, and, as such, it is not in violation of the gross premium tax. This measure is subject to a two-thirds majority vote. Staff is still working with the administration to finalize the draft language. It may be advisable to wait until a final draft is complete prior to adopting the proposed trailer bill language.

Staff Recommendation: Hold item open until language in trailer bill is finalized.

Vote:

8620 FAIR POLITICIAL PRACTICES COMMISSION

Department Overview: The Fair Political Practices Commission (FPPC) has primary responsibility for the impartial administration, implementation, and enforcement of the Political Reform Act of 1974 (Act), as amended by the voters and Legislature. The overriding purpose of the Act is to restore confidence in governmental processes. The major objectives of the Commission are to:

- Provide education about the Act and its requirements to the public and the regulated community including public officials, candidates, and lobbyists, and assist with compliance.
- Ensure that election campaign contribution and expenditure data is fully and accurately disclosed so that the voters may be fully informed.
- Enforce the provisions of the Act and regulations fairly and with due process.
- Regulate the activities of lobbyists and disclose their finances to prevent any improper influencing of public officials.
- Provide for the disclosure of assets and income of public officials, which may affect their official actions, to avoid any conflicts of interest, or appearances of impropriety.
- Provide adequate mechanisms to public officials and to private citizens to ensure vigorous enforcement of the Act.

Budget Overview: The Governor's Budget proposes total spending of $10.2 million ($9.5 million General Fund) for the FPPC in 2012-13. Proposed staffing totals 89.0 personnel years (PYs), an increase of 4.7 PYs compared with the current year.

Fund Source	2011-12	2012-13	2013-14
General Fund	$7,902	$8,653	$9,478
Reimbursements	--	$378	$718
Expenditures	$7,902	$9,031	$10,196
Personnel Years	75.0	84.3	89.0

Issue 1 – Treasurer Investigation Ongoing Workload

Governor’s Budget Request: The Governor’s 2013-14 budget includes a request for the continuation of $350,000 in resources. This request is a continuation of unanticipated workload requested in the 2012-13 budget.

Background: On September 8, 2011, Kindee Durkee was arrested and accused of embezzling millions of dollars from numerous campaign committees. The arrest followed an eighteen month investigation conducted by both the FPPC and the Federal Bureau of Investigations (FBI). Ms. Durkee served as the campaign treasurer for over 400 committees, ranging from United States Senate campaigns to local advisory boards.

The 2012-13 Budget included a request for additional position authority (six limited-term positions) that would assist the FPPC with the unanticipated workload stemming from the Kindee Durkee case. Due to the continued demands of the Kindee Durkee case workload, the FPPC has requested that three positions be converted from limited-term to permanent status. The FPPC has noted that while the Kindee Durkee case may be complete, there has been an increased level of disclosure conformance among the state’s 10,000 political committees.

Staff Comment: In the wake of the Kindee Durkee case, the FPPC is trying to determine whether or not there is a need to either issue a formal commission opinion or to amend current regulations. Either action is likely to generate additional workload requirements that will need to be addressed when the commission has made a determination as to what direction would be in the best interest of the state, its political committees, and the campaign

Staff Recommendation: Approve as budgeted.

Vote:

Issue 2 – Contract with San Bernadino County

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for reimbursement authority of $718,000 in the budget year to perform campaign finance ordinance work that was authorized by AB 2146 (Chapter 1659, Statutes of 2012). The request includes reimbursement authority in the current year for $378,000.

Background: AB 2146 (Chapter 1659, Statutes of 2012) authorizes the County of San Bernadino to contract with the FPPC to enforce San Bernadino's local campaign finance ordinance measures. Among several other items, AB 2146 authorizes the FPPC to do the following:

- To act as the administrator and enforce of local campaign finance ordinance that has been adopted by the Board of Supervisors.
- To act as the civil prosecutor responsible for the civil enforcement of ordinance measure adopted by the Board of Supervisors.
- To investigate possible violations of measures passed by the County Board of Supervisors.

According to the FPPC, the workload associated with this agreement will require an additional six positions; four in the enforcement division and two additional personnel in the technical assistance division.

Staff Comment: The County of San Bernadino, which has been subject to several campaign corruption cases, is in the process of developing a campaign finance ordinance that would establish contribution limits that mirror those applied to state legislative candidates. The 2013-14 budget display reflects a reimbursement of $378,000 in the current year and $718,000 in the budget year. Historically, the FPPC has been supported by the General Fund.

Staff Recommendation: Approve as budgeted.

Vote:

8820 COMMISSION ON THE STATUS OF WOMEN AND GIRLS

Department Overview: The Commission on the Status of Women and Girls is an independent, non-partisan agency working to advance the causes of women. Toward that end, the Commission influences public policy by advising the Governor and the Legislature on issues impacting women and educating and informing its constituencies-thereby providing opportunities that empower women and girls to make their maximum contribution to society. The Commission consists of a 17-member body including the Superintendent of Public Instruction, the Labor Commissioner, three Assemblymembers and three Senators. Nine of the 17 members are public members: one appointed by the Speaker of the Assembly, one by the Senate Committee on Rules, and seven are appointed by the Governor. Public members serve four-year terms and are reimbursed for necessary expenses.

Budget Overview: The January Governor's Budget provides the Commission on the Status of Women and Girls with $275,000 in special fund and 2.1 Personnel Years.

Issue 1 – Commission on the Status of Women and Girls Special Fund Trailer Bill

Governor's Budget Request: The Governor's 2013-14 Budget requests the inclusion of trailer bill language that would allow for the creation of a special fund to support the Commission on the Status of Women and Girls.

Background: SB 1038 (Chapter 46, Statutes of 2012) requires the commission to develop a strategy to attract financial support from private donors in order to reduce the commission's dependence on the General Fund. The proposed language would create a special fund in the Treasury for receipt of private donor money that supports the commission.

Staff Comment: This request conforms with previous action taken by the Legislature.

Staff Recommendation: Adopt proposed trailer bill language.

8950 CALIFORNIA DEPARTMENT OF VETERANS AFFAIRS

Department Overview: The California Department of Veterans Affairs (CDVA) promotes and delivers benefits to California veterans and their families. More specifically, the CDVA provides: (1) California veterans and their families with aid and assistance in presenting their claims for veterans' benefits under the laws of the United States; (2) California veterans with beneficial opportunities through direct low-cost loans to acquire farms and homes; and (3) the state aged and disabled veterans with rehabilitative, residential, and medical care and services in a home-like environment at the California Veterans Homes. The CDVA operates veterans' homes in Yountville, Barstow, Chula Vista, Ventura, Lancaster and West Los Angeles. Construction of both the Redding and Fresno veterans homes was completed in the spring of 2012.

Budget Overview: The Governor's budget proposes $386.9 million ($316.3 million GF) and 2,428.9 positions for the department. If implemented as proposed, General Fund support for the CDVA would increase from $328.6 million in 2012-13 to an anticipated $386.9 million in the budget year.

Summary of Expenditures (in thousands)

Program	**2012-13**	**2013-14**
Farm and Home Loans to Veterans	$68,277	$65,506
Veterans Claims and Rights	$12,525	$11,978
Care of Sick and Disabled Veterans	$247,812	$310,032
Total	**$328.64**	**$362,303**

Issue 1 – Veterans Homes of California – Redding Activation/Fresno Activation

April 2 Finance Letter: The Governor's 2013-14 Budget includes a request for an augmentation of $11.9 million General Fund and 120.2 Personnel Years to continue staffing ramp up and admission of residents at the Redding Veterans Home of California. Additionally, the Governor's Budget include a request for an augmentation of $12.6 million General Fund support and 127.8 positions in Budget Year 2013.-14 to continue staffing and ramp up of residents at the Fresno Veterans Home of California.

Background: CDVA provides residential and medical care services to honorably discharged California veterans who served on active duty and are over the age of 62 or disabled. The Veterans Homes of California (VHCs) are long-term residential care facilities that provide California's qualified aged or disabled veterans with rehabilitative, residential, medical, and support services in a home-like environment. Once an eligible veteran selects a VHC as his or her long-term care option, and is approved for admission, the veteran becomes a fee-paying resident of the VHC. Home residents are veterans of military service ranging from World War II, Korea, Vietnam, Gulf War I, Operation Enduring Freedom, and Operation Iraqi Freedom. Spouses of veterans may also be eligible for VHC residency. The VHCs provide a long-term continuum of care, from domiciliary care at one end of the spectrum, which is similar to independent living accommodations, to skilled nursing care at the other end of the spectrum, which provides continuous skilled nursing or rehabilitation services.

The 2012 Budget Act appropriated an additional $1.9 million (General Fund) and 16.7 Personnel Years to hire staff in advance of admitting residents at the Redding facility and $2.3 million and 21.6 Personnel Years at the Fresno facility. CDVA intends on admitting eight patients into the residential care facility beginning in October 2013 in both Redding and Fresno. Their intent is to continue to admit eight additional residents each month until full occupancy, which is currently forecasted to occur in June 2015 at the Redding facility and November 2016 at the Fresno facility. CDVA intends on admitting patients to the skilled nursing facility at both Redding and Fresno beginning in April 2014. Upon completion, the Redding facility will have capacity for 150 residents (90 residential care, 30 Skilled Nursing, and 30 skilled nursing memory care). Capacity of the Fresno facility will be 300 residents (180 skilled nursing, 60 skilled nursing, and 60 Skilled Nursing memory care).

Staff Comment: Original estimates for the opening of both the Fresno and Redding veterans homes were anticipated to cost $27 million in the budget year. However, CDVA has updated the cost estimates to reflect the less clinical approach that is being utilized at both homes. For example, CDVA has decided to staff the Residential Care Facility with licensed vocational nurses rather than registered nurses, provide a greater level of independence to the resident, and adjust the staff-to-resident ratio to provide a more “social model”, instead of the “medical model” currently utilized at the other veterans homes within the CDVA network.

Hearing Questions: The subcommittee may wish to ask the Administration the following questions.

1. How many individuals have expressed interest in residency at the Redding facility?

2. How long will it take to determine if the alternative staffing model being utilized at the Redding and Fresno facilities has been cost-effective, and has not impacted care to the resident?

Staff Recommendation: Approve as budgeted.

Vote:

Issue 2 – Veterans Claims and Rights

Background: Veterans currently living in California were provided with disability compensation and/or pension benefits totaling approximately $4.5 billion dollars in 2012. One of CDVA’s primary missions is to assist eligible veterans, and their dependents, in obtaining federal and state benefits by assisting the veteran with a specific claim. CDVA maintains a small number of staff (53.8 PY’s) to assist the state’s veterans with benefit representation. However, much of the claims representation process is managed by County Veterans Service Officers (CVSO). The Governor’s 2013-14 Budget provides $2.6 million in General Fund to support the efforts of the CVSOs (there are currently CVSOs in 54 of California’s 58 counties.)

Historically, veterans in California have received less than the national average in compensation and pension benefits. Nationally, veterans receive an average of $2,104 per month, while veterans in California received slightly below that at $1,929. While improvements have been made, California is still trending behind other states that have large veteran populations, such as Texas and Florida. To address this, the Legislature amended the funding distribution formula (Chapter 401, Statutes of 2012) for determining veterans’ compensation and benefits. Funding to support the CDVA will not change, but each county may receive a different level that more accurately reflects the level of compensation provided to the veterans that they serve. The CDVA has been charged with identifying a disbursement formula that more accurately accounts for the value of the return to the individual veteran, with expectations that this change will be fully implemented within a couple of years.

Additionally, CDVA has progressed towards the development of CalVet Connect, which is an off the shelf product that serves as both a database and a communication platform for the numerous CVSO's located throughout the state. The Legislature included funding ($500,000) to develop CalVet Connect in the 2012 Budget Act. The initiative is largely a response to a 2009 report conducted by the California Bureau of State Audits that found that the department offered a limited number of direct services to the state's veterans and had a limited amount of contact information for veterans living in the state. The system would benefit veterans by allowing them easier access to the department, and it would benefit the department by reducing manual entry of data. According to the most recent Feasibility Study Report submitted in November 2012, total project costs are estimated to be $1.3 million.

Since the audit, CDVA and the Legislature have sought avenues to improve the department's collection of veteran contact information. The 2010 Budget Act directed CDVA and the Department of Motor Vehicles (DMV) to develop a partnership that allows Californians to identify themselves as veterans when they apply for a driver's license. The veterans' information is then transferred from DMV to CDVA. According to report submitted by the DMV and CDVA, since July 2011, more than 28,500 individuals have requested veteran information through the DMV website. DMV anticipates that the veteran identification and information sharing process will be fully automated during the budget year. CDVA is inputting the data manually but expects the process to become automated once the "CalVet Connect" project is complete.

Staff Comment: It is apparent that CDVA, and the Legislature, have identified multiple efforts to assist with the outreach capacity of the agency. However, there is still a need to craft a comprehensive plan that supports many of the efforts identified above, and for the state to garner a better understanding of the constituency that they serve.

Staff commends CDVA for developing a long term strategic plan, the Enterprise Strategic Plan 2012. However, the plan tells us little about the constituency that their planning efforts are focused around, the state's veteran community. To ensure that future resources match the needs required of the veterans community staff recommends that Supplemental Reporting Language (SRL) be adopted that addresses the following:

- Employment and employment-related information such as earnings,
- Incidence of suicide,
- Higher education and the veterans community access to higher education,
- Veteran community involvement with the child welfare system and,
- Veteran involvement with the criminal justice system.

The additional data points will provide the Legislature with a better understanding of the demographic; ensuring that the veterans community is provided with a comprehensive level of service.

Staff Recommendation: Adopt Supplemental Reporting Language.

Issue 3 – Implementation of the Enterprise wide Veterans Homes Information System

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for $1.8 million to fund the implementation of the Enterprise wide Veterans Homes Information System (Ew-VHIS) at the Yountville Veterans Home.

Background: According to the CDVA, the Ew-VHIS is designed to provide an integrated level of care to all eight homes within the CDVA veterans home network. Prior to the original request made in 2007, CDVA operated three veterans homes that were semi-autonomous. According to the California Technology Agency, total project costs are estimated to be $36.7 million. The original Feasibility Study Report, submitted in 2007, estimated the total project cost to be $33.9 million.

The Ew-VHIS has now been installed, configured, and implemented at Headquarters and at the homes in Barstow, Chula Vista, West Los Angeles, Ventura, and Lancaster. Implementation at Yountville, which has the largest resident population and staffing, represents the third wave. A request for funding necessary to implement at the Redding and Fresno facilities will be addressed in a separate budget change proposal in the future.

Prior to the acquisition and implementation of the Ew-VHIS, the veterans homes of California (Yountville, Barstow, and Chula Vista) utilized a software platform (Meditech) that did not have full functionality for Long-Term Care purposes, and the Meditech platform was only partially used at the Chula Vista and Barstow facilities. According to CDVA, the Meditech platform lacked the capability to develop a long-term care plan in an electronic format, and lacked a continuum of care account for each patient.

An additional concern raised by CDVA is the need for an integrated network that can be more closely monitored at CDVA's headquarters in Sacramento. According to CDVA, a new integrated network will provide headquarters with the opportunity to improve administrative procedures, business processes, and will provide a greater level of clinical data management capabilities within the network.

Staff Comment: It is worth noting that CDVA did not choose the VISTA electronic healthcare platform developed by the U.S. Department of Veterans Affairs, VISTA. According to CDVA, the VISTA platform does not offer as good of a long-term care solution as the COTS software purchased by CDVA. According to CDVA, VISTA is more compatible with acute care and would need to be modified to support the Veterans Homes network. Additionally, CDVA has noted that the U.S. Department of Veterans Affairs would not allow data sharing between the two agencies. While CDVA did conduct a Request For Proposal (RFP) that included the VISTA platform as a component of a system desired by the agency, the value of that component was negligible and the bidder including that component was not awarded the final contract.

Budget staff appreciates the need for an updated software platform that will provide a better integrated level of care for each resident, and it has been noted that the contract on the current software will increase over 20 percent in the budget year. However, it is important to note that any software developments made at CDVA headquarters, including Ew-VHIS, should not only serve to make CDVA headquarters more efficient, but also more effective to the state's veteran community that may reside at one of the homes in the network. Staff does have concerns that when data is transferred from one platform to the other, it may not be seamless. To address this, CDVA has noted that the U.S. Department of Veterans Affairs has provided each home with a terminal with VISTA capabilities, however, multiple data entries for each resident does not represent a best case practice.

Hearing Questions: The subcommittee may wish to ask the Administration the following questions.

1. Can CDVA explain why the U.S. Department of Veterans Affairs was not interested in sharing health information records of veterans?

2. How does CDVA ensure that data transferred from one software platform to the other is done accurately?

3. Please describe an instance in which the VISTA terminal located at each facility is utilized, and how often that occurs.

Staff Recommendation:

Vote:

Issue 4 – Public Assistance and Reporting Information System

Background: A report conducted by the Legislative Analyst's Office (LAO) in 2007 found that there are approximately 144,000 veterans in the state that could be receiving comprehensive medical benefits from the U.S. Department of Veterans Affairs. According to their estimates, shifting that population from Medi-Cal to the U.S. Department of Veterans Affairs healthcare system could save the state approximately $250 million General Fund annually. The LAO has noted that the actual number of individuals eligible for U.S. Department of Veterans Affairs benefits could be determined by cross-referencing an information system utilized by the U.S. Department of Health and Human Services, the Public Assistance and Reporting Information System (PARIS). The PARIS is an information-sharing data match system that is managed by the U.S. Department of Health and Human Services. The database is accessible to certain state agencies that are impacted by Medicaid eligibility.

Recently, the Department of Health Care Services (DHCS) conducted the two-year Public Assistance and Reporting Information System (PARIS) pilot program to improve the identification of veterans (or their dependents) receiving high cost services, and to assist them in obtaining health benefits from the USDVA. Health benefits provided at the federal level potentially provide greater asset protection to the veteran and the state is able to redirect savings to the Medi-Cal program. This collaboration was done on a pilot basis and affected a small number of counties within the state.

DHCS was responsible for administering a veterans' specific PARIS query with the federal government, filtering match results, and sending outreach referrals to CDVA. CDVA selected which counties Fresno, San Bernardino, and San Diego were included in the pilot. The pilot was extended in mid-2010 to include seven more counties; Alameda, Orange, Sacramento, San Mateo, San Francisco, Santa Clara, and Solano. CDVA utilized their network of County Veteran Services Officers, which are active in 54 out of the 58 counties in the state, and the results were relayed to the DHCS. According to the report submitted by DHCS, the redirection of benefits resulted in cost avoidance of $1.48 million in General Fund after accounting for administrative costs. Additionally, they noted that the shift would occur on a more gradual basis and any cost avoidance may not occur immediately.

Staff Comment: According to a DHCS PARIS report submitted to the Legislature in April 2012, other states have more aggressively maximized the PARIS-Veterans data match and have shown substantial cost avoidance/savings results. For example, Pennsylvania estimated annualized cost avoidance/savings of approximately $27.8 million from a period covering nine quarters. Pennsylvania worked 40,769 cases resulting in reducing 4,448 cases from Medicaid.

In Washington State, the Washington Department of Social and Health Services paid the Washington Department of Veterans Affairs (WDVA) a yearly sum of $225,000 through an interagency contract with performance-based metrics. WDVA received ten percent of the actual savings verified by WDSHS. Because of this success, the performance contract was no longer needed as the Washington State Legislature appropriated $1.0 million dollars and four staff to WDVA to work exclusively on PARIS-V.

Hearing Questions: The subcommittee may wish to ask the Legislative Analysts Office the following questions.

1. Has LAO identified a cost avoidance method, currently being utilized in another state, that would be compatible to California?

2. Do the cost avoidance estimates made by the LAO regarding PARIS-Veterans remain the same as included in the 2007 report issued by LAO?

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The subcommittee may wish to ask CDVA the following questions.

3. Has CDVA engaged in any conversations with DHCS about expansion of the pilot program?

4. Could CDVA explain the process by which a county was selected for inclusion in the pilot project?

AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 4)

OUTCOMES

AGENDA – DISCUSSION / VOTE ITEMS

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Lois Wolk
Senator Tom Berryhill

Thursday, April 18, 2013
Upon Adjournment of Senate Budget and Fiscal Review
Room 112

Consultant: Brady Van Engelen

<u>Item Number and Title</u>

0840	State Controller
0890	Secretary of State
7502	California Technology Agency
8880	Financial Information System for California

(See Table of Contents on pages 1 and 2 for a More Specific Listing of Issues)

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AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 4)

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only:

	Issue	2013-14 Amount	Fund Source	Staff Recommendation
	Secretary of State (0890)			
1	Revision of Uniform Limited Liability Company Act	$89,000	Special Fund	APPROVE
2	Victims of Corporate Fraud Compensation Fund	$123,000 ($98,000 ongoing)	Special Fund	APPROVE
	California Technology Department (7502)			
3	Midrange Server Capacity	$14.9 million	Technology Service Revolving Fund	APPROVE
4	Mainframe CPU Processing Capacity	$7.21 million	Technology Service Revolving Fund	APPROVE
5	Enterprise Data Storage	$4.82 million	Technology Service Revolving Fund	APPROVE
6	Network Capacity	$5.12 million	Technology Service Revolving Fund	APPROVE

Issues Proposed for Vote Only – Issue Descriptions

Secretary of State

Issue 1 – Revision of Uniform Limited Liability Company (LLC) Act

Governor's Budget Request: The 2013-14 Governor's Budget includes a request for a one-time augmentation of $89,000 of Business Fees Funds to implement revisions per SB 323 (Chapter 419, Statutes of 2012).

Background: SB 323 (Chapter 419, Statutes of 2012) repealed an existing LLC law, contained in Title 2.5 of the California Corporations Code on December 31, 2013 and insert an entirely new LLC law contained in Title 2.6 effective January 1, 2014. The revisions are more uniform with current LLC law in other states.

The California Corporations Code requires LLC filings with the Business Programs Division to be on Secretary of State (SOS) prescribed forms. According to the SOS, the revisions in statute will require 23 LLC forms, instructions, and documents to be revised. Additionally, there are fifteen informational notices that will require revision and nine different SOS websites that will require updates. SOS does not intend on hiring additional personnel to make the necessary revisions.

Issue 2 – Victims of Corporate Fraud Compensation Fund

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for one permanent position and Business Fees Fund spending authority of $123,000 in the budget year, and ongoing expenditure authority of the Business Fees Fund of $98,000.

Background: SB 1058 (Chapter 564, Statutes of 2012) provided a statutory framework for the Secretary of State's (SOS) management of the Victims of Corporate Fraud Compensation Fund (VCFCF) by SOS, by codifying certain existing regulations promulgated by the SOS to administer the VCFCF, codifying changes to other existing regulations promulgated by the SOS, and adding new statutory language to facilitate the approval of valid claims from the VCFCF.

California Technology Department

Issue 3 – Midrange Server Capacity

Governor's Budget Request: The Governor's 2013-14 Budget requests increased expenditure authority of $14.91 million (Technology Services Revolving Fund). The request stems from the Office of Technology Services need for additional hardware, operating system software, applications software, Statewide E-mail, and Database software to ensure adequate midrange service capacity to meet the needs of customer driven workloads. This request also includes resources to meet the disaster recovery requirements of customers.

Background: There is an increased demand on services by customer departments at a variety of state entities. This increased demand, largely stemming from increased population and use of services, results in the growth of customer applications and the need for additional server capacity. Office of Technology Services (OTech) continues to experience a substantial increase in the midrange computing workload, database instances, Disaster Recovery, and web services.

Issue 4 – Mainframe CPU Processing Capacity

Governor's Budget Request: The Governor's 2013-14 Budget includes a proposal to increase expenditure authority by $7.21 million (Technology Services Revolving Fund) in Fiscal Year 2013-14 to allow the Office of Technology Services to purchase 1,872 millions of instructions per second (MIPS) of mainframe processing capacity to meet projected customer needs.

Background: In 2009-10, the Office of Technology Services relocated its raised floor computing operations and infrastructure from the Cannery Campus and South Annex building to the State Compensation Insurance Fund (SCIF) Vacaville building to provide ongoing lease cost savings, identified in the 2009-10 Data Center Relocation Budget Change Proposal. As a result of this relocation, the Office of Technology Services has two major mainframe data centers: Gold Camp and Vacaville.

The Office of Technology currently has over 500 customers of which, approximately 250 are mainframe processing customers, and many are still adding new applications, building new databases, and using WebSphere to add Web interfaces to their legacy applications. Mainframe computing demand is projected to increase by 12.1 percent in 2013-14.

Issue 5 – Enterprise Data Storage

Governor's Budget Request: The Governor's 2013-14 Budget includes a request to increase the spending authority of the Technology Agency by $4.82 million (Technology Services Revolving Fund) in Fiscal Year 2013-14 for hardware, software, and connectivity components to ensure adequate data storage support to meet the needs from customer-driven workloads, approved information technology (IT) projects, and disaster recovery.

Background: While providing for the increasing needs of current customers, the Office of Technology must provide resources for approved Information Technology projects supported by the Office of Technology. In order to achieve both normal growth and approved IT projects, the Office of Technology must increase the number and density of virtual servers in preparation of departments growing or migrating over to the Office of Technology. Virtual servers require large amounts of data storage to support their efficient and effective use of IT resources and data processing. Increased IT density allows the Office of Technology to support the migration of Information Technology workload from other agencies. In addition, the Office of Technology must provide for customers with Disaster Recovery data storage requirements that are currently located at the Office of Technology or relating them to the Office of Technology.

Issue 6 – Network Capacity

Governor's Budget Request: The Governor's 2013-14 Budget includes a request to increase the spending authority of the Technology Agency by $5.12 million (Technology Services Revolving Fund) in Fiscal Year 2013-14 to purchase switches, circuits, load balancers, firewalls and maintenance services.

Background: The Office of Technology currently manages two data centers located in Vacaville and Rancho Cordova, California. The Office of Technology is responsible for the network infrastructure needs of the data centers that provide network services connecting the Office of Technology data center facilities to most of the executive branch departments and local agencies.

This request addresses many of the objectives outlined in the 2012 Statewide IT Strategic Plan (ISTP), including:

- **Efficient, Consolidated, and Reliable Infrastructure and Services** – Leverage IT infrastructure and shared services that are secure and sustainable. Leveraging the advantages of cloud computing and establishing repeatable processes.

- **Accessible and Mobile Government** – Create a more accessible state government by increasing convenience, schedule and location accessibility issues. Create a more secure network for the state.

Issues Proposed for Discussion / Vote

0840 STATE CONTROLLER

Department Overview: The State Controller (SCO) is the Chief Fiscal Officer of California. The Controller provides fiscal control for, and independent oversight of, more than $100 billion in receipts and disbursements of public funds. In addition, the Controller offers fiscal guidance to local governments, and performs audit functions to uncover fraud and abuse of taxpayer dollars. The SCO's primary objectives are to:

- Account for and control disbursement of state funds.
- Determine legality and accuracy of claims against the State.
- Issue warrants in payment of the State's bills.
- Administer the Uniform State Payroll System.
- Audit and process personnel and payroll transactions for state civil service, exempt employees, and state university and college system employees.
- Audit state and local government programs.
- Inform the public of the State's financial condition.
- Administer the Unclaimed Property Law.
- Inform the public of financial transactions of city, county, and district governments.

The SCO is funded through the General Fund, as well as over 300 special funds and accounts and reimbursements. The Governor's Budget requests $173.25 million ($41.81 million General Fund) and 1,358 personnel years to support the SCO. This represents a substantial decrease in funding from the current year, due largely to the suspension of the 21st Century Project in February 2013.

2013-14 State Controller's Budget

FUND SOURCE	2011-12	2012-13	2013-14
General Fund	$74.83	$87.05	$41.81
Unclaimed Property Fund	$27.83	$32.78	$35.06
Central Service Cost Recovery Fund	$20.37	$20.10	$23.26
Other Special Funds and Accounts	$38.8	$48.73	$14.71
Reimbursements	$53.1	$59.3	$58.4
Total Expenditures	$215.10	$247.96	$173.24
Personnel Years	1,333.4	1,543.4	1,358.3

*Dollars in thousands

Issue 1 – Payroll Audits/Special Fund Audits

Governor's Budget Request: The State Controller's Office (SCO) has requested five two-year limited-term positions and $608,000 (General Fund) to perform payroll audits. Additionally, the State Controller's Office has requested 7.9 permanent positions and $828,000 to perform audits of the state's 570 special funds.

Background: Prior to the state adopting collective bargaining for state employees in 1979, the SCO performed many payroll functions under a more uniform standard. With the adoption of collective bargaining, the SCO decentralized many of the payroll functions, and the state provided four positions to audit many of the payroll functions that were delegated to state entities. According to the SCO office, budget constraints that existed in the early 1980s forced the state to eliminate the positions and the audit work performed by the SCO was no longer performed.

Government Code Section § 12476 affords the SCO the authority to audit the uniform state payroll system, the State Payroll Revolving Fund, and related records of state agencies within the uniform pay roll system. According to the SCO, the Audits Division will perform fourteen audits annually of state agencies that are deemed to be high-risk. The audit reports generated by the

SCO are designed to identify internal control weaknesses within each agency's payroll and personnel functions and will provide recommendations that the agency should adopt to address the identified weaknesses.

The SCO has submitted a second, but similar, budget change proposal that is being requested to support the audit of the state's 570 special funds. Specifically, SCO is requesting $828,000 in General Fund and 7.9 permanent positions to perform special fund auditing functions and provide annual reports to the Department of Finance (DOF). In light of a significant underreporting of funds available by a state agency to the DOF, the Governor directed the Department of Finance to conduct a fund-by-fund review in concert with the SCO to determine if any additional discrepancies in fund balances existed between the two agencies. This review led to the state to identify a number of accounting-related and reporting practices that would need to be adopted to address a continued special fund reconciliation process that has been outlined by the DOF and the SCO in a joint policy statement issued in August 2012.

Staff Comment: Both requests submitted are in response to the investigative work conducted by the Sacramento Bee, which found that the California Department of Parks and Recreation had been conducting a vacation buyout program that had distributed over $271,000. In a subsequent report, the Sacramento Bee discovered that the Department of Parks and Recreation had accumulated over $54 million in surplus money in two special funds managed by the Department.

Staff recognizes the need for SCO to be provided with additional resources to perform both the payroll and special fund audits. However, staff questions the need for the SCO to be provided with 7.9 permanent positions to support special fund audit related functions. The SCO has noted that the Financial Information Systems for California (FI$Cal), the business enterprise management system the state is preparing to implement, may have capabilities that assist in the review of special fund balances. While FI$Cal is not set for full implementation until July 1, 2016, FI$Cal is scheduled to begin its initial roll out in July 2013. Staff would recommend the requested 7.9 special fund audit positions be two-year limited term. Upon completion of the initial FI$Cal roll out, interested parties will have a better understanding of the capabilities of the FI$Cal platform and be able to make a more accurate assessment as to what, if any, personnel resources should be dedicated for special fund auditing purposes.

Staff Recommendation: Approve five two-year limited term positions and $608,000 in 2013-14 and 2014-15 (General Fund) to perform payroll audits. Approve 7.9 two-year limited-term positions to perform special fund audits, which includes $828,000 in 2013-14 and 2014-15 to perform special fund audits.

Vote:

0890 SECRETARY OF STATE

Department Overview: The Secretary of State (SOS), a statewide elected official, is the chief election officer of the State and is responsible for the administration and enforcement of election laws. The SOS is also responsible for the administration and enforcement of laws pertaining to filing documents associated with corporations, limited partnerships, and the perfection of security agreements. In addition, the office is responsible for commissioning notaries public, enforcing the notary laws, and in conjunction with being the home of the State Archives, preserving documents and records having historical significance. The SOS is the filing officer for lobbying and campaign registration and disclosure documents filed under the Political Reform Act. The SOS also operates the Safe-At-Home program, maintains the Domestic Partners and Advanced Health Care Directives Registries, and is home to the California Museum for History, Women and the Arts.

The Governor's Budget proposes total spending of $106.35 million ($26.62 million General Fund) for the SOS in 2013-14. Proposed staffing totals 503 personnel years (PYs), an increase of two PYs compared with the current year. The increase in proposed expenditures is due to a projected increase in Federal Trust Fund monies, which largely reflects counties' use of federal voting improvement funds. Counties' use of this money fluctuates annually.

2013-14 California Secretary of State Budget

Funding	**2011-12**	**2012-13**	**2013-14**
General Fund	$9.77	$26.57	$26.62
Secretary of State's Business Fees Fund	$35.52	$35.30	$35.17
Federal Trust Fund	$66.53	$19.15	$30.95
Reimbursements	$29.82	$10.51	$11.99
Victims of Corporate Fraud Compensation Fund	$2.96	$1.59	$1.53
Total Expenditures	$147.59	$91.12	$106.35
Personnel Years	470.5	501.0	503.0

*dollars in thousands

Issue 1 – Business Connect Project

Governor's Budget Request: The Governor's 2013-14 Budget proposes requests an augmentation of $3.721 million in reimbursement authority for the continuation of the California Business Connect Project.

Background: The Secretary of State is the filing officer for the state, responsible for filing commerce and trade documents such as business formations, state and federal tax lien notices, and keeping records of key persons or entities operating corporations and limited liability companies. The office receives more than one million business filings annually, and current systems rely on antiquated and paper databases, such as index cards, to process and maintain records. Many business services must be done in-person or by mail. These processes lead to very slow service, preventing new businesses from opening their doors and creating jobs. Processing times for the office have been as high as 117 days, preventing new companies from beginning operations and creating uncertainty for existing companies.

California Business Connect will automate these processes to allow for faster, more reliable services to businesses. Once completed, the project will allow for real-time filing or business records, allow government agencies to access information about businesses in a timely manner, and allow for more secure and timely processing of payments.

The Feasibility Study Report (FSR) for this project was approved by the Technology Agency in April 1, 2011. According to the most recent Project Status Report (PSR), which was released in March, the project management team is currently in confidential discussions with prospective bidders. The project management team anticipates the receipt of final proposals in June 2013. According to SOS project management, the requested $3.721 million in reimbursement authority will be utilized for contracting services for a project manager, independent project oversight consultant, independent validation and verification, information security vendor, test manager, and other operating expenses associated with the project.

Staff Comment: According to the FSR, the project is expected to cost $23.79 million to complete, with annual ongoing maintenance and support costs of $1.8 million. SOS believes that once the project is complete, it will provide a net benefit to the state of $5.8 million annually by allowing the office to eliminate 48 positions and creating a faster process to collect business fees, and potentially provide a greater source of revenue to the General Fund. The project is expected to see full implementation in June 2016.

The project will be funded through a portion of a $5 disclosure fee that is paid at the time domestic stock and foreign corporations file their annual Statements of Information, and expedited fees paid by businesses to ensure a quicker turnaround time. The use of this money is in compliance with California Corporations Code sections 1502 and 2117, which requires that one-half of disclosure fees must be utilized to enhance program services, including the development of an online database to provide public access to all information contained in the Statement of Information filing.

SOS states that it will not need to increase filing fees or seek General Fund monies to pay for this project. SOS will continue to seek expenditure authority for this project on an annual basis.

Staff Recommendation: Approve as Budgeted.

Vote:

Issue 2 – Help America Vote Act (HAVA) - VoteCal

Governor's Budget Request: The Governor's budget requests $27.079 million in expenditure authority from the Federal Trust Fund to continue work on the VoteCal system, an information technology project that will create a statewide database of voter registration information.

Background: Section 303 of the federal HAVA mandates that each state implement a uniform, centralized, interactive, computerized voter registration database that is administered at the state level. The state-managed system also must provide an interface for counties that are charged with conducting elections to allow counties to access and update registration data.

Currently, counties maintain voter registration data autonomously with their own election management systems. Data from these systems is uploaded to the state at varying intervals into a state database called CalVoter 1. This system has been approved by the federal government on a temporary basis until VoteCal is fully implemented.

The VoteCal project will create a new, interactive database and update county systems to allow interconnectivity. VoteCal also will allow connections to various databases in order to confirm voter identity (such as the Department of Motor Vehicles, and the Social Security Administration), and to vital records and criminal justice records in order to validate information on deaths and felony convictions.

According to the most recently submitted Special Project Report, (SPR5), total estimated costs are $98.17 million. Total current year spending for the project is approximately $4.7 million. The project will be deployed on a pilot basis in September 2015, and will be fully deployed in June 2016. The project is completely funded by the federal government. Operating costs – which SOS estimates will be $4 million annually, and will eventually be assumed by the state.

Staff Comment: On December 28, 2012 SOS awarded the System Integration (SI) contract to a vendor, CGI Technologies and Solutions. SOS and the vendor have developed a seven phase project timeline which includes; (1) project planning, (2) Design, (3) Development, (4)Testing, (5) Pilot Deployment, (6) Full Deployment and Cutover, and (7) First year operations and closeout. Throughout the process, SOS has committed to maintaining regular interactions with county election officials.

Staff Recommendation: Approve as budgeted.

Issue 3 – Help America Vote Act (HAVA) – Spending Plan

Governor's Budget Request: The Governor's 2012-13 Budget includes $3.8 million in spending authority from the Federal Trust Fund to continue implementing the Help America Vote Act of 2002 (HAVA).

Background: On October 29, 2002, President Bush signed into law the Help America Vote Act of 2002. This legislation requires states and localities to meet uniform and nondiscriminatory election technology and administration requirements applicable to federal elections. To date, California has received $433.9 million in federal HAVA funds, including interest earned.

HAVA has, so far, allowed the state and counties to replace punch-card voting systems and improve voter outreach, poll worker training, county security measures, and voter access for persons with disabilities. Activities in 2013-14 include voting system testing and approval and voter education programs. Grants to counties account for $1.12 million of the funding. In addition, the Secretary of State is continuing work on the VoteCal project. Continuing to fund the HAVA program is critical to meeting federal mandates.

Staff Comment: The Budget Act of 2004 included a one-time augmentation of $266.1 million in federal funds to continue HAVA implementation. However, spending authority was subject to annual spending plan update. Most recently, the 2012 Budget Act authorized expenditure authority of $4.4 million for voter education, voter system testing and approval, election assistance for individuals with disabilities, completion of the Post-Election Audit study, and regular administrative functions.

Staff Recommendation: Approve as Budgeted.

Issue 4 – SB 1001 Lobbyists and Committees Fees

Governor's Budget Request: The Governor's 2013-14 Budget requests an augmentation of one Personnel Year and $81,000 in expenditure authority from the Political Disclosure Accountability, Transparency and Access Fund to administer the provisions of SB 1001.

Background: Existing law, pursuant to the Political Reform Act of 1974 (PRA), requires the SOS, in consultation with the Fair Political Practices Commission, to provide online and electronic filing processes for use by specified political committees, lobbyists, lobbying firms, and lobbyist employers. Those processes must enable a user to comply with all relevant disclosure requirements. The SOS must also make all the data filed available on the Internet for public viewing in an easily understood format. This online reporting and disclosure system is commonly referred to as the Cal-Access system.

SB 1001 created the Political Disclosure Accountability, Transparency and Access Fund, increased the filing fee for lobbyists to $50 per year, and increased the filing fee for political committees. The intent of SB 1001 was to provide a source of revenue to assist the SOS with the maintenance and stabilization of Cal-Access. Cal-Access is a suite of applications developed in 13 different programming languages which, until recently, ran the system on a server cluster and associated components that are more than 12 years old, using an uncommon version of the Unix operating system. While the SOS has the funding to maintain the existing hardware and software, finding parts and qualified people to do the maintenance on such outdated equipment has been increasingly difficult.

Staff Comment: The Cal-Access system went down November 30, 2011, was restored December 7, 2011, went down December 9, 2011, and was restored again on December 30, 2011. The causes of the outages were layered and complex and no quick fix was available. The recovery efforts pursued in December 2011 stabilized Cal-Access and enable it to continue running. However, a long term alternative solution has yet to be identified.

Staff Recommendation: Approve as Budgeted.

Issue 5 – Elections Mandates

Governor's Budget Request: The Governor's 2013-14 Budget proposes to suspend three newly identified elections mandates, totaling $10.6 million in General Fund savings.

Background: Mandate suspension does not impact state statute. However, compliance with State Statute is subject to local election officials as the suspended mandates are not considered reimbursable activities. The three mandates proposed for suspension include:

Voter Identification Procedures: SB 414 (Chapter 260, Statutes of 2000) requires local election officials to compare signatures on provisional ballot envelopes with signatures on voter registration materials and reject provisional ballots if they determine the signatures do not match. Estimated statewide costs associated with this mandate are estimated to be $7.2 million.

Permanent Absent Voters: A series of measures (AB 1520, Chapter 922, Statutes of 2001, AB 3034, Chapter 664 Statutes of 2002 and AB 188, Chapter 347, Statutes of 2003) have increased accessibility to permanent absentee voter status for eligible voters. The Commission on State Mandates has determined that maintenance of that list is a reimbursable activity and statewide cost is estimated to be $2.3 million.

Modified Primary Election: The blanket primary system established under Proposition 198 (1996), allowed voters not affiliated with political parties to vote in party primaries. The Legislature passed SB 28 (Chapter 898, Statutes of 2000) upon a Supreme Court ruling which deemed Prop 198 unconstitutional, which restored many of the same voting practices put in place prior to 1996, with the exception that voters could participate in the party primaries at the party's discretion. The scope of reimbursable costs has been reduced significantly upon the passage of Proposition 14, which established the current open primary system and are related only to Presidential primaries and elections for party officials. The Commission on State Mandates has determined that reimbursable costs associated with this mandate total $1 million.

LAO Recommendation: In addition to the three mandates proposed for suspension the 2013-14 Budget, the LAO has identified six others that relate to local elections. The LAO has raised concerns with the level of uniformity that would exist if the proposed three mandates are suspended, and has recommended that the Legislature fund all elections mandates. Doing so would require $60 million in 2013-14 and ongoing costs would be approximately $30 million. Additionally, the LAO has suggested that the Legislature direct the Administration to work with counties to explore alternative funding mechanisms for elections mandates. Estimates for each currently suspended mandate and the mandates proposed for suspension are listed below:

MANDATE	2013-14	2014-15	2015-16
Voter Identification Procedures	$7.2 million	$4 million	$4 million
Permanent Absentee Voters II	$2.3 million	$4 million	$4 million
Modified Primary	$1.0 million	------------	$0.5 million
Absentee Ballots	$49.6 million	------------	$25 million
Absentee Ballot – Tabulation by Precinct	$70k	------------	$70k
Brendan Maguire Act	---------------	------------	Negligible
Handicapped Voter Access Information	---------------	------------	Negligible
Voter Registration Procedures	$2.5 million	------------	$1.5 million
TOTAL	$60 million	$10 million	$30 million

Staff Recommendation: Action related to this item will be taken at a later Subcommittee hearing.

7502 DEPARTMENT OF TECHNOLOGY

Department Overview: The Department of Technology supports state programs and departments in the delivery of state services and information to constituents and businesses through agile, cost-effective, innovative, reliable and secure technology. The Department retains statewide authority to centralize and unify information technology projects and data center services to enhance the ability to develop, launch, manage and monitor large information technology projects.

In August 2010, the California State Legislature passed AB 2408 (Chapter 404, Statutes of 2010) to reestablish the Office of the State Chief Information Officer (OCIO) as the California Technology Agency and to rename the State Chief Information Officer as the Secretary of the California Technology Agency. While Senate Bill 90 (Chapter 183, Statutes of 2007) had already made the OCIO a cabinet-level agency with statutory authority over strategic vision and planning, enterprise architecture, IT policy, and project approval and oversight for the state in 2007; AB 2408 codified into law significant functions, duties, and responsibilities of the office that had been assigned to the Office of the Chief Information Officer. In addition to consolidating statewide IT functions under one cabinet-level agency, the legislation passed in 2010 was also responsible for coordinating the activities of agency and department CIOs and promoting the efficient and effective use of IT in state operations.

Effective July 1, 2013, the Governor's Reorganization Plan No. 2 (GRP2) creates the Government Operations Agency and, as a part of that plan, moves the California Technology Agency (previous Organization Code 0502) under the newly created Government Operations Agency.

The Office of Technology Services (OTech), within the Department of Technology, provides the Information Technology processing platforms for over 500 customers, including the Executive Branch and public entitites. OTech is accountable to its customers for providing secure services that are responsive to their needs and represent best value to the state. The OTech is a fee-for-service organization and operates as a 100 percent reimbursable department. OTech's Service Level Agreements with its customers include a 99.9 percent service availability goal for IT services. The OTech must continue to provide sufficient processing capacity to deliver their performance and service agreed to in the Service Level Agreements.

Budget Overview: The Governor's 2013-14 Budget proposes $543.49 million dollars ($4.24 million General Fund) and 1,242.2 Personnel Years. The Governor's 2013-14 Budget request reflects an increase of $57.7 million dollars ($60,000 General Fund decrease) and an increase of 5.0 Personnel Years that were approved in the Fiscal Year 2012-13 Governor's Budget.

2013-14 California Technology Agency Budget Overview

Funding	2011-12	2012-13	2013-14
General Fund	$3.31	$4.30	$4.24
State Emergency Telephone Number Account	$93.99	$111.86	$113.07
Federal Trust Fund	$1.93	$1.93	$1.93
Reimbursements	$1.63	$2.81	$2.81
Technology Services Revolving Fund	$324.27	$362.13	$418.26
Central Service Cost Recovery Fund	$3.29	$3.20	$3.19
Total Expenditures	$428.43	$486.22	$543.49
Personnel Years	1,145.9	1,237.2	1,242.2

*dollars in thousands

Issue 1 – Information Technology Procurement Transfer

Spring Finance Letter: The Governor's 2013-14 Budget requestis the transfer of the Information Technology (IT) Procurement Section within the Department of General Services (DGS) to the Technology Department (department). This request includes a request to transfer funding and 23 positions to the department. Includes a request for a $212,000 budget augmentation to support the facilities costs associated with absorbing 23 personnel and also includes trailer bill language necessary to provide the department with the appropriate authority to conduct IT procurement-related activities.

Background: AB 1498 (Chapter 139, Statutes of 2012) required the DGS and the department to develop a plan for the transition of IT procurement authority from DGS to the department. Shortly thereafter, the Information Technology Procurement Authority Workgroup (ITPAW) was formed, and tasked with providing a recommendation to the Governor regarding organization responsibility for IT procurement authority. The ITPAW recommended moving procurement authority from DGS to the department effective July 1, 2013.

According to the department, this request represents a significant increase in workload and cannot be absorbed internally. Included in this request is a $212,000 budget augmentation that will allow the department to absorb IT procurement staff currently located at DGS. The DGS has submitted a conforming Spring Finance Letter that will transfer authority and the associated positions to the Technology Department.

Staff Comment: Staff notes that the request underscores the greater level of efficiencies that will be achieved by transferring technology procurement authority from the DGS to the department. Staff recommends that the department report to the Legislature the extent to which efficiencies are made. Specifically, the extent to which:

- Procurement timelines are reduced, and
- Size and requirements of procurement documents are reduced,

Staff Recommendation: Approve the Spring Finance Letter request, approve draft trailer bill and approve conforming Spring Finance Letter request submitted by the Department of General Services. Adopt proposed Supplement Reporting Language as defined in staff recommendation.

Issue 2 – Telecommunications Procurement Transfer

Spring Finance Letter: The Governor's 2013-14 Budget requests the transfer of 4.5 positions and funding related to telecommunication procurement activities within the Department of General Services to the Technology Department (department). This proposal also includes trailer bill language necessary to provide the department with the authority to conduct telecommunication procurement oversight related activities.

Background: Currently, the Department of General Services Procurement Division is responsible for the acquisition of telecommunication goods or services. AB 2408 (Chapter 404, Statutes of 2010) amended the Public Contract Code and transferred this authority to the then California Technology Agency. The transition began on February 1, 2012 and the agency created the Telecommunications Procurement Branch (TPB). The requested 4.5 permanent positions will be tasked with the development of workload rates associated with the procurement of telecommunications for the state.

Staff Comment: This request conforms with previous action taken by the Legislature.

Staff Recommendation: Approve Spring Finance Letter request, approve draft trailer bill language and approve conforming Spring Finance Letter request submitted by the Department of General Services.

8880 FINANCIAL INFORMATION SYSTEM FOR CALIFORNIA (FI$CAL)

Budget Overview: The 2012 Budget Act revised the funding formula for FI$Cal, such that nearly all of the financial support directed to FI$Cal is provided through various special and nongovernmental cost funds. The Governor's Proposed 2013-14 Budget includes $84.8 million, ($2.1 million General Fund) in support for the FI$Cal. FI$Cal's positions for 2011-12 totalled 158. As of December 1, 2012, FI$Cal had 242.5 positions, 231 were permanent and 11.5 were temporary.

Background: The Financial Information System for California (FI$Cal) is an enterprise resource planning IT platform designed to consolidate the functions of budgeting, accounting, procurement, financial management and cash management. FI$Cal is based on an off-the-shelf software package and the project is designed to require a limited number of modifications. The FI$Cal project stems from a requirement for the Department of Finance (DOF) to establish a new budget information system that would replace the current network of legacy systems that exist throughout the state's departments and agencies. FI$Cal will eliminate the need for more than 2,500 independent legacy systems and department-specific applications that now support the internal financial management operations of the State. Many of the requirements of FI$Cal are identified in Government Code Section § 15849.22.

The most recent projections for the overall cost of the project are $616.8 million, representing a significant reduction from the earlier estimate of $1.6 billion. This downward revision is attributable to cost reductions in several areas, including: departmental project staff; data management, and departmental end-user staff. In addition, the primary vendor was able to develop a more detailed and reduced cost estimate as the program has continued to evolve.

The final wave of FI$Cal has a go-live date of July 2016, and will begin standard maintenance and operations procedures by the 2017-18 fiscal year. The FI$Cal system is scheduled to be deployed in five waves, composed of a Pre-Wave and Waves 1-4. Pre-Wave is scheduled to go live July 1, 2013. Waves 1 through 4 are scheduled to go live in the subsequent three years. Pre-Wave is set to include the following: Agricultural Labor Relations Board, Office of Environmental Health Hazard Assessment, Department of Aging, California Arts Council and the Department of Fair Employment and Housing.

Wave 1, which is scheduled for July 1, 2014 will include: Alcohol and Beverage Control Appeals Board, California Alternative Energy and Advanced Transportation Financing Authority, California Citizens Compensation Commission, California Debt and Investment Advisory Commission, California Debt Limit Allocation Committee, California Educational Facilities

Authority, California Health Facilities Financing, California Industrial Development Financing Advisory Commission, California Pollution Control Financing Authority, California Postsecondary Education Commission, California School Finance Authority, California State Summer School for the Arts, California Tax Credit Allocation Committee, California Urban Waterfront Area Restoration Financing Authority, Department of Alcohol and Beverage Control, Department of Justice, Department of General Services – Contracted Fiscal Services, Fair Employment and Housing Commission, San Francisco Bay Conservation and Development Commission, Scholarshare Investment Board, State Board of Equalization, State Controller's Office, State Treasurer's Office and the Department of Finance.

The implementation of FI$Cal remains on track; however, there are still some issues that could alter either the cost or implementation timeline of the project. For example, the Bureau of State Audits (BSA) found, in its most recent annual update on the FI$Cal project, that there are a few issues that could be of concern to the Legislature, including data management and conversion, which are critical components required to fully implement FI$Cal.

Another issue that has been identified by the BSA is the current level of staffing of critical activities associated with the implementation of FI$Cal. As of February 2013, there was a 22.5 percent staff vacancy rate at FI$Cal. While staffing levels have increased, FI$Cal has seen a net gain of 66 staff in the calendar year, the FI$Cal project management team has noted that there are a limited pool of applicants that meet the necessary skill sets required to fill the positions.

The project management team has completed an inventory and has identified 2,200 legacy systems that will need to be converted to FI$Cal. Additionally, there are 3,400 interfaces that will exchange data with FI$Cal. The project management team cancelled the procurement of a data management contractor in June 2011, and the procurement of a new data management vendor had not been completed at the time of the completion of the audit conducted by BSA.

Staff Comment: This item is included as an informational item.

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Lois Wolk
Senator Tom Berryhill

Thursday, April 18, 2013
Upon Adjournment of Senate Budget and Fiscal Review
Room 112

Consultant: Brady Van Engelen

<u>Item Number and Title</u>

0840	State Controller
0890	Secretary of State
7502	California Technology Agency
8880	Financial Information System for California

(See Table of Contents on pages 1 and 2 for a More Specific Listing of Issues)

AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 4)

OUTCOMES

AGENDA – DISCUSSION / VOTE ITEMS

Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Lois Wolk

Thursday, April 25, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Mark Ibele

Agenda Part A

State Administration and Local Finance

Overview of Redevelopment Agencies and Fiscal Impacts

Proposed Discussion / Vote Calendar:

Overview of Redevelopment Agencies and Fiscal Impacts

Presentation from the Legislative Analyst's Office and the Department of Finance, focusing on the process of the dissolution of redevelopment agencies, property tax distributions, and impacts on local agencies.

Legislative Analyst's Office
- Marianne O'Malley
- Brian Uhler

Department of Finance
- Chris Hill
- Andrea Scharffer

Background: Since the Governor initially proposed eliminating redevelopment agencies (RDAs) as a key component of the 2011-12 Budget, the Legislature has been grappling with the issues related to their dissolution and associated concerns regarding community development. The Governor's initial proposal was anchored by the perspective that the diversion of over $5 billion in property taxes to RDAs was no longer feasible and such resources should be more effectively channeled to cities, counties, schools and other local governments. After consideration of the Governor's proposal, the Legislature altered the approach by developing legislation that addressed the state's budgetary requirements while accounting for a continuing need for local economic tools.

The Legislature's approach, incorporated in the 2011-12 budget agreement, established an alternative voluntary redevelopment program pursuant to AB 27 X1, (Chapter 6, Statutes of 2011), but eliminated RDAs in AB 26 X1, (Statutes of 2011, Chapter 5) for communities that chose not to participate in the alternative program. RDAs could avoid elimination if the communities that formed them agreed to participate in the alternative voluntary redevelopment program and remit annual payments to K-14 education. The approach provided for significant budgetary relief, by allowing additional revenues to flow to K-14 education, but retained RDA functions for local governments in the long-term. The adopted budget assumed $1.7 billion in RDA payments would offset General Fund spending in the budget year and $400 million annually in subsequent years.

Following the passage of these complementary measures, the California Redevelopment Association challenged the constitutionality of both pieces of legislation. In its December 20011 ruling, the California Supreme Court held that AB 26 X1, allowing for the dissolution of RDAs was valid, but that the companion measure assuring their continuation was invalid. As a result, AB 26 X1 went into effect; RDAs were dissolved as of February 1, 2012, with their affairs, including the disposal of RDA assets, to be resolved by individual successor agencies. As a result of the court decision, property taxes that formerly went to RDAs were directed to existing ‘pass-through’ requirements for local agencies; successor agencies for the retirement of RDAs’ debts and other obligations; and cities, counties, K-14 education and special districts.

The 2012-13 Governor’s Budget incorporated the court decision, resulting in revised estimates for the General Fund offset for K-14 education funding requirements. The General Fund savings for 2011-12 was estimated at $1.1 billion (from $1.7 billion), but increased to $1.1 billion (from $400 million) for 2012-13 as a result of increased flow of property taxes. This resulted in a net gain over the two year period from the prior estimate. The 2012-13 Budget assumed that approximately $1.7 billion would be received by K-14 education and serve to offset the state's Prop 98 General Fund obligation, with an additional $1.4 billion to be received from freed-up former RDA cash and cash-equivalent assets during the budget year.

As part of the 2012-13 Budget, AB 1484 (Chapter 26, Statutes of 2012) provided additional tools for successor agencies, oversight boards, and the Department of Finance (DOF) to facilitate the orderly wind-down of RDA activities. AB 1484 created a process to: transfer former RDA housing assets to housing successor entities; require audits of various RDA funds and accounts to identify unencumbered funds that should be remitted to local taxing entities; and require the completion of a long-range property management plan to facilitate the disposition of RDA properties. The legislation also allowed local communities that received a ‘finding of completion’ from the DOF additional discretion regarding former RDA real property assets, loan repayments to the local community, and the use of proceeds from bonds issued by the former RDA. The finding of completion is an indication that all amounts determined to be due from the former RDA have been paid and satisfied.

Governor’s Budget and Current Activities: The Governor’s Budget includes no new initiatives regarding RDA dissolution or alternative community development approaches, but the ongoing procedures for existing policies represent a substantial commitment of resources. The process of winding-down a $5.0 billion plus annual program administered, controlled and implemented at the local level has proven to be exceedingly complex and time-consuming, in addition to being highly contentious. Thus, the central thrust of the Governor’s proposal is to continue the process of unwinding the RDAs and facilitating the flow of additional property tax dollars to local governments, while maintain payments on existing obligations.

Ongoing workload related to the winding-down of RDAs involves the generation, submittal, and review of hundreds of so-called Recognized Obligation Payment Schedules (ROPS) each with a multitude of entries. Every six months, successor agencies must submit to DOF their ROPS, which indicates their proposed payments for the next payment cycle. The DOF reviews each ROPS to determine whether the identified payments are enforceable obligations. The successor agencies are then provided property tax allocations to pay the approved enforceable obligations. Any property tax revenue remaining after the enforceable obligations are paid is distributed to the affected taxing entities based on their property tax share. The additional property tax revenue received by local schools generally offsets the state's Proposition 98 General Fund costs.

As the background discussion suggests, accurately estimating the property tax revenue available for local governments has been a significant budgetary challenge. This is mainly because comprehensive information concerning the amount of property taxes required by RDAs for paying enforceable obligations was not available early on, nor was consistent data on cash assets available. Now that three payment cycles worth of information is available and cash assets are more apparent, more accurate estimates are possible. The Governor's Budget includes Proposition 98-related General Fund savings totaling $2.1 billion in 2012-13 and $1.1 billion in 2013-14. This is revised downward from the 2012 Budget Act estimate of $3.2 billion in 2012-13 and $1.6 billion in 2013-14, and accounts for both on-going revenues and the one-time distribution of cash assets. Going forward, the obligations of the former RDAs will continue to decline as debts are paid off and the ongoing savings to the state will increase. It is estimated that by 2016-17 approximately $1 billion in ongoing savings will be achieved.

Staff Comments: Many communities had significant numbers of complex projects currently funded by property tax revenues, as well as plans for additional redevelopment expenditures. A significant portion of former RDA funds are committed to the payment of existing obligations and, as a result, drafting a plan for local governments to unwind their RDA programs and successfully navigate the many legal, administrative, and financial factors has been complex. In particular, many communities have raised concerns regarding the completion of planned or partially finished projects.

RDA dissolution has prompted interest in developing a replacement program and a discussion of elements that such a program might contain. AB 1484 provided some additional tools for local communities, in that localities that comply with RDA dissolution requirements can retain and develop existing assets, as well as use bond proceeds from prior bond issues. Longer term solutions will require analysis on the proper roles—fiscal and otherwise—of state and local governments in supporting local government development efforts. There may be suitable options for programs that allow local discretion in community development efforts and provide accompanying fiscal tools, but eliminate the fiscal exposure to the state.

Proposed Discussion / Vote Calendar:

8885 Commission on State Mandates

Department and Budget Overview: The Commission on State Mandates (Commission) is a quasi-judicial body created for the purpose of determining the state mandated costs. The objective of the Commission is to impartially hear and determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state consistent with Article XIII B, section 6 of the California Constitution. The Commission consists of the Director of Finance, the State Controller, the State Treasurer, the Director of the Office of Planning and Research, and a public member and two local government representatives appointed by the Governor and approved by the Senate.

For 2012-13, the Commission was budgeted at $1.6 million and 11 positions for state operations. This administrative support level is proposed to increase slightly to $1.8 million and 13 positions in the budget year. Costs associated with funding mandates proposed in the Governor's Budget are approximately $50 million in both the current and budget year.

Background and Detail: The Commission is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments, and for establishing the appropriate reimbursement to local governments from a mandate claim. The Constitution generally requires the state to reimburse local governments when it mandates that they provide a new program or higher level of service. Activities or services required by the Constitution are not considered reimbursable mandates. The Constitution, as amended by Proposition 1A of 2004, requires that the Legislature either fund or suspend local mandates. Payments for mandate costs incurred prior to 2004 are one exception noted in the Constitution and such pre-2004 mandate costs can be repaid over time. Another exception in the Constitution is for mandates related to labor relations. In these cases, the state can defer payment of the mandates and still retain the mandates' requirements. In most cases, if the Legislature fails to fund a mandate, or if the Governor vetoes funding, the legal requirements are considered suspended pursuant to the Constitution.

Mandate reimbursement claims are filed with the Commission for the prior fiscal year—after that fiscal year is completed and actual costs are known. The state pays the mandate claims in the following fiscal year. For example, local costs incurred in 2011-12 are reported and claimed in 2012-13, and the state will reimburse locals for these costs as part of the 2013-14 budget. Suspending a mandate does not relieve the state of the obligation of reimbursing valid claims from prior-years, but it does allow the state to defer payment. For example, several elections-related mandates were suspended for the first time in the 2011-12 budget. This means the activities for locals were optional in 2011-12 and locals cannot claim reimbursement for any new costs incurred in 2011-12. However, the mandate claims for these costs in 2009-10 and 2010-11 are still due—either over time or all at once in the year when the mandate suspension is lifted. The state owes local governments approximately $1.8 billion in non-education mandate payments. Of this, about $900 million is associated with pre-2004 mandate claims.

Issues Proposed for Discussion / Vote:

1. **Mandate Reform (Discussion Issue).** Determining whether a particular requirement is a state-mandated local program and the process by which the reimbursable cost is determined is an extensive, time-consuming, and multi-stage undertaking. State and local officials have expressed significant concerns about the mandate determination process, especially its length and the complexity of reimbursement claiming methodologies.

   According to an LAO review a few years ago, it took the Commission over five years to complete the mandate determination process for a successful local government test claimant. The review of new mandates claims found that the Commission took almost three years from the date a test claim was filed to render a decision as to the existence of a state-reimbursable mandate. The Commission took more than another year to adopt the mandate's claiming methodology and almost another year to estimate its costs and report the mandate to the Legislature. Because of the current backlog, the delay can be even longer. The Commission has submitted a budget change proposal for 2013-14 to address the backlog issue and speed up the mandate process but the resulting improvements are still not expected to meet the statutory time frame.

   This lengthy period of review and determination presents several difficulties that affect both the state and local governments. Among the most important are flip sides of the same coin, specifically:

   - Local governments must carry out the mandated requirements without reimbursements for a period of some years, plus any additional time associated with development of the mandate test claim, appropriation of reimbursement funds, and the issuance of checks.

   - State mandate liabilities accumulate during the determination period and make the amount of state costs reported to the Legislature higher than they would be with an expedited process. Policy review of mandates is hindered because the Legislature receives cost information years after the debate regarding its imposition.

   In addition to the delays that characterize the review and determination process, there are other significant issues. On the cost determination side, since most mandates relate to expanding existing programs (rather than instituting completely new ones), local governments have difficulty in measuring the associated marginal costs. The complexity of the claiming methodologies means local governments' claimed costs frequently are not supported by source documents showing the validity of such costs or are not allowable under the mandate's reimbursement methodology. Accordingly, the State Controller's Office has disallowed a significant number of all reimbursement claims over the last few years, leading to frequent appeals, more uncertainty and mounting bills.

Staff Comment and Questions: The Administration indicates in the Governor's Budget that it will pursue policies to improve the mandate process, including deferring decisions to local government decision-makers and allowing for maximum flexibility. In addition, LAO has in the past recommended a 'best practices' approach for various local activities and requirements. The Legislature could consider these approaches and compare their advantages with policies adopted at the state level and the likely costs of such mandated programs. In addition, in some cases, reimbursement amounts for local government activities are well in excess of reasonable costs, which appear to warrant some additional oversight of reimbursement standards and practices.

Questions: *(1) What suggested reforms do you have for the mandate process? (2) Absent fundamental reform, what are the best interim steps the Legislature can take to synchronize imposing requirements on local governments and awareness of cost imposed on the state? (3) What type of reforms are necessary to address incidents of high cost reimbursement claims by local governments?*

Staff Recommendation: No action required. Information issue.

2. **Additional Staff for Timely Mandate Determinations (Governor's Budget BCP#1):** The Governor's Budget proposes an augmentation of $245,000 (General Fund) for additional staff for the Commission. The requested positions would be devoted to increasing the capacity of the Commission to better comply with statutory time frames and accelerate the reduction in the backlogs associated with various Commission activities, including: test claims, establishment and amendments to parameters and guidelines, statewide cost estimates, and incorrect reductions claims. The proposal is for one staff attorney and a senior legal analyst.

   Background: As noted in the discussion below, the mandate process suffers from a number of fundamental weaknesses. One of the areas of administrative shortfall is the timeliness of responses from the Commission with respect to the activities noted above. With limited resources, the Commission has made some progress in reducing the backlogs, and this proposal will further advance these efforts.

   Staff Comment: The proposal clearly does not address the more fundamental issues associated with mandate determination and cost reimbursement. Most of these issues must be addressed through legislation. Nevertheless, the proposal would result in additional progress to reducing the delays that are endemic in the current system.

Staff Recommendation: Approve the budget request.

Vote:

3. **Mandate Funding (Governor's Budget Proposal):** The Governor's mandate proposal is a continuation of the status quo in terms of mandates in effect and mandates not in effect**.** The Governor's Budget proposes expenditures of $48.4 million (General Fund) related to 13 non-education mandates. These 13 mandates are identical to those funded and kept in force during the current year, the payments on which constitute the bulk of the General Fund cost for this item. These mandates all relate to public safety or property taxes and are listed in the following table:

Mandate Funding in Governor's Budget
General Fund
(Dollars in Thousands)

Funded Mandate Title	Amount
Allocation of Property Tax Revenue	$520
Crime Victim's Domestic Violence Incident Reports	175
Custody of Minors-Child Abduction and Recovery	11,977
Domestic Violence Arrests and Victim's Assistance	1,438
Domestic Violence Arrest Policies	7,334
Domestic Violence Treatment Services	2,041
Health Benefits for Survivors of Public Safety Officers	1,780
Medical Beneficiary Death Notices	10
Peace Officer Personnel Records	690
Rape Victim Counseling	344
Sexually Violent Predators	21,792
Threats Against Police Officers	3
Unitary Countywide Tax Rates	255
Total	**$48,359**

Staff Comment: At the time the agenda was finalized, no concerns had been raised with this budget request. The mandates selected for funding continue the policy adopted in previous years by the Legislature.

Staff Recommendation: Approve the budget request for continued funding of selected local government mandates.

Vote:

4. Mandate Suspensions (Governor's Budget Proposal): The Governor's Budget proposes the suspension of numerous mandates in order to achieve budgetary savings. Many of these have been suspended for several years, typically as part of the budget process. In general, mandate suspension has not been subject to thorough policy review that would evaluate the costs and benefits of the mandate, but rather have been suspended solely for the purpose of budgetary savings. The policy decision to establish the mandate in the first place has not generally been a substantial component of the discussion.

Mandates proposed for suspension include mandates suspended in prior years (Group 1), immediate suspension of five new mandates with statewide cost estimates (Group 2), and four new mandates without statewide cost estimates (Group 3). These are discussed separately below.

Group 1: The mandates proposed for continued suspension are those mandates which have been previously suspended (Group 1). These are listed in the figure below.

Mandates Suspended in Governor's Budget
General Fund
(Dollars in Thousands)

Suspended Mandate Title—Group 1	Amount
Adult Felony Restitution	$0
Absentee Ballots *	49,598
Absentee Ballots-Tabulation by Precinct *	68
AIDS/Search Warrant	1,596
Airport Land Use Commission/Plans	1,263
Animal Adoption	45,321
Brendon Maguire Act*	0
Conservatorship: Developmentally Disabled Adults	349
Coroners Costs	222
Crime Statistics Reports for the Department of Justice & CSRDOJ Amended	160,705
Crime Victims' Domestic Violence Incident Reports II	2,010
Deaf Teletype Equipment	0
Developmentally Disabled Attorneys' Services	1,198
DNA Database & Amendments to Postmortem Examinations: Unidentified Bodies	310
Domestic Violence Information	0
Elder Abuse, Law Enforcement Training	0
Extended Commitment, Youth Authority	0
False Reports of Police Misconduct	10
Fifteen-Day Close of Voter Registration*	0
Firearm Hearings for Discharged Inpatients	156

Grand Jury Proceedings	0
Handicapped Voter Access Information*	0
In-Home Supportive Services II	444
Inmate AIDS Testing	0
Judiciary Proceedings (for Mentally Retarded Persons)	274
Law Enforcement Sexual Harassment Training	0
Local Coastal Plans	0
Mandate Reimbursement Process I	6,910
Mandate Reimbursement Process II (includes consolidation of MRPI and MRPII)	0
Mentally Disordered Offenders': Treatment as a Condition of Parole	4,909
Mentally Disordered Offenders' Extended Commitments Proceedings	7,215
Mentally Disordered Sex Offenders' Recommitments - Verify Name	340
Mentally Retarded Defendants Representation	36
Missing Person Report III	0
Not Guilty by Reason of Insanity	5,213
Open Meetings Act/Brown Act Reform	113,101
Pacific Beach Safety: Water Quality and Closures	344
Perinatal Services	2,337
Personal Safety Alarm Devices	0
Photographic Record of Evidence	279
Pocket Masks (CPR)	0
Post Conviction: DNA Court Proceedings	411
Postmortem Examinations: Unidentified Bodies, Human Remains	5
Prisoner Parental Rights	0
Senior Citizens Property Tax Postponement	481
Sex Crime Confidentiality	0
Sex Offenders: Disclosure by Law Enforcement Officers	0
SIDS Autopsies	0
SIDS Contacts by Local Health Officers	0
SIDS Training for Firefighters	0
Stolen Vehicle Notification	1,117
Very High Fire Hazard Severity Zones	0
Victims' Statements-Minors	0
Voter Registration Procedures*	2,481
	$408,703

LAO Perspective: LAO has raised questions regarding the six mandates slated for suspension by the Governor's Budget that deal with elections matters. The LAO recommended that these six mandates identified by an asterisk (*) in the table above not be suspended but rather funded in the budget, along with the direction that the Administration work with counties to explore alternative funding mechanisms.

Staff Comment: No concerns have been raised regarding the continued suspension of these mandates, other than issues noted by LAO. Staff notes that suspending the election mandates would not preclude the Administration from working with counties to explore alternative funding mechanism, as suggested by LAO. The selected mandates in the figure have been suspended in prior years.

Staff Recommendation—Group 1: Approve the continued suspension of all the mandates included in the table above.

Vote:

Group 2: The second group of mandates proposed for suspension is made up of five mandates with newly identified cost estimates. These comprise three mandates associated with elections—Modified Primary Election, Permanent Absentee Voter, and Voter Identification Procedures. These three mandates are considered by the committee as a separate agenda budget item. The remaining two mandates with statewide cost estimates are related to public safety—Domestic Violence Background Checks and Identity Theft—and will be considered in Senate Subcommittee #5. Note that these five mandates constitute the so-called "Reserve Builders", the suspension of which generates $111.0 million in General Fund savings.

Staff Recommendation—Group 2: No action required in this item.

Group 3: The third group of mandates designated for suspension is made up of four mandates without statewide cost estimates, as yet. Two of these mandates—Tuberculosis Control and Interagency Child Abuse and Neglect Investigation Reports—will be addressed in Senate Subcommittee #3. The remaining two mandates in this group—California Public Records Act and Local Agency Ethics—are discussed below.

- **California Public Records Act.** The core provisions of the California Public Records Act (CPRA), relating to the right of residents to inspect public records and receive copies on request, are not reimbursable mandates. The reimbursable mandate portions of the CPRA relate to providing assistance to those seeking records, notification to the requestor regarding whether the records may be disclosed, and expunging home addresses and phone numbers of employees that relate to request. Suspension would not affect the obligations of local governments to comply with the core provisions of the CPRA. LAO recommends that the provisions of the law that constitute mandates be recast as optional 'best practices.' LAO indicates that the statewide costs—when they are provided—are likely to be in the tens of millions of dollars annually.

- **Local Agency Ethics**. The Commission determined that state law makes it mandatory for some local governments (largely general law cities, and certain special districts, that are required to pay compensation) to adopt policies relating to reimbursement of expenses and provide ethics training for officials who receive compensation. LAO points out the somewhat puzzling inconsistency of imposing the mandate on local governments (that are required to pay compensation) and not on others. LAO recommends changes in law that would make compensation optional for all local governments (thus removing the mandate) or exclude from the requirement those local governments that are obligated to pay compensation.

Staff Comment: There are important policy issues that are imbedded in each of the two mandate programs discussed in this item. LAO's proposal to recast the CPRA mandate as best practices makes policy sense, as it would require local governments to adopt the best practices or, alternatively, announce at the first public meeting that it was not going to adopt best practices. Similarly, for the Local Agency Ethics mandate, there are numerous issues associated with local government compensation and associated ethics that are best left to a policy discussion.

Staff Recommendation—Group 3: Approve suspension of Local Agency Ethics and California Public Records Act mandates.

Vote:

5. Open Meeting Act Mandate (LAO Issue). Most of the core requirements pertaining to California's Open Meeting Act preceded the 1975 operative date of mandate law and are thus not reimbursable. However, the Commission has determined that certain post-1975 procedural amendments to the Brown Act are a reimbursable state mandate. These "Open Meeting Act" mandates require local agencies to (1) prepare and post agendas 72 hours before a hearing, and (2) follow certain noticing and reporting procedures for items considered in closed session. The Open Meeting Act mandate has been suspended since 2011-12, and the Governor's budget proposes to suspend the Open Meeting Act mandate in 2013-14. Suspending this mandate would make local governments' compliance with provisions related to posting and preparation of agendas and closed session procedures optional in 2013-14.

In November 2012, voters approved Proposition 30 which included language intended to prospectively exempt all provisions of the Open Meeting Act statutes from being considered a state-reimbursable mandate. However, the proposition did not explicitly set aside the Commission decision on the Open Meeting Act mandate. State law defines a process by which local governments and state agencies may request the Commission to issue a new mandate decision based on subsequent changes in law or other factors. Since Proposition 30 passed, no such requests have been filed with the Commission.

In the absence of a new Commission decision, the Legislature's requirement to fund, suspend, or repeal the Open Meeting Act mandate in 2013-14 is somewhat opaque. Although Proposition 30 states that the Open Meeting Act mandate statutes "shall not be a reimbursable mandate," it does not explicitly (1) set aside the Commission ruling on the Open Meeting Act or (2) modify the constitutional requirement that the Legislature fund, suspend, or repeal laws determined to be a reimbursable mandate.

LAO Perspective: In order to avoid the risk of litigation, LAO suggests the Legislature fund, suspend, or repeal the Open Meeting Act mandate in 2013-14, and direct DOF to file a request for a new Commission decision on the Open Meeting Act mandate as soon as possible.

Staff Comment: If the Open Meetings Act mandate were funded in the budget year, the fiscal impact would be significant. Suspension of the mandate allows the state to defer payment of prior year local government reimbursements of $113 million and avoid any additional annual cost.

Staff Recommendation: Direct DOF to file a request for a new Commission decision on the Open Meeting Act mandate as soon as practicable.

Vote:

6. **Repeal Selected Mandates (Governor's Budget—Proposed Trailer Bill).** The Governor has proposed trailer bill language that would effectively repeal five mandates by making them permissive. The proposal would make permissive five mandates that have been suspended since 1992. These mandates have been either pre-empted by federal law or state constitutional requirements or represent best practices that local governments have provided or should be providing to citizens without state involvement or reimbursement. The five mandates proposed for recasting as permissive are:

    - **Adult Felony Restitution**. The California Penal Code requires probation officers to recommend to the sentencing judge whether restitution to the victim should be a condition of a defendants' probation before a probation-eligible defendant is sentenced for felony conviction. The statute is now unnecessary. Victims have a right under the California Constitutional to restitution and courts must order restitution from the wrongdoer in every case where a victim suffers a loss—independent of probation's recommendation. The essential issue here, a victim's right to restitution, is protected by the Constitution. Therefore, making this statute permissive will have no effect on that core issue.

- **Victims' Statements-Minors.** The California Welfare and Institutions Code requires probation officers to obtain a statement from a victim of a felony committed by minor. The officer must include the statement in the officer's social study that is submitted to the court. Marsy's Law gives victims the constitutional right to give probation officers information regarding an offense's impact on them. These activities are part of a probation department's core responsibilities that by this time should be a "best practice" to conform to Marsy's Law.

- **Deaf Teletype Equipment.** The California Government Code requires counties, which provide any emergency services, to provide deaf teletype equipment at a central location within the county to relay requests for such emergency services. This mandate is preempted by federal law (Title II of the American with Disabilities Act (1990), and its implementing regulations, which prevent a public entity from denying a benefit to a qualified individual on the basis of his or her disability. Locals are potentially subject to an ADA lawsuit should they not provide this equipment.

- **Pocket Masks.** The California Penal Code requires law enforcement agencies to provide each peace officer a portable manual mask designed to prevent spread of communicable diseases when applying CPR. This should be a standard operating procedure that local agencies perform without regard to whether it is a reimbursable mandate, since local governments have an inherent interest to keep officers and the public safe by using such preventive measures.

- **Domestic Violence Information.** The California Penal Code imposes a reimbursable mandate by requiring the following from local law enforcement agencies: development and implementation of policies for officers' responses to, and recording of, domestic violence calls; preparation of a statement of information for domestic violence victims; monthly compilation of summary reports submitted to the Attorney General; and, development and maintenance of protection order records and systems to verify such orders at an incident scene. The statues that make up this mandate were enacted in 1984. Nearly 30 years later, society has a raised awareness of the seriousness of domestic violence crimes and enforcement of domestic violence-related offenses is a major part of local law enforcements' standard protocol. Consequently, the requirements in these statutes should be standard operating procedure without reimbursement.

Staff Comments: The mandates noted above have been suspended in excess of 20 years. During this time, local governments have not been required to carry-out the activity—based on state law. However, the first three mandates discussed are specifically pre-empted by federal law or the California Constitution. The latter two mandates should be carried-out by local governments as a matter of course.

Staff Recommendation: Approve the proposed trailer bill language.

Vote:

9210 Local Government Financing

Item Overview: The 9210 budget item includes several programs that make State subventions to local governments. In the current year the payments include $2.1 billion General Fund for constitutionally-required repayment of 2009-10 "Prop 1A" borrowing from local governments; a small subvention related to former Redevelopment Agencies (RDAs) to help retire a portion of outstanding debt that was backed by the personal property tax – (about $500,000), and a subvention of $1.5 million for Amador County and cities in the county.

Budget Overview: The proposed budget for the 9210 item is $1.8 million General Fund. Year-over-year comparisons show a major decrease in expenditures as Proposition 1A borrowing will be fully repaid in 2012-13. The amount proposed in the Governor's Budget is for subventions to the Counties of Amador and San Mateo and the cities within these counties. The subventions are related to the so-called 'Triple Flip' and 'Vehicle License Fee (VLF) Swap,' both of which are described below. Since the Governor's Budget, the administration now anticipates that the total subvention amounts for these counties may be closer to $1.6 million (approximately $200,000 for San Mateo and the remainder for Amador). However, there are also indications that Alpine County may be in a situation that could call for a state subvention. DOF indicates it will not know the final subvention amounts for each of these counties until following the May Revision.

Issues Proposed for <u>Discussion / Vote:</u>

1. **Subventions to Amador and San Mateo Counties (Governor's Budget Proposal):** The Governor's Budget proposes a General Fund subvention of $1.8 million to backfill Amador and San Mateo counties due to circumstances that reduced property tax directed to those county governments, and cities within those counties, in 2011-12. These circumstances also occurred in Amador County last year, and the state provided a subvention. The revenue losses will likely continue into 2012-13 and likely beyond, but the Administration indicates it has not determined at this time whether its proposal is one-time or ongoing.

   Background and Detail: Legislation enacted early in the Schwarzenegger Administration shifted local property tax from schools to cities and counties to accommodate two State fiscal initiatives. Schools were then backfilled with state funds for each of these initiatives. Overall, the fiscal changes resulted in a large net revenue gain for cities and counties as the replacement revenue streams have grown faster than the relinquished revenue streams. However, unique circumstances reportedly reversed this outcome in 2010-11 for Amador County and in 2011-12 for Amador and San Mateo counties, and it is possible this outcome could occur for a few additional counties in the future.

   In the 2004 primary election, voters approved Proposition 58, which allowed the state to sell Economic Recovery Bonds (ERBs) to pay its accumulated budget deficit. The local sales tax for cities and counties was reduced by one-quarter cent and the state sales tax was increased by one-quarter cent to create a dedicated funding source to repay the ERBs. Property tax was redirected from schools to cities and counties, and the state backfilled schools via the Proposition 98 funding guarantee. This financing mechanism is sometimes called the Triple Flip, and the process was intended to hold local governments harmless. At the time the ERBs are repaid (in 2016-17 or earlier), the local sales tax rate will be restored, and no flip—triple or otherwise—will be necessary.

Also in 2004, the Legislature enacted the VLF Swap. The measure was designed to provide a more reliable funding mechanism to backfill cities and counties for the local revenue decrease resulting from the action that the reduced the VLF tax on motor vehicle from 2.0 percent of a vehicle's value to 0.65 percent of a vehicle's value. Here again, the state redirected property tax from schools to cities and counties to make up for the VLF cut and backfilled schools for the property tax loses with state funds.

The backfill for the Triple Flip and the VLF Swap must originate from property taxes either shifted from the Education Revenue Augmentation Fund (ERAF) or from non-basic aid K-12 and community college districts (but not from so-called 'basic aid' schools). This funding mechanism stopped fully working for Amador County reportedly in 2010-11 due to all the schools in those counties becoming basic aid schools. Basic aid schools receive sufficient local property tax to fully fund the per-student amounts required by the Proposition 98 guarantee, and therefore, the state's funding is minimal. Due to this 'basic aid' situation, current law will not provide backfill for such schools for any property tax shifted to cities and counties. County auditors have reportedly reduced or discontinued the shift of property tax from schools to those cities and counties.

Staff Comments and Questions: The financing shifts and educational financing provisions are complex, and perhaps not entirely relevant to making a determination on this budget request. The subcommittee may instead want to focus on some broader ideas and issues:

- The funding shifts included revenue growth uncertainty and risk, as the relative growth of various revenue streams over many years was unknown. On a statewide basis, data suggests most counties, have received a net benefit from the shifts.

- There was no backfill guaranteed in the original legislation, although the Amador and San Mateo outcomes were also not anticipated. The enacting legislation did not include provisions for the state to backfill locals with new subventions if the baseline funding mechanism proved to be insufficient.

- At the time of the legislation, stakeholders were likely aware of the risk of variable levels of growth for different revenue streams, but may not have anticipated that outcome of all schools within the county becoming basic aid.

The committee may consider approving the budget request, with one-half the funding to be provided initially and the remainder to be disbursed upon a finding of necessity by the Department of Finance based on criteria established in budget bill language. Absent a finding by Department of Finance, the funds would revert to the General Fund.

Questions: *(1) Since the outcomes in Amador and San Mateo counties may not have been foreseen by the state or local governments at the time of bill enactment, does the state have a responsibility to backfill for this revenue loss? (2) Since many cities and counties are continuing to experience budget shortfalls, should the Legislature consider the fiscal conditions of the two counties relative to other counties as a factor in the determination? For example, has the decline in revenue for these counties since 2007-08 exceeded the statewide average?*

LAO Perspective: LAO suggests that the state could reimburse cities and counties for all triple flip and VLF swap funding shortfalls, as proposed in the Governor's Budget or, in recognition of the significant fiscal benefits cities and counties receive under the VLF swap, reimburse cities and counties only where necessary to replace actual sales tax and VLF revenue losses. Under this latter approach, no state funding would be provided to Amador and San Mateo counties for 2011-12 funding shortfalls. Either level of reimbursement could be accomplished through the budget or through a shift in property taxes. The former approach would be more revealing as to the cost, while the former would provide more revenue certainty for local governments.

Staff Recommendation: Staff recommends holding the item open, pending May Revision request. There is some indication that Alpine County may also require subvention.

Vote:

0509 Governor's Office of Business and Economic Development

Department Overview: The Governor's Office of Business and Economic Development (GO-Biz) was created to serve as a single point of contact for economic development and job creation efforts. The department offers a range of services to businesses including: business attraction, retention and expansion services; site location selection; permit assistance; regulatory filing and approval assistance; small business assistance; international trade development; and assistance with state government. Under the Governor's Reorganization Plan No. 2 (GRP 2), the Infrastructure Development Bank, the California Film Commission, the Office of Tourism, and the Small Business Loan Guarantee Program will be transitioned from the Business, Transportation and Housing Agency (BT&H) to GO-Biz, effective July 1, 2013.

Budget Overview: The department is budgeted for $20.1 million and 71 positions in 2013-14. This represents a significant increase in funding and positions, due largely to the shift of departments and programs from BT&H to GO-Biz. With the shift of programs and personnel, most of the funding (46 percent) is derived from California Infrastructure and Economic Development Bank Fund, with an additional 36 percent coming from the General Fund.

Issues Proposed for <u>Discussion / Vote:</u>

1. **Workload and Moving Expenses (Governor's Budget BCP #1):** The Governor's Budget calls for an additional three positions for activities associated with the GO-Biz program. The request calls for $564,000 in on-going funding and $286,000 in one-time funding. The three positions will provide for management of legal affairs, information technology and external affairs of the department. The positions include a deputy director for legal affairs, systems software specialist and a deputy director for external affairs.

   Background: On a temporary basis, the department has relied on other entities to assist with legal services, information technology and external affairs. Of the 28 positions received by the department in 2012-13, the areas addressed were small business, international trade, innovation, business attraction, business retention, legislation and administrative services. The original positions did not include staffing for the positions indicated in this budget request.

   Staff Comments: Staff has no concerns with this proposal.

   Staff Recommendation: Approve the budget request.

   <u>Vote:</u>

Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Lois Wolk

Thursday, April 25, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Mark Ibele

Agenda Part A

State Administration and Local Finance

Overview of Redevelopment Agencies and Fiscal Impacts

Proposed Discussion / Vote Calendar:

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-651-1505. Requests should be made one week in advance whenever possible.

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Lois Wolk
Senator Tom Berryhill

Thursday, April 25, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

Agenda Part B

Item Number and Title

0845	Department of Insurance
2240	Department of Housing and Community Development
7760	Department of General Services

(See Table of Contents on pages 1 and 2 for a More Specific Listing of Issues)

AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 3)

Item **Department** **Page**

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only:

	Issue	2013-14 Amount	Fund Source	Staff Recommendation
	Department of Insurance (0845)			
1	Amendment to Budget Bill	$218,000	Special Fund	APPROVE
2	Health Care Coverage	$113,000	Special Fund	APPROVE
3	Reinsurance	$119,000	Special Fund	APPROVE
	Department of Housing and Community Development (2240)			
4	Emergency Solutions Grants Program	$7.925 million	Federal Trust Fund	APPROVE
5	HOME Program Funding Reduction	-$27.02 million	Federal Trust Fund	APPROVE
6	Headquarters Relocation	$2.02 million ($36,000 General Fund)	Special Fund/General Fund	APPROVE
	Department of General Services (7760)			
7	Technical Adjustments	-$3.6 million	Special Fund	APPROVE
8	Program Reductions	-$5.6 million	Special Fund	APPROVE
9	Contracted Fiscal Services	$610,000	Special Fund	APPROVE
10	Central Plant Renovation		Re-appropriation	APPROVE

Issues Proposed for Vote Only – Issue Descriptions

Department of Insurance

Issue 1 – Amendment to Budget Bill Item 0845-001-0217

Spring Finance Letter: The 2013-14 Governor's budget includes a request for an increase of $218,000 (Insurance Fund) in 2013-14 to address workload associated with AB 1083 (Chapter 852, Statutes of 2012) and SB 951 (Chapter 866, Statutes of 2012).

Background: AB 1083 gives the Department of Insurance (CDI) broad authority for emergency rulemaking in the small group market, for both grandfathered and non-grandfathered health insurance products. According to the Department of Insurance, the resources are necessary because the Department of Insurance currently has no additional capacity to absorb rulemaking procedures. To address the need for additional rulemaking capacity, the Department of Insurance is requesting $79,000 and one six-month limited-term position.

SB 951 has added a need for additional policy form review responsibilities and a necessity to promulgate emergency rulemaking regulations. To address the additional workload, the Department of Insurance has requested an additional $139,000 in expenditure authority from the Insurance Fund to promulgate regulations related to essential health benefit coverage, which was a requirement of SB 951.

Issue 2 – Health Care Coverage (AB 2470)

Governor's Budget Request: The Governor's 2013-14 budget includes a request for an increase in special fund authority of $113,000 (Insurance Fund) for Fiscal Year 2013-14 and Fiscal Year 2014-15 to extend one two-year limited-term attorney position to address workload associated with AB 2470 (Chapter 658, Statutes of 2010).

Background: AB 2470 added a new provision to the Insurance Code, which provides a mechanism for the policyholder, certificate holder, or other insured, who alleges a policy has or will be cancelled, to request review by the Insurance Commissioner. Prior to AB 2470, there had been no formal process for a policyholder to obtain recourse. The measure calls for a review process, followed by a hearing, if necessary. Due to the administrative nature of the review process and the hearing process, CDI contends that the position is best suited for an attorney.

Issue 3 – Reinsurance (SB 1216)

Governor's Budget Request: The Governor's 2013-14 budget includes a request for an increase in special fund authority of $119,000 (Insurance Fund) for Fiscal Year 2013-14 and one one-year limited-term position to address workload requirements from SB 1216 (Chapter 277, Statutes of 2012).

Background: SB 1216 provided for different categories of regulated insurers. While the measure brought the state into conformance with National Association of Insurance Commissioner's (NAIC) model laws and regulations, it will create additional workload for the CDI.

Department of Housing and Community Development

Issue 4 – Emergency Solutions Grant Program

Governor's Budget Request: The Governor's 2013-14 budget requests increased federal budget authority for the Emergency Solutions Grant Program. The request includes an increase of $425,000 and 4.0 personnel years for state operations and $7.5 million in local assistance.

Background: This request is in response to the U.S. Department of Housing and Urban Development (HUD) combining and expanding previous homeless assistance programs. Federal guidelines dictate much of the workload associated with the four requested permanent positions that will support state operations.

Issue 5 – HOME Program Funding Adjustment

Governor's Budget Request: The Governor's 2013-14 budget includes a request for a reduction in expenditure federal expenditure authority of $1.02 million and 7.0 personnel years for state operations and $26.0 million reduction in federal expenditure authority for local assistance.

Background: This request is in response to a decrease in federal funding for the Home Investment Partnership Program (HOME). The HOME program is the largest federal block grant program to state and local governments and was developed exclusively for the creation and preservation of affordable housing. California receives an annual formula-based allocation of funds, through a contractual agreement with HUD to provide several forms of assistance to build or rehabilitate single family homes or rental apartments for both low and very low-income households. In 2012 Congress authorized a total of $1.0 billion in HOME funds nationally. The funding is provided by HCD to cities and counties not receiving direct HOME assistance from HUD and/or community housing development organizations in those cities and counties. Due to the decrease in available funding, HCD will be managing a smaller workload and has asked for a reduction in position authority, as well. This request includes a request for a negative adjustment in 2014-15, as well; reduction in federal expenditure authority of $877,000 and 6.0 personnel years for state operations, and a reduction of $9.0 million in local assistance.

Issue 6 – Headquarters Relocation

Governor's Budget Request: The Governor's budget includes a request for $2.02 million ($36,000 General Fund) to relocate the Department of Housing and Community Development headquarters.

Background: The Department of Housing and Community Development's (HCD) current headquarters will be required to relocate due to the current landlord exercising its option to not enter into a new lease with HCD. Subsequent to learning HCD headquarters would not be able to remain at the same location, HCD began the process of identifying a new location.

The total amount for this request is $3.13 million. However, HCD has made a deposit into the Architectural Revolving Fund and will only be required to contribute the $2.02 million included in this request. It is estimated that there will be $274,000 in ongoing facility costs associated with the move. HCD has signed a lease for the new headquarters location and is expected to complete the move by August 2013.

Department of General Services

Issue 7 – Technical Adjustments

Spring Finance Letter: The Governor's budget requests technical adjustments to be made to the following items:

- 7760-001-0666 – increased by $4.387 million
- Increase the Office of Administrative Hearings by $961,000. The 2012 Budget Act includes funding to support a contract between the Office of Administrative Hearings and the Department of State Hospitals. The funding was inadvertently scheduled for reimbursements and a technical change will need to be made to restore the funding to its proper fund source.
- Increase item 7760-001-6057 by $68,000 to correct a posting error related to the Office of Public Construction.

The Administration has requested that the following items be adjusted to accurately reflect the distribution of administrative costs associated with the Department of General Services.

- Increase item 7760-001-0002 by $111,000
- Increase item 7760-001-0003 by $27,000
- Decrease item 7760-001-0006 by $50,000
- Increase item 7760-001-0026 by $165,000
- Decrease item 7760-001-0328 by $527,000
- Increase item 7760-001-0465 by $39,000
- Increase item 7760-001-0602 by $3.5 million
- Decrease item 7760-001-0666 by $3.36 million
- Decrease item 7760-001-3091 by $8,000
- Increase item 7760-001-3144 by $31,000
- Increase item 7760-001-3245 by $72,000

Background: This request will adjust funding distribution for administration to more accurately reflect the level of services being provided by various programs within the Department of General Services. The net impact results in a decrease of $3.6 million contributed to the Service

Revolving Fund, which is the fund utilized for the payment of rent the cost of maintaining, operating, and insuring building space the purchase and sale of materials, supplies, and equipment; the rendering of services to state and other public agencies and, in connection for the employment and compensation of personnel and expenses.

Issue 8 – Program Reductions

Governor's Budget Request: The Governor's 2013-14 budget includes a request for a reduction of $5.6 million and 22.5 positions in Fiscal Year 2013-14. This request includes trailer bill that will increase the requirement for review exemption by DGS to which contracts by state agencies can be awarded from the current $75,000 to $150,000.

Background: The Governor's 2012-13 Budget included an unallocated reduction of $59.08 million. However, the Department of General Services achieved a total of $33.39 million and 45.5 positions in reductions in the 2012-13 fiscal year. DGS has identified additional positions and services that can be reduced in the budget year in order to achieve a greater level of savings:

- $2.4 million and 15 positions reduction through implementation of a streamlined administrative process.
- $1.2 million reduction to the Service Revolving Fund.
- $1 million reduction to the Division of State Architects.
- $656,000 and 6 positions from the elimination of the California Meeting Management Program.
- $154,000 reduction associated with shifting defensive driver training courses to an online format.
- $150,000 and 1.5 positions from raising threshold over what the DGS Office of Legal Services must review contracts for $75,000 or more. This change will require trailer bill language to be adopted.

Issue 9 – Contracted Fiscal Services

Governor's Budget Request: The Governor's 2013-14 budget includes a request 6.0 positions and $610,000 to perform fiscal functions for three new state agency clients.

Spring Finance Letter: The Administration has modified the original request and has asked that the request for $660,000 be reduced by $220,000. The workload and funding associated with those positions will be assumed by the California High Speed Rail Authority.

Background: The Governor's Office of Business Development (Go-Biz) and the San Diego River Conservancy became clients of the Department of General Services Contract Fiscal Services (CFS) on July 1, 2012. The Fair Political Practices Commission, in an attempt to achieve cost savings, has requested to become a client of CFS on July 1, 2013. Additional workload requirements have also been generated by existing clients including: Office of System Integration and the Financial Information System for California. The requested positions will be funded through the Service Revolving Fund.

Issue 10 – Central Plant Renovation

Spring Finance Letter: The Governor's budget requests a reappropriation of the remaining balance of supplemental construction funds for renovation of a Central Plant located in Sacramento.

Background: The 2012 Budget Act extended the liquidation period for the Central Plant Renovation project's construction funds to June 30, 2013. However, three unresolved issues have extended the original project timeline and an extension of the liquidation period will be required to ensure that the project is complete by June 2014.

Issues Proposed for Discussion / Vote

0845 DEPARTMENT OF INSURANCE

Department and Budget Overview. The California Department of Insurance (CDI) regulates the California insurance market and enforces the California Insurance Code, including conducting examinations and investigations of insurance companies and producers and responding to consumer inquiries. CDI reviews and approves insurance rates to enforce the statutory requirement that rates are not excessive or unfair. CDI also administers the conservation and liquidation of insolvent and delinquent insurance companies and fights insurance fraud, in conjunction with local and state law enforcement agencies. The January Budget provides CDI with 1,326.3 authorized positions and $237.44 million (Insurance Fund, federal funds, and reimbursements).

Issue 1 – Health Benefit Exchange

Governor's Budget Request: The California Department of Insurance (CDI) is requesting an increase of special fund authority of $834,000 to fund seven attorney positions (six limited-term, one permanent) to support implementation activities, policy form review, and enforcement actions related to the California Health Benefit Exchange (Exchange).

Background: SB 900 (Chapter 659, Statutes of 2010) created the Health Benefit Exchange, which is an independent public entity. The measure required that the Insurance Commissioner, in coordination with the Director of the Department of Managed Health Care, review the federal Health and Human Services internet portal, prior to January 1, 2015, to determine whether it provides sufficient information to facilitate fair and affirmative marketing of all individual and small employer health insurance, particularly outside of the Exchange.

AB 1602 (Chapter 655, Statutes of 2010) enacted the California Patient Protection and Affordable Care Act (PPACA), and provided the Exchange with the operation authority, as well as the authority to implement the Exchange and navigator provisions of the Patient Protection Act by 2014.

Staff Comment: According to the request submitted by CDI, workload associated with the Exchange will only necessitate 3.5 positions in 2014-15. CDI has forecasted that it will only require one attorney position beyond the 2014-15 budget year.

Staff Recommendation: Approve as budgeted.

Vote:

Issue 2 – Health Insurance Reform

Governor's Budget Request: The California Department of Insurance (CDI) is requesting an increase in special fund expenditure authority of $865,000 in Fiscal Year 2013-14 and 2014-15 to address the ongoing workload associated with health insurance reform.

Background: The Patient Protection Act and Affordable Care Act (PPACA) was enacted in 2010. Many of the provisions in federal law have already come into effect, while most of the components including health insurance exchange, will become operation on January 1, 2014. PPACA will have a significant impact on the regulatory requirements of CDI as well as changes to the health insurance marketplace in California.

Staff Comment: Limited-term resources were original approved in 2011-12 and this request reflects an extension of the same request for an additional two years.

Staff Recommendation: Approve as budgeted.

Issue 3 – Health Insurance Fraud

Governor's Budget Request: The CDI is requesting an increase in special fund expenditure authority of $6.2 million for Local Assistance for Fiscal Year 2013-14 and $5.1 million ongoing, for increased workload for the local district attorneys to investigate and prosecute health and disability fraud. Also included is a request for an increase of $1.1 million for state operations in 2013-14, and $835,000 ongoing, to fund eight positions within the Fraud Division that support investigations related to the work on health and disability cases with the local district attorneys. This request also includes budget bill language to allow for current year expenditure authority adjustments to the Fraud Local Assistance Programs to align with available revenue designated for the programs.

Background: Prior to the passage of AB 2138 (Chapter 444, Statutes of 2012), revenue for the Fraud Health and Disability Program was derived from a special purpose assessment of up to $0.10 annually for each insured under an individual or group insurance policy issued in California. AB 2138 provided CDI with additional revenue for local assistance and the Fraud Division by increasing the assessment amount to $0.20 per insured. The assessment will be allocated 70 percent to local district attorneys and 30 percent to Fraud Division operations. The following is the proposed budget bill language.

0845-101-0217

Provisions:

1. *Notwithstanding any other provision of law, to the extent that the Department of Insurance determines by September 1 that additional revenue from fraud assessments is available for distribution, the Department of Finance may augment this item in Schedule (2) 20 – Fraud Control by up to 10 percent not sooner than 30 days after notification in writing is provided to the chairpersons of the fiscal committees in each house of the Legislature and the Chairperson of the Joint Legislative Budget Committee.*

Staff Comment: Staff has no issue with the requested funding or language.

Staff Recommendation: Approve as budgeted.

Issue 4 – Health Insurance Premium Rate Review

Governor's Budget Request: The CDI is requesting a special fund expenditure authority increase of $1.2 million (Insurance Fund) in Fiscal Year 2013-14, and ongoing, and to convert nine limited-term positions to permanent to address workload associated with health insurance rate filings.

Background: SB 1163 (Chapter 661, Statutes of 2010) began the process of aligning California's laws with the federal health care reform. The passage of SB 1163 defined many of the roles that the CDI would have to take to implement health care reform. In Fiscal Year 2011-12, the Legislature approved nine two-year limited-term positions and one one-year limited-term position to address the workload associated with the review of health insurance rate filings and one-time rulemaking, as required by SB 1163.

The CDI has also utilized approximately $2.5 million in federal funding to assist with the implementation of health care reform. However, the use of the federal funds is limited to carrying out specific requirements required by per each federal grant, and funding is limited to four years.

Staff Comment: Upon review of available federal moneys CDI has brought to staff's attention that CDI's expenditure authority could be reduced by $576,000 in 2013-14. This will require an increase in federal fund authority of $136,000 in Fiscal Year 2013-14. The second grant provided to CDI does not expire until September 30, 2014.

Staff Recommendation: Augment Federal Trust Fund Authority by an additional $136,000 in Fiscal Year 2013-14. Decrease Insurance Fund expenditure authority by $576,000 in Fiscal Year 2013-14.

Issue 5 – Rate Review – Predictive Model Analysis

Governor's Budget Request: The CDI is requesting a special fund expenditure authority increase of $350,000 in Fiscal Year 2013-14 and 2014-15, to engage outside consultants to assist in the technical analysis and additional workload involved in the review of predictive models.

Background: Insurers are increasingly using predictive modeling in development of their rates, particularly related to property and casualty catastrophes (e.g., fires, earthquakes). Due to the complex, technical nature of these filings, the Department currently does not have the expertise necessary to sufficiently review these rates and ensure they are not inadequate, excessive, or unfairly discriminatory, as required by Proposition 103 and California Insurance Code Section 1861.05(a).

Predictive models are computer programs that analyze past losses to identify additional risk attributes that are predictive of future claims. The requested funds would allow the Department to engage outside consultants to assist in the technical analysis and additional workload involved in the review of predictive models. The funding will also assist in training activities of Department staff. The Department contends that in two years they expect to hire and train staff with the necessary knowledge and ability to address the increasingly complex nature of predictive models.

Staff Recommendation: Approve as budgeted.

2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

Department Overview: The mission of the Department of Housing and Community Development (HCD) is to preserve and expand safe and affordable housing opportunities and promote strong communities for all Californians. The HCD: (1) administers housing finance, economic development and community development programs; (2) develops housing policy and advocates for an adequate housing supply; and (3) develops building codes and regulates manufactured homes and mobile-home parks. The HCD also provides technical and financial assistance to local agencies to support housing development.

Budget Overview: The Governor's 2013-14 Budget proposes total spending of $368.64 million ($7.12 million General Fund) for HCD in 2013-14. The General Fund contribution for 2013-14 is slightly greater than the 2012-13 General Fund contribution. The large increase in personnel is the Governor’s Reorganization Plan Number 2 (GRP2), the 2013-14 information for the California Housing Finance Agency is merging with this department.

Fund Source	**2011-12**	**2012-13**	**2013-14**
General Fund	$7.32	$7.04	$7.12
Federal Trust Fund	$137.21	$150.65	$131.51
Other Funds	$367.77	$180.88	$230.01
Total Expenditures	$512.30	$338.57	$368.64
Personnel Years	497.6	538.1	863.9

Issue 1 – Housing-Related Parks Program

Spring Finance Letter: The Governor's budget proposes a permanent baseline Local Assistance appropriation of $25 million for new awards, pursuant to Proposition 1C Housing Related Parks Program (HRPP).

Background: In 2006, voters approved Proposition 1C, authorizing the largest housing bond in the nation. The new bond measure authorized an additional $2.85 billion, most of which was used to support affordable housing efforts. The Housing-Related Parks Program, funded through Proposition 1C, was designed to encourage the construction of low-income housing units by providing funding to cities and counties that can be used for the development and renovation of parks for each qualified housing permit they issue. As of December 31, 2012 there is an estimated $166 million available for award.

Staff Comment: While voters approved Proposition 1C in November 2006, the bond required the Legislature to adopt subsequent legislation to implement the Housing-Related Parks Program. AB 2494 (Chapter 641, Statutes of 2008) established the Housing-Related Parks Program, under the Administration of the Department of Housing and Community Development. It was originally anticipated that HCD would make roughly $25 million in awards per year starting with awards for the 2009 calendar year. However, local governments only qualified for $8.8 million in awards in 2010. HCD issued a Notice of Funding Availability (NOFA) again for the 2011 calendar year, and local governments qualified for only $11.3 million. More recently, the Legislature has made an attempt to streamline the awards process of the Housing-Related Parks Program.

Staff Recommendation: Approve spring finance letter.

Vote:

Issue 2 – Housing Element Review

Governor's Budget Request: The Governor’s 2013-14 budget includes a request for $649,000 to fund five two-year limited-term positions from the Air Pollution Control Fund. This request is necessary to implement the state’s only oversight role in reviewing and approving regional and local governments’ housing land-use.

Background: State law requires each city and county to adopt a general plan containing at least seven mandatory elements including housing. Unlike the other general plan elements, the housing element is subject to detailed statutory requirements and mandatory review by a State agency, the HCD. Housing elements have been mandatory portions of local general plans since 1969. This reflects the statutory recognition that housing is a matter of statewide importance and cooperation between government and that the private sector is critical to attainment of the state's housing goals.

In 2007, the Legislature enacted SB 375 (Chapter 728, Statues of 2007), which sought to help the state achieve greenhouse gas emission goals, outlined in AB 32 (Chapter 488, Statutes of 2006), by reducing vehicle emissions. SB 375 requires regional greenhouse gas reduction targets, requires regional agencies to prepare land use plans that will help achieve the greenhouse gas reduction targets (known as a Sustainable Communities Strategy), and provides incentives for high-density, transit-oriented housing projects.

SB 375 links, for the first time, regional planning efforts for transportation and housing. Under the bill, all transportation and housing planning processes are put on the same eight-year schedule; housing plans must be updated once every eight years, which will now align with two four-year Regional Transportation Plan planning cycles. The single largest sector of greenhouse gas emitters are cars and light trucks. While greenhouse gas emissions can be reduced by creating more fuel efficient vehicles, it is also a necessity to reduce the number of miles traveled to achieve the state's standards. Specifically, SB 375 integrated and aligned planning for housing, land use, transportation and greenhouse gas emissions.

This change in timing will have dramatic impact on HCD. Instead of receiving housing elements on a staggered schedule, SB 375's changes require that 85 percent of the state's 539 cities and counties will be submitting housing elements in calendar years 2013 and 2014. According to HCD, most jurisdictions submit a draft nine months prior to their due date. HCD spends, on average, 120 hours of staff time per element review. Further compounding time requirements spent on each jurisdictional review is the fact that most local governments submit at least four drafts prior to final submission of an element review.

Staff Comment: HCD serves as the only state entity with the capacity to ensure that local governments are conforming to land-use strategies that will locate their higher density and infill housing closer to jobs, services and transportation modes. A reduction in overall vehicle trips and vehicle miles travelled are critical components of achieving Greenhouse Gas emission reduction targets. Furthermore, HCD's element review process supports removal of regulatory barriers to implementing the streamlining intended by SB 375.

Staff Recommendation: Approve as budgeted.

7760 DEPARTMENT OF GENERAL SERVICES

Department Overview: The Department of General Services (DGS) is responsible for the management, review control and support of state agencies as assigned by the Governor and specified by statute. The department's functions include; acquisition, development, leasing, disposal and management of state properties; architectural approval of local schools and other state buildings; printing services provided by the second largest government printing plant in the U.S; procurement of supplies needed by other state agencies; and maintenance of the vast fleet of state vehicles.

Effective July 1, 2013, the Governor's Reorganization Proposal Plan Number 2 (GRP2) moves the Department of General Services to the newly created Government Operations Agency.

Budget Overview: The Governor's 2013-14 budget proposes $1.01 billion dollars ($7.08 million General Fund) and 3,592.4 Personnel Years. The Governor's 2013-14 budget request reflects an increase of $7.2 million dollars ($4.38 General Fund increase) were approved in the Fiscal Year 2012-13 Governor's budget.

Issue 1 – Agnews Developmental Center

Spring Finance Letter: The Governor's Budget request a one-time $993,000 increase in Property Acquisition Law Money Account expenditure authority to support the surplus disposition of the Agnews Developmental Center.

Background: SB 136 (Chapter 166, Statutes of 2009) provides that the Department of General Services may dispose of any portion of approximately 85 acres of property located at the East Campus of the Agnews Developmental Center in San Jose. Pursuant to an agreement between the Department of General Services (DGS), Department of Developmental Services (DDS), and the Department of Finance (DOF), jurisdiction of the Agnews Developmental Center was transferred to DGS effective July 1, 2011. The Asset Management Branch of the Real Estate Services Division has requested the one-time $933,000 increase in Property Acquisition Law Money Account expenditure authority to provide for property management services, security, fire protection, grounds keeping, repair costs and utilities at the Agnews Developmental Center.

Staff Comment: The Property Acquisition Law Money Account will receive a one-time loan from the General Fund, and the loan amount will be recouped upon completion of the sales transaction of the property.

Staff Recommendation: Approve the Spring Finance Letter request.

Issue 2 – Statewide Parking Repairs and Deferred Maintenance

Governor's Budget Request: The Governor's 2013-14 budget includes a request for a permanent augmentation of $1.07 million to the Motor Vehicle Parking Facilities Account to address a number of structural and mechanical deficiencies in the Sacramento State Garage.

Background: The Motor Vehicle Parking Facilities Fund is a continuously appropriated account that is used for the development and management of state-owned parking facilities. The DGS operates the statewide parking program (program). The program supports the 21 state-owned parking facilities and provides monthly and daily parking to nearly 10,000 users each month.

The program generates revenue of approximately $3.4 million annually. Approximately $2.3 million pays for operating costs and general maintenance of the state garages and lots. Prior to 2012, the remaining $1.1 million was used to pay for debt service on lease-revenue bonds. As of December 2012, the lease-revenue bonds have been paid in full. Therefore, the $1.1 million requested by the Department of General Services can be redirected to pay for deferred maintenance of the state's parking-related assets.

Staff Comment: The Legislative Analysts Office (LAO) previously raised concern with the scope of the maintenance plan detailed by the DGS. DGS has subsequently modified their plan to address the scoping issues raised by LAO, and have expanded the use of the funds to all 21 state-owned parking garages.

Staff Recommendation: Approve as budgeted.

Issue 3 – Statewide Disability Access and Education Program

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for a permanent augmentation of 5.0 positions and expenditure authority of $532,000 (Disability Access and Education Revolving Fund) in 2013-14 to provide the necessary support to implement SB 1186 (Chapter 383, Statutes of 2012).

Background: The Division of State Architects (DSA), within the DGS operates the Certified Access Specialist Program (CASp). A CASp is an individual licensed by the state to evaluate accessibility of buildings. Since 2009, state law provides special protections to businesses inspected and certified by a CASp. DSA also performs regular audits of work performed by CASps.

SB 1186 made several changes to the state's accessibility laws, including several related to the CASp program. Recognizing that this measure would require additional workload of CASps, the measure also addressed the need for additional CASps. To fund the workload the measure imposed a $1 charge on all business licenses issued or renewed in the state from 2013 to 2018. Local government will retain 70 percent of collections and the remainder would go to the Disability Access and Education Revolving Fund to address the additional workload requirements. DGS estimates the fee to provide $900,000 to the Disability Access and Education Revolving Fund annually.

Staff Recommendation: Approve as budgeted.

Issue 4 – Special Repairs: Americans with Disabilities Act Compliance

Governor's Budget: The Governor's budget requests an augmentation of $11 million in Service Revolving Fund authority for special repair projects associated with Americans with Disability Act (ADA) compliance.

Background: Total repairs are projected to cost approximately $110 million and will be conducted over the next ten years. The augmentation will require an increase in the Building Rental Account and the Individual Rental Rate, which are managed by the DGS. In 2009 DGS conducted a survey of all of the buildings with ADA deficiencies, and the study found deficiencies in nearly every building in the DGS portfolio. DGS has calculated that the repairs will require $82 million and there is approximately $28 million in deferred maintenance that will need to be addressed, as well. DGS has identified a ten-year timeline to complete the work identified in the deficiencies study.

LAO Recommendation: The LAO recommends that the Legislature reject the proposal because a temporary, across-the-board $0.10 rate increase is an inappropriate way to fund special repairs across multiple facilities. The rental rates should be set at amounts sufficient to cover debt service, ongoing operations, and maintenance costs as well as build up a reserve for the repair or replacement of building systems and equipment.

Accordingly, the LAO recommends that the Legislature direct DGS to adjust existing rates to meet each facility's individual needs over time. While more complex, such individual adjustments would result in rental rates that more accurately reflect the cost of operating and maintaining each building. For buildings with significant ADA compliance issues and deferred maintenance, the new building rate may need to include a temporary multi-year increase to cover these one-time costs as well as an increase in the base rental rate to prevent the accumulation of additional deferred maintenance. For newer buildings, DGS also may determine that minor rate increases are needed to establish a sufficient reserve for future scheduled maintenance and special repairs.

Staff Comment: The Administration has noted that occupants, state entities, have little control over the condition of the building upon occupancy, which seems to be a more compelling case. The Assembly has approved this item as budgeted.

Staff Recommendation: Approve as budgeted.

Issue 5 – Real Estate Services: High Speed Rail

Governor's Budget: The Governor's Budget includes a request for a permanent augmentation of $648,000 and five personnel year's in order to assist California High Speed Rail Authority with real estate and legal services workload associated with property acquisition.

Background: On July 6, 2012 the Legislature approved construction financing for the initial stage of the California High Speed Rail project. The segment is to be completed by 2018 and completion of all four phases will be done by 2028. The Real Estate Services Division within the DGS has been tasked with assisting the California High Speed Rail Authority with the transaction review, appraisal review, setting of just compensation, property acquisition review, relocation assistance plan review, state-owned leasing services, staff support for the State Public Works Board approval process, escrow closing process, resolution of title process, transfers of jurisdiction, easement, acquisition and granting, facilitating utility relocations, project consultation/coordination, Statewide Property Inventory reporting, disposition of excess property and legal consultation support from the DGS Office of Legal Services.

LAO Recommendation: The LAO has noted that the workload associated with this project is temporary. The process of acquiring Right-of-Way began in the current year and will continue through the 2015-16 Budget Year. LAO recommend that the workload associated with these positions be adjusted to two-year limited-term.

Staff Recommendation: Adopt LAO recommendation, to provide Real Estate Services with five two-year limited-term positions to the support California High-Speed Rail.

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Lois Wolk
Senator Tom Berryhill

Thursday, April 25, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

Agenda Part B

OUTCOMES

Item Number and Title

0845	Department of Insurance
2240	Department of Housing and Community Development
7760	Department of General Services

(See Table of Contents on pages 1 and 2 for a More Specific Listing of Issues)

AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 3)

AGENDA – DISCUSSION / VOTE ITEMS

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Lois Wolk

Thursday, May 9, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Mark Ibele

Part A

State and Local Finance

Proposed Vote-Only Calendar:

Proposed Discussion / Vote Calendar:

Perspective on Enterprise Zones: Economic and Fiscal Impacts

Presentation from the Franchise Tax Board, Legislative Analyst's Office and the California Budget Project, focusing on the effectiveness of Enterprise Zones and their economic and fiscal impacts.

Franchise Tax Board

- Scott Reid, Manager, Economics and Statistical Research Bureau
- Allen Prohofsky, Chief Economist

Legislative Analyst's Office

- Jason Sisney, Deputy Legislative Analyst, State and Local Finance
- Brian Uhler, Fiscal and Policy Analyst

California Budget Project

- Christopher Hoene, Executive Director

Overview and Purpose

Enterprise Zones (EZs) are geographic areas designated by the state that provide for substantial tax incentives for business activities conducted within their borders. [1] Cities and counties apply to the Department of Housing and Community Development (HCD) for zone designation based on unemployment rates, participation in subsidized meal programs, median resident income, recent plant closures, and certain other socio-economic characteristics. Statutory authority allows for the creation by HCD of up to 42 zones for a 15-year period. Currently, the state has 40 designated zones; two zones were allowed to expire in 2012. EZs are widespread throughout the state and result in various tax benefits for virtually all types of industries. As a result of the various incentives granted by the Legislature through the EZs and other similar programs, the annual revenue impact on the state is on the order of $750 million and growing.

The general intent of the EZ program is to generate, in designated areas, economic activity that would otherwise not occur; however, the effectiveness of the EZ program in this regard is the subject of substantial criticism. EZ critics assert the program offers a poor return on the state's sizable investment due to flaws in the program's specific design and implementation or, more fundamentally, as a consequence of the ineffectiveness and inefficiencies inherent in tax incentive programs of this type. EZ advocates, including numerous business interests and local administrators, argue the program represents California's best tool for economic development. They cite the

[1] Selected tax incentives are also available for certain other designated geographic areas, comprising Local Area Military Base Recovery Areas, Targeted Tax Areas, Manufacturing Enhancement Areas, and Los Angeles Revitalization Zone. These areas constitute a minor portion of the tax incentive participation.

fact that the program results in lower costs for businesses operating in these zones and thus attracts economic activity to disadvantaged or distressed areas of the state.

Budget Perspective

Why consider tax programs—such as EZ tax incentives—in the context of the state budget? The basis for such consideration relates to the concept of tax expenditures. [2] EZ programs, like other special tax provisions, result in beneficial treatment of individuals or businesses who engage in specified activities. The policies that provide this special treatment are known as 'tax expenditure programs' (TEPs), in that they result in the 'expenditure' on a designated program of revenues that would otherwise be received by the state.

The TEP construct draws a parallel between direct expenditures of the state on an activity—for example, expending funds on economic activities in a certain geographic area—and the provision of a tax credit to the private sector for engaging in activities in the area. Thus, from a fiscal perspective, there exists a substantial equivalence between a direct expenditure and tax expenditure. Alternatively, looked at from the taxpayer perspective, elimination of or reductions in TEPs would allow for a broad-based reduction in taxes for all taxpayers while maintaining the same level of revenue.

Although the fiscal similarities are apparent, from a budgetary perspective, there is a significant difference between 'direct' and 'tax' expenditures. Unlike direct spending, TEPs do not come through the legislative budget process, and thus, are not regularly evaluated as to their appropriateness or effectiveness. Some TEPs are of limited duration ('sunsetted') or limited as to the aggregate amount ('capped'), but since TEPs are embodied in the tax code, they generally grow with their associated tax base. Absent a cap or sunset, eliminating or limiting a TEP is typically considered a tax increase. As a result, TEPs are on the equivalent of 'automatic pilot,' similar to a programmatic entitlement.

The growth in EZ tax incentives has been significant and has resulted in increased budgetary pressures. Absent a regular structured forum to evaluate their effectiveness, the state is hindered in its ability to curtail or alter the EZ programs. This means that the growth in these tax programs may be crowding-out the state's ability to fund more effective programs, maintain an adequate budget reserve, or even provide broad-based or other, more effective, targeted tax relief. The growth rate of EZ tax incentives is discussed below.

[2] The tax expenditure concept is widely attributed to Stanley S. Surrey who in 1967, as Assistant Secretary of the US Treasury for Tax Policy, instructed his staff to compile a list of preferences and concessions in the income tax that had the nature of expenditure programs. See Surrey, Stanley S., and Paul R. McDaniel, *Tax Expenditures.* (Cambridge, MA: Harvard University Press) 1985.

EZ Tax Incentives Program Detail

Taxpayers with business activities located in an EZ can claim various tax incentives through both the corporation tax (CT) and the personal income tax (PIT). The available programs include tax credits for hiring certain qualified individuals, sales taxes paid on equipment purchases, and net interest deductions for banks making loans to an EZ business. In addition, EZ businesses may benefit from accelerated depreciation of equipment and the carry-over of 100 percent of business losses to future tax years.

Hiring Credit. The largest EZ-related incentive is the hiring credit. California law provides this credit to taxpayers that employ qualified employees in an EZ during the taxable year equal to: (1) 50 percent of qualified wages in the first year of employment; (2) 40 percent of qualified wages in the second year of employment; (3) 30 percent of qualified wages in the third year of employment; (4) 20 percent of qualified wages in the fourth year of employment; and, (5) 10 percent of qualified wages in the fifth year of employment.

In general, "qualified wages" means wages that do not exceed 150 percent of the minimum wage. A "qualified employee," in turn, means an individual who meets both of the following requirements: (1) At least 90 percent of the individual's work for the taxpayer is directly related to the conduct of the taxpayer's trade or business located in an EZ; and, (2) At least 50 percent of the individual's services for the taxpayer are performed within the boundaries of an EZ.

In addition, a "qualified employee" must fall within at least one of several statutorily designated categories. Listed categories include economically disadvantaged individuals, dislocated workers, disabled individuals, ex-offenders, recipients of certain federal or state aid, members of a federally-recognized Indian tribe, and residents of a "targeted employment area" as defined by Government Code Section 7072. [3]

Finally, to qualify for the hiring credit, the taxpayer must obtain a certification (or "voucher") providing that the employee meets the eligibility criteria specified above. Taxpayers are required to retain a copy of this voucher and provide it upon request to the Franchise Tax Board (FTB), the state agency charged with administering the CT and the PIT.

Sales or Use Tax Credit. Taxpayers engaged in a trade or business within an EZ may take a credit equal to the sales or use tax paid during the taxable year in connection with the purchase of qualified property. Qualified property includes

[3] Targeted Employment Areas (TEAs) may be designated by cities and counties with EZs as census tracts where more than 50 percent of the residents are low and moderate income (defined as 80 percent of the area or county median). Thus, residents of the TEAs are considered qualified individuals for purposes of the EZ hiring credit, regardless of their individual income or employability characteristics.

specified machinery and machinery parts, data processing and communications equipment, and motion picture manufacturing equipment central to production and postproduction. The total cost of qualified property that may be taken into account for purposes of claiming this credit may not exceed $1 million for PIT filers and $20 million for CT filers. Moreover, the qualified property must be used by the taxpayer exclusively in an EZ.

Net Interest Deduction. California law provides for the deduction of net interest income on loans made to a trade or business located solely within an EZ. For purposes of the EZ net interest deduction, a qualified taxpayer (creditor) is defined as an entity that loans funds on or after the designation date of the EZ to a qualified business (debtor) and receives interest payments thereon. It should be noted that the taxpayer (creditor) does not have to be located in the EZ to take advantage of the net interest deduction; only the debtor needs to operate within the EZ.

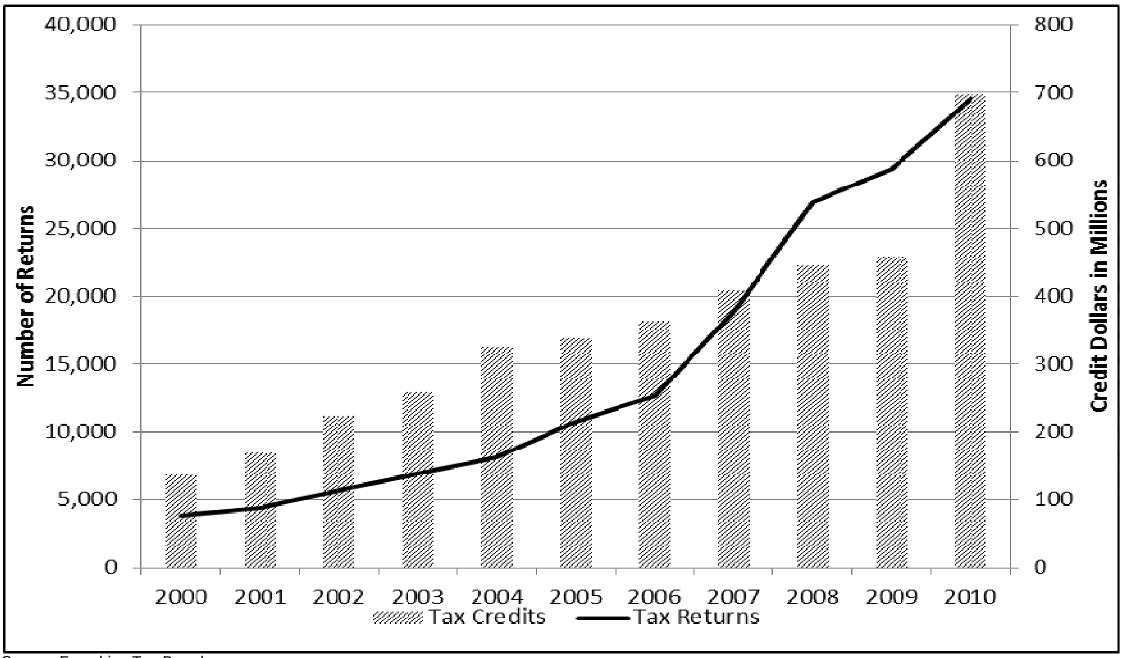
Accelerated Depreciation. Existing law allows EZ taxpayers to treat 40 percent of the cost of specified property as an expense not chargeable to the taxpayer's capital account. Any such cost may be allowed as a deduction for the taxable year in which the taxpayer places the property in service. Such property must be for exclusive use in a trade or business conducted within an EZ.

Employee Tax Credit. Finally, existing law allows an income tax credit equal to 5 percent of qualified wages, as defined, received by a qualified EZ employee during the taxable year. However, for each dollar of income received by the employee in excess of qualified wages, the credit is reduced by nine cents.

Substantial Growth in EZ Tax Incentives

From the perspective of the state fisc, the resource commitment to and budgetary impact of this program has grown quickly and is substantial. According to FTB figures, the combined PIT and CT impact of EZ and related credits was $201 million in tax year 2001 and had grown to $402 million by 2005. Despite the impacts of the steep economic downturn that began in 2008, credit usage continued to increase; by 2010 the annual revenue impact of the EZ program had risen to an estimated $746 million. Over the last decade, increases in EZ costs have been greater than 15 percent annually, even during a period of economic contraction. The growth from 2009 to 2010 was over 50 percent. Capping the program at a certain level, much the same way many direct expenditures are controlled, would limit the state’s fiscal exposure. The following chart depicts the number of returns claiming certain EZ credits (line) and the dollar value of the credits claimed (bar) over the last decade.

Enterprise Zone Hiring and Sales and Use Tax Credits
Corporation Tax / Personal Income Tax



Source: Franchise Tax Board

EZ credits are claimed by businesses large and small, but the majority of returns with credit claims stem from businesses with assets of $5 million or less. However, in terms of the value of the credit, the great bulk of credits offered under the various EZ programs are used by larger corporations or other businesses. Based on FTB data, 65 percent of the value of the corporation tax credits went to businesses with assets of $1 billion or more, while 80 percent went to businesses with assets of $100 million and over. Some have suggested instituting a gross revenue threshold that would channel more credits to small business.

The EZ program incentives are used by businesses in a broad array of industries, including construction, trade, manufacturing, and services. The most significant share of credits is used by wholesale and retail trade, which together comprises about 30 percent of the total. Durable and non-durable goods manufacturing constitute another 29 percent of the total usage. Financial and information services constitute an additional 21 percent of EZ incentive usage. Some analysts, who believe that the trade industries may constitute too large a share of the use, have proposed the program be limited to specific industries.

The growth in the program is not only reflected in the credits actually used, but also in the amount of accompanying—and significant—growth in earned but unused credits. Companies may not be in the position to avail themselves of credits earned—for example, due to insufficient tax liability to allow for a complete use of the credit earned. In 2010, while $410 million in hiring and sales and use tax credits were applied to corporation tax liabilities, corporations actually earned $700 million in credits. These accrued credits may be carried-over into future years; currently carry-overs of CT and PIT EZ credits total $2.3 billion.

<u>Effectiveness of EZ Programs is in Question</u>

The preponderance of evidence with respect to the impact of state taxes generally, concludes that while they can have an effect on business location and investment decisions, the impact is quite small and swamped by factors such as labor quality, social and physical infrastructure, and market access. Furthermore, the dominant economic perspective related to tax incentives is consistently critical of their inefficiencies as well as their general lack of effectiveness. With respect to particular tax incentives, such as EZ tax incentives, the research is somewhat mixed; however, as with tax incentives in general, EZ incentives appear in the great bulk of analyses to generate a limited economic response, if any. [4] Fundamentally, in the "on the one hand—on the other hand" world of economics, most objective research indicates that policies such as the state's EZ program do not result in additional overall economic activity in the state, but simply shift business activity and employment around.

There are a number of studies that have examined the impact of overall tax reductions in designated EZs. LAO's review of EZ incentives from a few years ago drew several important conclusions from these studies, including the following:

- Intra-metropolitan location activity is more sensitive to tax differences than is interstate location activity. This indicates that EZs may to a large extent merely result in shifting jobs within a state or region rather than increasing the actual number of jobs in that state or region.

- EZ incentives are most effective in assisting a target area if the EZ does not extend beyond that area. Since EZs may simply shift jobs around, the more narrowly targeted the EZ, the more effective it can be in meeting its objective.

- Hiring credits have a greater impact on job creation than other types of incentives. The existence credit for labor costs can increase the demand for labor and assuming a qualified workforce is available, can result in job creation.

- Significant tax incentives are required to overcome actual or perceived higher operating costs in an EZ. To overcome the costs associated with poor infrastructure and perceived or actual less productive labor, tax incentives offered must be relatively generous in order to stimulate additional economic activity.

[4] The results in this area are somewhat dependent on when the study was conducted, the research methodology employed, and the particular types of program incentives available.

Among some specific studies that have been conducted in recent years, the most noteworthy include the following:

In *"Do California's Enterprise Zones Create Jobs?"* (Public Policy Institute of California; Kolko and Neumark, 2009), the authors compared employment data of EZs and control areas in order to assess the extent to which EZs have created additional employment. The report concluded that program has no statistically significant effect on employment. Although it did not look at the effect of EZs on poverty and unemployment, it is unlikely that these would be positively affected in the absence of increasing employment. The study questions the value in the EZ program given that there is a lack of proven benefit to California.

In *"Government Programs Can Improve Local Labor Markets: Evidence from State Enterprise Zones, Federal Empowerment Zones and Federal Enterprise Communities"* (University of Southern California; Ham, Imrohoroglu and Swenson, 2008), the authors used Census tracts focusing on five labor market variables (unemployment rate, poverty rate, fraction of households with wage and salary income, average wage and salary income, and total employment) as a means of analyzing the impact of EZs. The research concluded EZ designation has positive impacts on local labor markets, but impacts of federal programs were substantially larger than state programs. Curiously, the study found that California EZs had no significant effect on employment, but did have a significant effect on the unemployment rate, poverty rate, and the proportion with wage and salary income.

In *"State Enterprise Zone Programs: Have They Worked,"* (Peters and Fischer, 2002), generally gave a low grade to state EZs in terms of accomplishing their objectives. The authors conclude that EZs have typically little impact overall on new investment and do relatively little to improve job prospects of residents of the EZs. The authors do acknowledge heterogeneity in the data and indicate that the success of individual EZs may be favorable, depending upon specific circumstances.

Other papers from the California Budget Project (CBP), *"Enterprise Zone Program: No Bang for the Buck," (2011)* and the Legislative Analyst's Office (LAO) *"California's Enterprise Zone Program: Prepared for the Senate Committee on Revenue and Taxation"* (2010), focused on the administrative and design inefficiencies of the program.

- The CBP paper notes that EZs credits do not require the creation of new jobs, the majority of EZ credits claimed is on the basis of residency rather than barriers to employment, the EZs are too large to direct economic activity to the areas most in need, and EZ eligibility criteria are too broad.

- The LAO paper concluded the program is expensive and not highly effective and recommends its elimination or restructuring. The report identified weakness in the program such as the lack of a narrowly tailored approach, lack of competiveness for area designation, restrictions on types of employees eligible for the credit, and retroactive credits.

Efforts to Reform EZ Tax Programs

The EZ programs have been the subject of numerous attempts at reform, stimulated by concerns over the growing cost as well as their questionable effectiveness.

Legislative Efforts. There have been numerous legislative efforts to reform the EZ program. In recent years SB 974 (Steinberg, 2010) and AB 1139 (Perez, 2009) proposed to repeal the TEA criterion and so-called 'retro-vouchering,' but nether bill advanced out of the Legislature. In the current session, SB 434 (Hill), proposes a number of reforms to the EZ program, including: eliminating retro-vouchering, requiring net state-wide job creation, establishing quality job requirements, capping the cost of the program, sunsetting the program, requiring legislative review, creating a public database of companies receiving tax benefits, and regulating tax consultants in the area. The bill was passed out of Senate Governance and Finance Committee on May 1.

2013-14 Governor's Budget. As part of the 2013-14 Governor's budget, the Administration proposed certain regulatory changes to the EZ program. The Governor proposes regulatory changes that are intended to eliminate or mitigate some of the most obvious weaknesses and inconsistencies in the program. The proposed regulations are designed to:

- Limit retro-vouchering by requiring all voucher applications to be made within one year of the date of hire.
- Require third-party verification of employee residence within a Targeted Employment Area.
- Streamline the vouchering process for hiring veterans and recipients of public assistance.
- Create stricter zone audit procedures and audit failure procedures.

The proposed regulations will affect primarily revenues from the CT but have a minor impact on the PIT as well. The Administration estimates that the changes will result in increased revenues of $10 million in 2012-13 and $50 million in 2013-14. In addition to these proposed regulations, the Administration has indicated that it will be pursuing further EZ reform through legislation, although to date, no language on the proposed statutory reforms has been made available.

2011-12 Governor's Budget. The 2011-12 Governor's budget took a more dramatic approach by proposing to eliminate all EZ tax incentives for tax years beginning on or after January 1, 2011. The proposed elimination would apply to both newly earned credits and deductions, as well as to unused credits earned in prior years. Local agencies would have been permitted to maintain any applicable local incentives. This proposal was estimated to generate additional state revenues of $343 million in FY 2010-11 and $581 million in FY 2011-12.

The proposal would have significantly changed the way local development efforts are handled by transferring responsibility and authority to local jurisdictions and their voters. Eliminating state tax benefits for EZs was considered a fundamental part of this change. Because the primary benefit of these zones is to shift economic activity from one geographic region within California to another geographic region within California, the Administration noted that they are not of statewide interest. The proposal did not make it out of the Legislature.

<u>Can We Do Better?</u>

Two reforms that have been proposed would greatly improve the functioning of the EZ tax credit as an incentive. The first proposal, included in the Governor's Budget as well as in legislation, addresses the existence of retro-vouchering of employees. This feature allows businesses to claim the credit for a qualified individual for past years of employment prior to the determination of their eligibility. This aspect can result in the EZ credit acting not like an incentive (since the hiring occurred in the past), but rather as a bonus for prior behavior. Regulatory and legislative initiatives would curtail this practice.

The second proposal, incorporated in the legislation mentioned above, would be designed to address the issue of businesses simply shifting jobs around the state to advantage themselves of the EZ credits without actually creating any new jobs in the state. Current legislation would establish a requirement that businesses that avail themselves of the EZ credit create net new jobs in the state instead of potentially receiving the credit for simply replacing displaced employees.

These and other related reforms would improve the state's tax incentive 'bang for the buck.' [5] However, there may be other types of reforms or structural changes that could also be considered by redirecting all or some of the 'costs' associated with EZ tax incentives and essentially reallocating the credit. Some of these alternatives could be potentially designed to provide assistance to localities that use EZ programs intensively. The non-inclusive list below provides a brief description of possible alternatives:

- **Job and Technical Training Programs.** These programs would focus on developing human capital for prospective employees for industries requiring technical expertise.

[5] Another significant reform proposal is to include additional criteria for employment that is eligible for EZ credits by increasing the minimum wages and meeting certain job retention requirements.

- **Manufacturers Investment Credit/Sales Tax Exemption.** A partial sales tax exemption (or equivalent) could be targeted to certain industries or areas and also address the phenomenon of 'tax pyramiding.' [6]
- **State-Wide Jobs Credit.** A statewide tax credit would address the issue of job relocation within the state by allowing for a credit to be used anywhere within the state.

As a cautionary note, the tax system is a blunt policy tool for encouraging specific and targeted economic activity. Even if flaws in the EZ program are addressed, the more fundamental difficulty will remain. The central issue is the limitation of existing policy tools to structure a program that can differentiate between incentive and reward. That is, for a tax program to be effective and efficient in generating the desired response, it should only provide a tax benefit for behavior that occurs solely due to the presence of the incentive. In fact, for the EZ program—like most other tax incentives—substantial tax benefits accrue to businesses that would have undertaken the activity regardless. Any new or redesigned program would need to address this issue to be effective and efficient.

[6] Tax pyramiding occurs when inputs to production are taxed as well as the outputs. For example, when the purchase of equipment used to produce taxable items is itself subject to taxation.

Proposed Vote-Only Calendar

0984 California Secure Choice Retirement Savings Investment Board

Department Summary: The California Secure Choice Retirement Savings Board (CSCRSIB) was established through SB 1234, (DeLeon), Chapter 734, Statutes of 2012. The CSCRSIB was established for the purpose of creating a statewide retirement savings plan for private workers who do not participate in any other type of employer sponsored retirement savings plan.

Issue Proposed for <u>Vote-Only</u>:

1. **Addition of Budget Bill Item 0984-001-8081—Support for California Secure Choice Retirement Savings Investment Board and Budget Bill Language (Spring Finance Letter and Proposed Budget Bill Language):** The Spring Finance Letter (SFL) proposes expenditure authority of $1.0 million to conduct the market analysis related to private pensions specified in SB 1234 associated with the California Secure Choice Retirement Savings Program (CSCRSP). The market analysis is to determine whether the necessary conditions for implementation of the CSCRSP can be met, with such conditions to include likely participations rates, participants' comfort with various investment vehicles and degree of risk, contribution levels and the rate of account closures and rollovers. The expenditure authority is only available based on the receipt of funds from non-profit, private, or federal funding. Budget bill language provides that the expenditure authority over the $1.0 million is also contingent upon the receipt of funding provided through a non-profit or private entity or the federal government.

   Staff Comment: Staff has no concerns with this proposal.

   Staff Recommendation: Approve the SFL and accompanying budget bill language.

   <u>Vote:</u>

8885 Commission on State Mandates

Issue Proposed for <u>Vote-Only</u>:

1. **Mandate Suspensions (Governor's Budget Proposal):** This item was discussed at the April 25 hearing and held open. The Governor's budget proposes the suspension of numerous mandates in order to achieve budgetary savings. Many of these have been suspended for several years, typically as part of the budget process. In general, mandate suspension has not been subject to thorough policy review that would evaluate the costs and benefits of the mandate, but rather have been suspended solely for the purpose of budgetary savings. The policy decision to establish the mandate in the first place has not generally been a substantial component of the discussion.

   Mandates proposed for suspension include mandates suspended in prior years (Group 1), immediate suspension of five new mandates with statewide cost estimates (Group 2), and four new mandates without statewide cost estimates (Group 3). These are discussed separately below.

   <u>Group 1:</u> The mandates proposed for continued suspension are those mandates which have been previously suspended (Group 1). These are listed in the figure below.

Mandates Suspended in Governor's Budget
General Fund
(Dollars in Thousands)

Suspended Mandate Title—Group 1	Amount
Adult Felony Restitution	$0
Absentee Ballots*	49,598
Absentee Ballots-Tabulation by Precinct*	68
AIDS/Search Warrant	1,596
Airport Land Use Commission/Plans	1,263
Animal Adoption	45,321
Brendon Maguire Act*	0
Conservatorship: Developmentally Disabled Adults	349
Coroners Costs	222
Crime Statistics Reports for the Department of Justice & CSRDOJ Amended	160,705
Crime Victims' Domestic Violence Incident Reports II	2,010
Deaf Teletype Equipment	0
Developmentally Disabled Attorneys' Services	1,198
DNA Database & Amendments to Postmortem Examinations: Unidentified Bodies	310
Domestic Violence Information	0
Elder Abuse, Law Enforcement Training	0

Extended Commitment, Youth Authority	0
False Reports of Police Misconduct	10
Fifteen-Day Close of Voter Registration*	0
Firearm Hearings for Discharged Inpatients	156
Grand Jury Proceedings	0
Handicapped Voter Access Information*	0
In-Home Supportive Services II	444
Inmate AIDS Testing	0
Judiciary Proceedings (for Mentally Retarded Persons)	274
Law Enforcement Sexual Harassment Training	0
Local Coastal Plans	0
Mandate Reimbursement Process I	6,910
Mandate Reimbursement Process II (includes consolidation of MRPI and MRPII)	0
Mentally Disordered Offenders': Treatment as a Condition of Parole	4,909
Mentally Disordered Offenders' Extended Commitments Proceedings	7,215
Mentally Disordered Sex Offenders' Recommitments - Verify Name	340
Mentally Retarded Defendants Representation	36
Missing Person Report III	0
Not Guilty by Reason of Insanity	5,213
Open Meetings Act/Brown Act Reform	113,101
Pacific Beach Safety: Water Quality and Closures	344
Perinatal Services	2,337
Personal Safety Alarm Devices	0
Photographic Record of Evidence	279
Pocket Masks (CPR)	0
Post Conviction: DNA Court Proceedings	411
Postmortem Examinations: Unidentified Bodies, Human Remains	5
Prisoner Parental Rights	0
Senior Citizens Property Tax Postponement	481
Sex Crime Confidentiality	0
Sex Offenders: Disclosure by Law Enforcement Officers	0
SIDS Autopsies	0
SIDS Contacts by Local Health Officers	0
SIDS Training for Firefighters	0
Stolen Vehicle Notification	1,117
Very High Fire Hazard Severity Zones	0
Victims' Statements-Minors	0
Voter Registration Procedures*	2,481
	$408,703

LAO Perspective: LAO has raised questions regarding the six mandates slated for suspension by the Governor's budget that deal with elections matters. The LAO recommended that these six mandates identified by an asterisk (*) in the table above not be suspended but rather funded in the budget, along with the direction that the Administration work with counties to explore alternative funding mechanisms.

Staff Comment: No concerns have been raised regarding the continued suspension of these mandates, other than issues noted by LAO. Staff notes that suspending the election mandates would not preclude the Administration from working with counties to explore an alternative funding mechanism, as suggested by LAO. The selected mandates in the figure have been suspended in prior years.

Group 2: The second group of mandates proposed for suspension is made up of five mandates with newly identified cost estimates. These comprise three mandates associated with elections—Modified Primary Election, Permanent Absentee Voter, and Voter Identification Procedures. These three mandates were considered by the committee as a separate agenda budget item. The remaining two mandates with statewide cost estimates are related to public safety—Domestic Violence Background Checks and Identity Theft—and will be considered in Senate Budget Subcommittee #5. Note that these five mandates constitute the so-called "Reserve Builders," the suspension of which generates $111.0 million in General Fund savings.

Group 3: The third group of mandates designated for suspension is made up of four mandates without statewide cost estimates, as yet. One of these mandates—Tuberculosis Control—will be addressed in Senate Budget Subcommittee #3. The remaining three mandates in this group—California Public Records Act, Local Agency Ethics and Interagency Child Abuse and Neglect Reporting—are discussed below.

- **California Public Records Act.** The core provisions of the California Public Records Act (CPRA), relating to the right of residents to inspect public records and receive copies on request, are not reimbursable mandates. The reimbursable mandate portions of the CPRA relate to providing assistance to those seeking records, notification to the requestor regarding whether the records may be disclosed, and expunging home addresses and phone numbers of employees that relate to request. Suspension would not affect the obligations of local governments to comply with the core provisions of the CPRA. LAO recommends that the provisions of the law that constitute mandates be recast as optional 'best practices.' LAO indicates that the statewide costs—when they are provided—are likely to be in the tens of millions of dollars annually.

- **Local Agency Ethics.** The Commission determined that state law makes it mandatory for some local governments (largely general law cities, and certain special districts, that are required to pay compensation) to adopt policies relating to reimbursement of certain expenses and provide ethics training for officials who receive compensation. The Commission found that some activities related to the adoption of policies relating to reimbursement of expenses and provision of ethics training are reimbursable mandates. LAO points out the somewhat puzzling inconsistency of imposing the mandate on local governments (that are required to pay compensation) and not on others. LAO recommends changes in law that would make compensation optional for all local governments (thus removing the mandate) or exclude from the requirement those local governments that are obligated to pay compensation.

- **Interagency Child Abuse and Neglect Investigation Reports.** As discussed in the Senate Budget Subcommittee #3 agenda for April 11, 2013, the Governor's budget proposes to suspend, in 2013-14, parts of the Child Abuse and Neglect Reporting Act (CANRA) that collectively form what is called the Interagency Child Abuse and Neglect Reporting (ICAN) mandate. Suspending this mandate would make local compliance with the provisions of related statutes optional in 2013-14. Assembly Budget Subcommittee #3 rejected the suspension of this mandate.

Staff Comment: There are important policy issues that are imbedded in each of the three mandate programs discussed in this item. LAO's proposal to recast the CPRA mandate as best practices makes policy sense, as it would require local governments to adopt the best practices or, alternatively, announce at the first public meeting that it was not going to adopt best practices. Similarly, for the Local Agency Ethics mandate, there are numerous issues associated with local government compensation and associated ethics that are best left to a policy discussion. The LAO recommended a workgroup to address issues associated with CANRA, which should occur irrespective of the suspension of the mandate.

Staff Recommendation: Approve suspension of all prior suspended mandates identified in Group 1; suspension of the three election mandates identified in Group 2; and suspension of Local Agency Ethics, California Public Records Act, and Child Abuse and Neglect Reporting Act mandates identified in Group 3.

Vote:

7730 Franchise Tax Board

Issue Proposed for Vote-Only:

1. **Enterprise Data to Revenue Project (Governor's Budget BCP#1):** This request was discussed at the March 21 hearing and held open. FTB processes more than 15 million personal income tax returns and one million business enterprise returns annually. Its operations are heavily reliant on effective storage and use of data from a variety of sources. This request is for a third year of funding for its Enterprise Data to Revenue (EDR) project, which will address the agency's return processing and utilization of data and connect various systems. The request calls for $152.1 million General Fund and 184 permanent positions in 2013-14. The request includes conversion of 26 positions associated with the project from limited-term to permanent. In addition, the proposal includes a placeholder for the department's project needs in 2014-15 of $87.6 million and 36 positions. Of the $152.1 million in 2013-14, $133.5 million is for a vendor payment (for 2014-15, the vendor payment is $68.5 million). EDR is a fixed-price, benefits-funded project in that timing of the vendor payment is contingent on the state receiving additional revenues attributable to the project. Because of flexibility inherent in the contract structure, FTB is requesting encumbrance and expenditure authority for a portion of the 2013-14 vendor payment until 2014-15. Anticipated revenue attributable to EDR is $261.6 million in 2013-14 and $684.6 million in 2014-15.

   Detail of Project: EDR will replace several older FTB information technology systems and streamline other existing systems. Over the long term, the project is expected to generate and safeguard significant state revenues in the high hundreds of millions of dollars. As a result of certain components coming on-line, the project and related activities generated $7.5 million in revenues in 2009-10, $25.4 million in 2010-11, and $115.7 million in 2011-12. The amounts projected for each of these years were $3.8 million, $13.7 million and $65.3 million, respectively. Total cost of the project through 2017-18 is estimated to be $689.9 million, with approximately $398.9 million payable as a vendor payment. Total revenue generated by the EDR project over this period is expected to be roughly $4.7 billion, for a benefit cost ratio of 6.8:1.

   The continuation of the EDR project is expected to fund the technology-intensive portion of the project. FTB indicates that the initial revenues generated by the EDR project were primarily from adding staff to process the current backlog of business entity returns and begin collection correspondence in order to accelerate revenue. Beginning in 2011-12, substantial revenues were generated by the EDR project proper.

   Main Goals: The EDR project has three major goals. First, it seeks to capture all tax return data in an electronic form. Second, the project will integrate the various existing "siloed" tax databases at FTB into a data warehouse. Third, the project will enable FTB to add third-party data (for example, county assessor data) to its data warehouse. The FTB asserts that the EDR project will allow it to substantially improve detection of underpayment and fraud in order to collect taxes from those who are not paying the full amount that they owe. In addition, FTB indicates that the project will enable it to improve service and give taxpayers better access to their tax records.

Project Components: The project includes the following improvements to FTB's systems that process personal income tax and business entity tax returns:

- An underpayment modeling process that would be integrated with the Accounts Receivable Collections System and Taxpayer Information System.
- An enterprise data warehouse with data search and analysis tools.
- A taxpayer records folder that is accessible to the taxpayer and allows taxpayers and FTB staff to access the information.
- Re–engineering of existing business processes—including imaging of tax returns, data capture, fraud and underpayment detection, tax return validation, filing enforcement, and other audit processes—and integration of these enhanced business processes with FTB's existing tax systems.
- Improved business services at FTB such as address verification, issuance of notices, and a single internal password sign-on for its IT systems.

Benefits-Funded Approach: FTB indicates that it plans to finance the EDR project using a benefit-funded approach. Contractor payment for system development and implementation will be conditioned on generating additional revenue that will more than cover the cost. This approach is intended to protect the state and also give the contractors a strong incentive to develop the project in a manner that produces significant revenue quickly. The FTB has used this approach previously. FTB's benefit-funded approach makes use of revenue gains from reducing the business entity backlog to more than offset costs in 2009-10 through 2012-13. Although these gains could be accomplished regardless of whether project development goes forward, it makes sense to move forward now because cleaning up the backlog is a necessary condition to efficient project development. In subsequent years, the estimates in the project's Feasibility Study Report (FSR) indicate large increases in annual revenue gains that would be more directly attributable to the IT project. From 2011-12 through 2015-16, annual revenue gains increase from $115.7 million to $1.1 billion, while IT project implementation costs increase from $37.0 million in 2011-12 to a peak of $147.6 million in 2013-14 and then decline to $54.3 million by 2015-16. The method of financing EDR is similar to that used by the Employment Development Department for certain technology projects.

Staff Comment: The net benefit of this project (as estimated in the FSR) ramps up quickly. As noted above, the project began to produce significant net revenues starting in 2011-12. The FTB has among the best track records in California state government for the successful development and implementation of major information technology projects. FTB projects have experienced some delays and cost increases in certain phases, although these problems generally have not prevented successful completion of project phases. Generally, the project has come on-line faster than anticipated. Existing Supplemental Reporting Language requires FTB to report to the Legislature when revenue, costs, scope or schedule variances exceed 10 percent. The committee may ask the LAO and the California Technology Agency (CTA) to comment on the project.

Staff Recommendation: Approve the budget request.

Vote:

0860 Board of Equalization

Issue Proposed for <u>Vote-Only</u>:

1. **Enhancement of E-Services (Governor's Budget BCP#1):** The Governor's Budget proposes $950,000 ($690,000 General Fund) and 4.0 limited-term positions in 2013-14 and 2014-15 to make enhancements to the e-registration system. The additional staff and resources will pay for enhancements to allow taxpayers to register online with more ease and make account maintenance adjustments that are currently handled by BOE staff.

   Background: Additional funding for the department's electronic services expansion has allowed for implementation of a new registration system, electronic filing, and online requests for extensions, relief of penalty and declarations of timely mailing. The BOE expects the savings resulting from the new system to be $13.42 million by the end of 2013-14. Savings from the system for 2008-09 through 2013-14 were or are expected to be redirected. The next step in the electronic services process is to allow taxpayers to make changes to their accounts on-line, including changes in business location, mailing address, business name, officer information, e-mail addresses, and phone numbers.

   Staff Comment: The advantages of electronic services can accrue to taxpayers by increasing convenience as well as reducing costs. BOE indicates that significant savings have occurred through it electronic services efforts, totaling $53.6 million over the five year period ending 2013-14. This is largely through a reduction in staffing resources that are necessary for administration. This item was discussed in subcommittee hearing on March 21 and held open in order to clarify certain budget figures in the BCP.

   Staff Recommendation: Approve the budget request.

   <u>Vote:</u>

Proposed Discussion / Vote Calendar:

0860 / 7730 Board of Equalization / Franchise Tax Board

Issue Proposed for Discussion / Vote:

1. **Civil Proceedings—Limit on Attorney Fees (Governor's Budget Trailer Bill):** This issue was discussed during the March 21 hearing. The Governor's budget proposed budget trailer bill that limit the means through which attorneys may be compensated in suits against the state involving taxation. The statutory change would affect taxes administered by both the FTB and the BOE. Under the bill, the provisions in the tax laws applicable to personal income tax, corporate franchise tax, and sales and use taxes, regarding prevailing party and reasonable litigation costs would be the exclusive means by which litigation costs and attorneys' fees may be awarded against the FTB and the BOE. These provisions would generally be extended to property taxation and other taxes and fees administered by BOE. The provisions would limit fees to $160 per hour (adjusted on the basis of changes in the California Consumer Price Index) unless the court determines that a special factor justifies a higher rate. Certain aspects of the proposed language have been revised, as discussed below under "Staff Comments."

   Background: Current state law provides two methods for determining attorney's fees in tax related cases: the Revenue & Taxation Code (R&TC) which caps attorney's fees at an hourly rate, and the Code of Civil Procedure which uses a multiplier to determine attorney's fees. Prevailing parties are not eligible for payment of attorney fees if the state establishes that its position is substantially justified, based on a 'reasonable person' test. The proposed change in statute would place the state in virtual conformity with the federal government by limiting fees to those determined under the R&TC. Current federal law provides similar provisions to the state R&TC for capping attorney's fees for parties that prevail against the Internal Revenue Service (IRS). The Administration notes that over $2 million in fees have been paid on four cases over the last 10 years under the Code of Civil Procedure.

   LAO Perspective: LAO notes that the proposal may foreclose the option of highly qualified tax counsel based on hourly fee limitation. In addition, it notes that the change may have an effect on limiting legal procedures which might have an equitable purpose.

   Staff Comment: The proposal would not limit, in any way, a taxpayer's right to file a claim for refund for any tax and only regulates the way they pay unrelated third parties seeking refunds on their behalf. In addition, the provisions would not disallow contingency fee structures, but rather address the fees that could be paid under such plans. The proposal apparently addresses a drafting error from 1983 when the state intended to conform to federal law requiring all attorneys' fees related to tax cases to be awarded under the R&TC with an hourly cap versus under the Code of Civil Procedure. The chance that a fee limit could serve to discourage suits that may have a substantial public purpose in clarifying or correcting existing law, has been substantially addressed by the revisions to the proposal. Assembly Budget Subcommittee #4 rejected the proposed trailer bill at its March 19 hearing.

At its March 21 meeting, the Chair directed staff to work with the Administration to refine certain aspects of the trailer bill to address concerns of the subcommittee. Subsequent to this, and based on these recommend consultations, the Administration revised its language in the following manner:

- Raises the statutory attorney fee limit to $400 per hour, from the previous $160 per hour. Courts would continue to be allowed discretion to award higher fees based on special factors.
- Specifies that the state's compliance with the constitutional obligation to defend a statute would not by itself constitute 'substantial justification' for purposes of defending itself against the payment of attorney fees to a prevailing party.
- Allows attorney fees only in situations where the prevailing parties net worth did not exceed $2.0 million, in the case of an individual, and $7.0 million in the case of a business. These are equivalent to the federal thresholds.

Staff Recommendation: Adopt the proposed trailer bill language.

Vote:

7730 Franchise Tax Board

Issue Proposed for Discussion / Vote:

1. **Section 1031—Like-Kind Exchanges (Committee Issue):** This issue was discussed at the March 21 hearing and held open. California's income laws provide for "like-kind exchanges," which allow the owner of qualified business or investment property (such as a building or equipment) to sell the property and purchase other similar property. When the newly-acquired property is sold, the deferred gain on the original property is then subject to taxation. In this manner, the program acts as a means to defer the gain on the sale of property. Qualified property does not include property used for personal purposes (e.g., home or family car), property sold by a business (e.g., inventories), specifically excluded property (such as securities), and certain other types of property. California conforms to federal law with respect to this program.

   Program Detail: There are significant policy and revenue implications of the program. The like-kind exchange program facilitates exchanges of business assets and allows owners of exchanged property to keep the full value of exchanged property invested in their businesses. Without the program, some otherwise productive transactions might not be undertaken in order to avoid having any resulting gains subject to taxation. Thus, the program could facilitate a more efficient use of productive assets by allowing such exchanges to occur *ex tax*. By allowing investors to retain the lower basis in the property, the tax gains deferral in like-kind exchanges can increase the revenue loss of the "step-up" provision of the estate tax. The step-up provision allows the basis of inherited property to increase for tax purposes to its fair market value at the time of death of the original owner. In addition, if the property owner exchanges California property for non-California property, California may never tax the full amount of the gain on the California property because of the inability to ensure income tax compliance with respect to any gain on a sale by a non-resident. Like any other deferral, to the extent taxes are finally imposed, no consideration is given regarding the loss of the use of revenues between the time of the transaction and the date the taxes are paid.

   Alternative Approaches: There are significant compliance issues associated with out-of-state like-kind exchanges, and because of this, the state may never collect the tax liability that may result. Given the compliance issues, at its March 21 hearing, the subcommittee discussed various options for increasing compliance with the like-kind exchanges. Alternative means by which to address the tax avoidance associated with out-of-state like-kind exchanges have been suggested, including:

   - **Holding Period.** Require a holding period on purchased or exchanged property. This would restrict flipping of investment property and reduce the attractiveness of tax avoidance.

- **Reporting Requirement.** Establish an annual reporting requirement for taxpayers who engaged in a like-kind exchange. Similar annual reporting is required of insurance companies regarding the transfer of certain assets, and reporting is required by some states.
- **Deposit Methods.** Institute withholding of capital gains taxes for like-kind exchanges. Alternatively, require the posting of a bond or allowing the state to establish a property lien.
- **Data Collection.** Pursue information and enforcement of like-kind exchanges with federal and state governments to track the event and location of capital gains realizations.

LAO Perspective: In prior years, the LAO has urged the elimination of the like-kind exchange either in whole or in part. As part of its review of the 2008-09 budget, LAO called for limiting the like-kind exchange to in-state properties only. Subsequently, as part of its 2009-10 budget analysis series, LAO recommended a total elimination of the like-kind exchange.

Staff Comment: This issue is not a proposal of the Franchise Tax Board (FTB) or the Administration. At its March 21 hearing, the subcommittee heard from FTB staff and LAO on advantages and disadvantages of alternatives for addressing non-compliance resulting from this program, including the options identified above. At the direction of the subcommittee, staff looked at advantages and disadvantages of the various approaches, through discussions with FTB and the LAO. On the basis of these discussions, and other research, the annual reporting requirement emerged as the most prudent of the approaches. While imposing the least burden on business, this option would ensure that the state has the necessary enforcement and compliance tools available to it.

The proposed trailer bill would require that taxpayers file an information return with the FTB if the property acquired in a like-kind exchange is located out-of-state. The proposed trailer bill language would exclude from non-recognition of income any exchange in which the out-of-state real property is received in exchange for real property located in California, if the taxpayer fails to file the return. FTB indicates that the proposal would result in additional information that would facilitate audit and other enforcement efforts and result in additional direct revenues of approximately $1.0 million and increasing, once the benefits of the program are fully realized. In addition, there would be indirect benefits from increased compliance.

Staff Recommendation: Adopted proposed trailer bill language that would require an annual information return with respect to out-of-state like-kind exchanges.

Vote:

0860 Board of Equalization

Issues Proposed for Discussion / Vote:

1. **Accounts Receivable Growth (Committee Issue):** The Board of Equalization (BOE) maintains an accounts receivable (AR) inventory of assessed and uncollected tax liabilities. Over the period of the economic downturn, BOE's AR inventory has increased dramatically, growing from $725 million in 2007 to $1.8 billion in 2012—a roughly 250 percent increase. The staff devoted to collecting on these unpaid accounts has increased during this period as well (from 396 positions to 473 position), but not sufficiently to manage the magnitude of the increase.

   The increase in the AR inventory has occurred as a result of several contributing factors. Some of the primary factors are the recession has led to decreased ability of businesses to remain current on accounts, legislative changes that have increased the base of taxpayers, and an increase in the size of the underground economy. As a result, the BOE has realized increased resources in the past, equating to 178 positions over the last four years, but the growth in the AR has continued. One concern is that as the accounts age, they become increasingly difficult to collect. Currently, about one-third of accounts are five years or older and over 50 percent are older than three years.

   Proposal Detail: The collection program activities cover a broad assortment of activities including: making required contacts with the taxpayer, offering installment payment agreements to those unable to make the full payment, fielding calls and other inquiries, and pursuing other options such as wage garnishments, keeper warrants, till taps, and finally, prosecutions in some instances. The department has indicated that additional resources could be deployed to work down the existing inventory to more manageable levels. Specially, an additional 97 collector positions in 2013-14 would generate an additional $33.1 million in revenue for a benefit/cost ratio of 2.9:1. Increasing the position authority to 165 in 2014-15 would generate approximately $60 million for a benefit/cost ratio of 3.5:1. BOE notes that the activities of the collectors will incorporate the use of new software components that will facilitate the training of collectors and improve their productivity.

   Staff Comments: As noted, BOE has received increased resources in the recent past for the purposes of working down the AR inventory. However, current resource levels have not adequately addressed the AR buildup and the inventory has continued to grow, Not only does the state lose in terms of access to incurred tax liabilities, but the accounts themselves become increasing difficult to collect as they age. This suggests the prudence of attacking the problem sooner rather than later—due both to the opportunity cost of uncollected accounts and the deterioration in the quality of the AR. Staff notes that the budgeting of additional resources for the AR activity may not be required on a permanent basis and the committee may consider limited-term positions.

Staff Recommendation: Approve 97.4 three-year, limited-term positions and \$11.3 million (\$8.2 million GF) in 2013-14 and 165.5 limited-term positions and \$17.1 million (\$12.4 million GF), to generate state and local revenues of \$33.1 million in 2013-14 and \$59.5 million in 2014-15.

<u>Vote:</u>

CALIFORNIA BUDGET PROJECT

Restructuring California's Enterprise Zone Program

CHRISTOPHER HOENE
Executive Director
May 2013

1107 9th Street,
Suite 310
Sacramento,
California 95814
(916) 444-0500
www.cbp.org
cbp@cbp.org

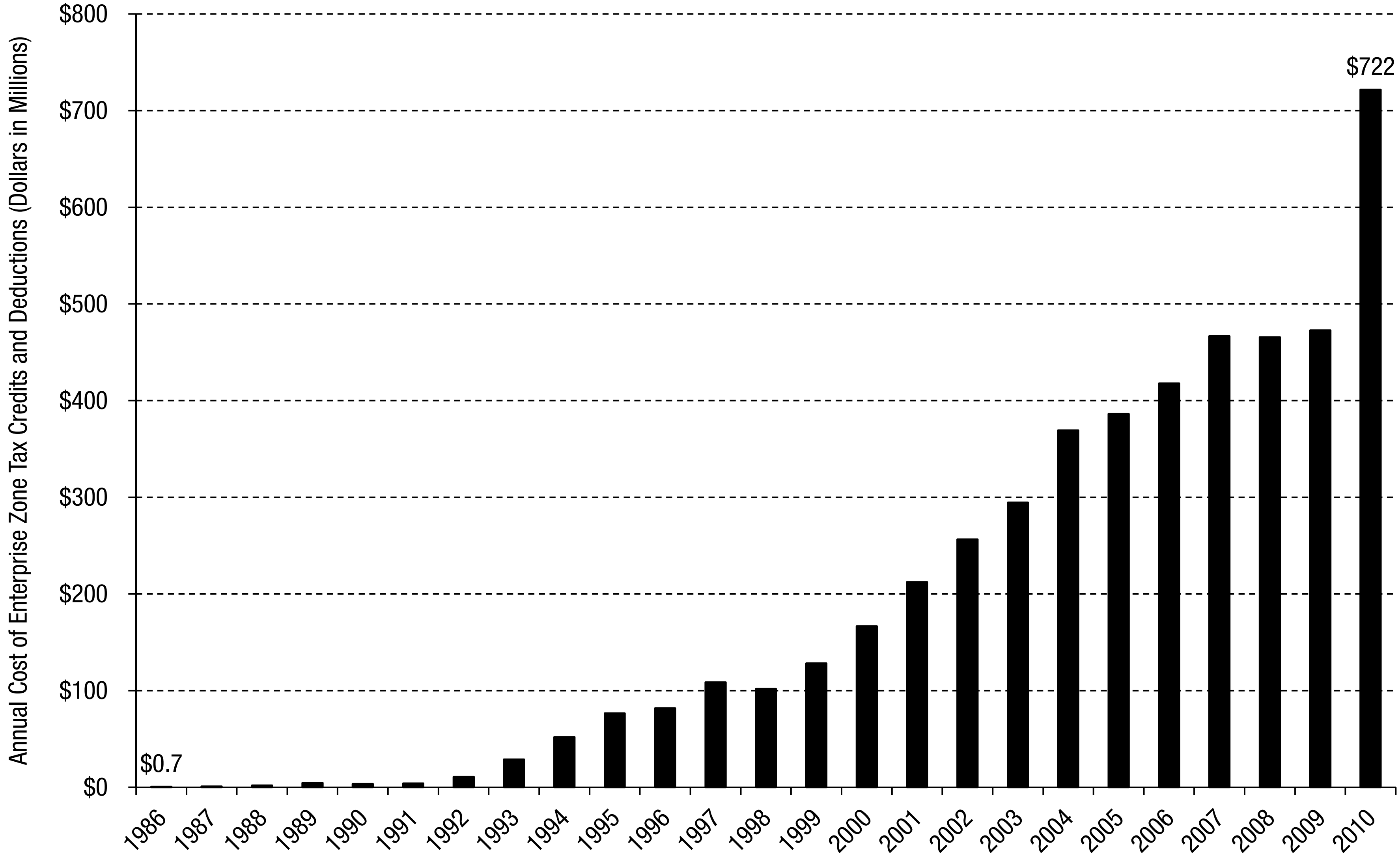
Overview

- While the purpose of California's Enterprise Zone (EZ) program is to promote business development and job creation in economic distressed areas, the program, as currently structured, fails to achieve its goals and places an increasing strain on the state budget.
- The program should be restructured to increase its likelihood of success and reduce its hit to the state budget.

Enterprise Zones Are Very Costly and Have Placed an Increased Strain on the State Budget

CALIFORNIA BUDGET PROJECT

The Cost of Enterprise Zone Tax Credits and Deductions Has Skyrocketed to More Than $700 Million

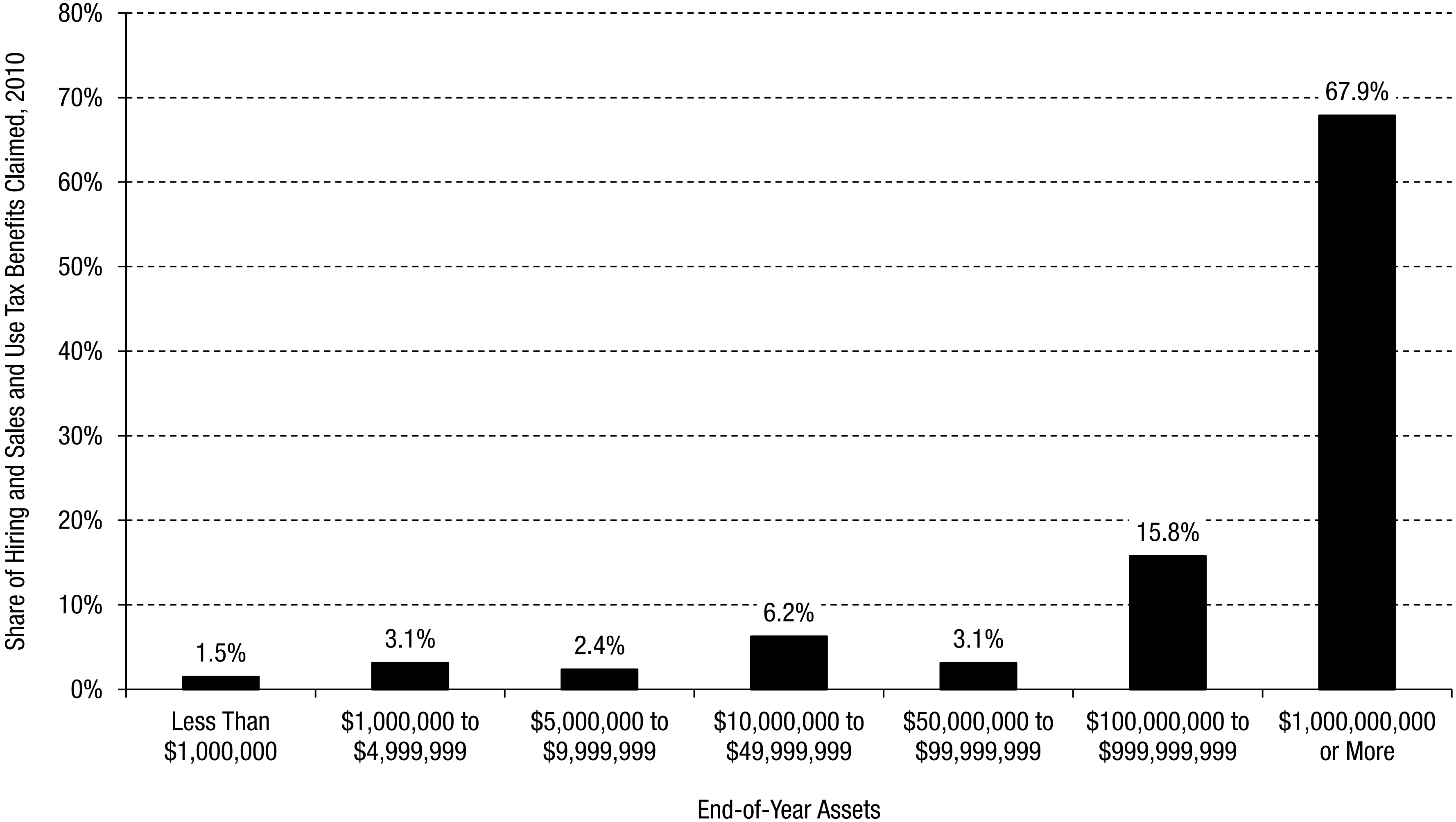


Source: Franchise Tax Board

Very Large Corporations — Not Small Businesses — Are the Primary Beneficiaries of Enterprise Zone Tax Credits

More Than Two-Thirds of Enterprise Zone Tax Benefits Go to Corporations With Assets of $1 Billion or More

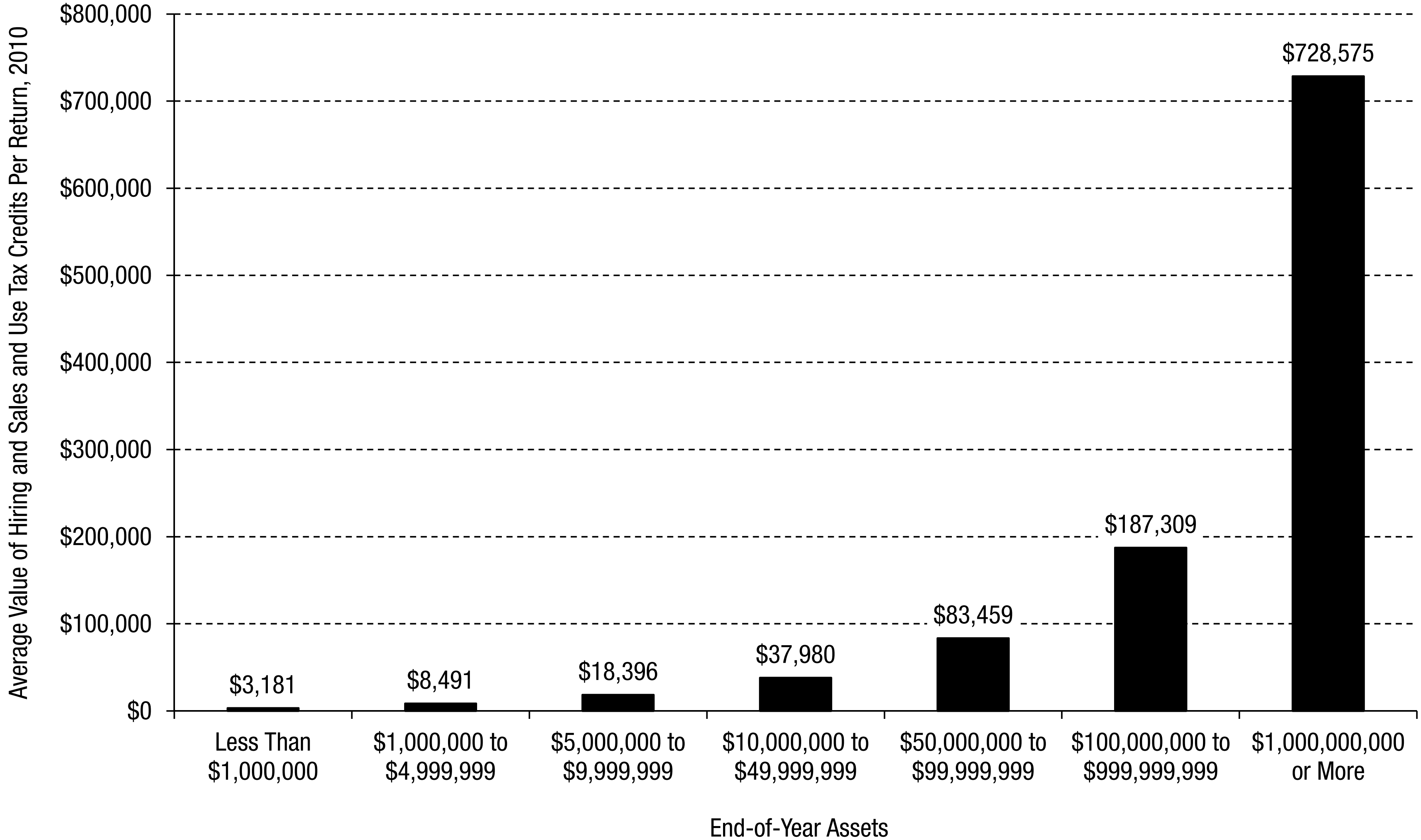
Less Than Half of 1 Percent of Corporations Filing Tax Returns in California Have At Least $1 Billion in Assets



Note: Data exclude companies that file personal income tax returns and claims with missing or negative values.
Source: Franchise Tax Board

cbp CALIFORNIA BUDGET PROJECT

The Largest Corporations Claim an Average of About $730,000 in Enterprise Zone Tax Credits



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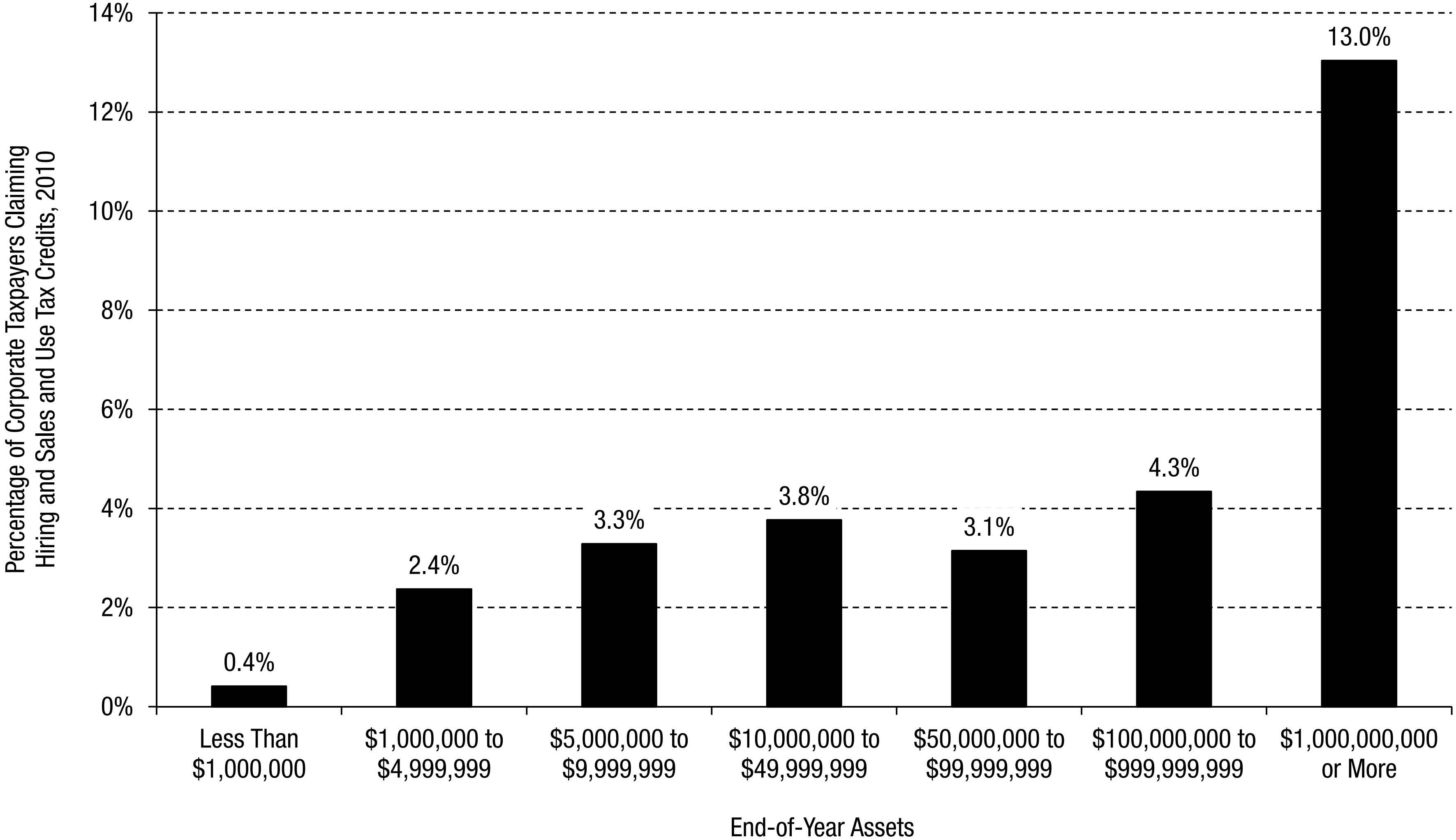
Note: Data exclude companies that file personal income tax returns.
Source: Franchise Tax Board

More Than One Out of Eight Corporations With Assets of $1 Billion or More Claim Enterprise Zone Credits



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Note: Data exclude companies that file personal income tax returns and claims with negative or missing values.
Source: Franchise Tax Board

Enterprise Zones Have Not Boosted Employment Growth

CALIFORNIA BUDGET PROJECT

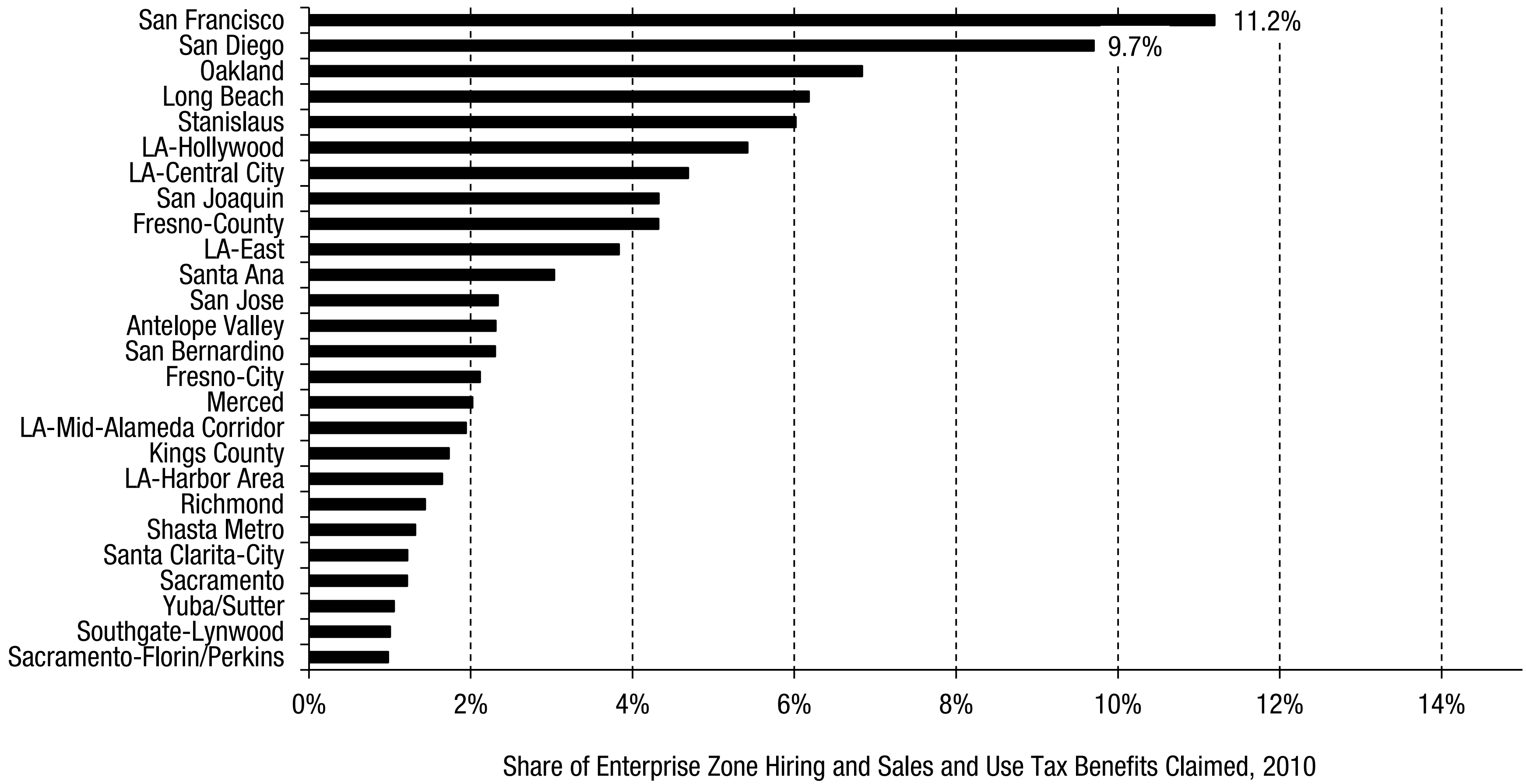
Research Shows Little Effect on Jobs, Growth

- Public Policy Institute of California found that "California's enterprise zone program – the state's largest economic development program – has no statistically significant effect on employment."
- Why? One reason is flaws in the Hiring Tax Credit, including:
  - No requirement for net new jobs created;
  - Retroactive hiring credits; and,
  - Targeted Employment Areas.

CALIFORNIA BUDGET PROJECT

Enterprise Zones Are Not Well Targeted to the Most Economically Distressed Areas

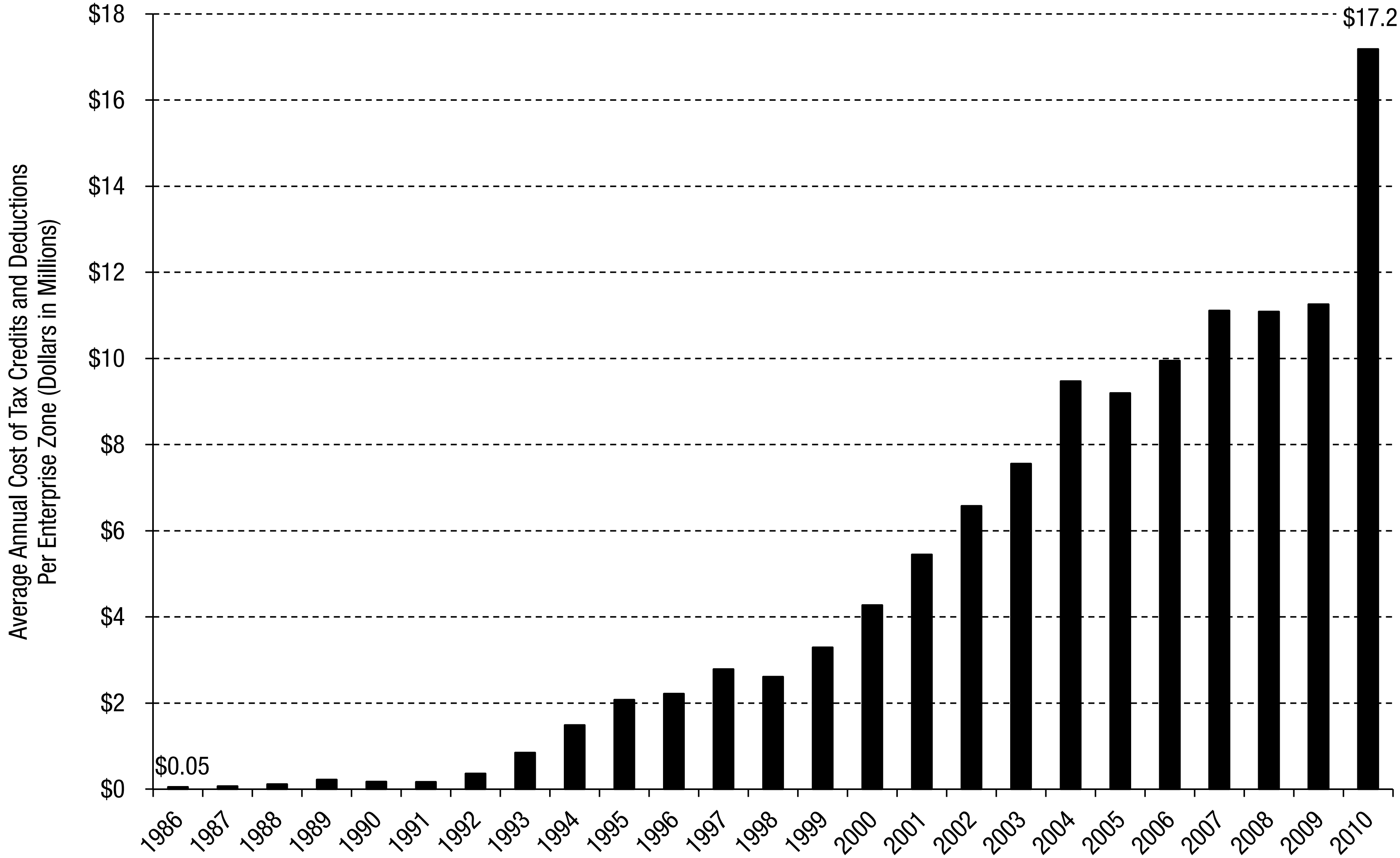
The San Francisco and San Diego Enterprise Zones Account for the Largest Shares of Enterprise Zone Tax Benefits



Note: Data exclude credits for companies that file personal income tax returns and companies claiming credits in multiple zones or with unknown locations. Data include expired enterprise zones due to companies' ability to claim credits retroactively. The 29 zones each claiming less than 1 percent of tax benefits are not shown.
Source: Franchise Tax Board

CALIFORNIA BUDGET PROJECT

The Cost of Tax Credits and Deductions Per Zone Has Increased Substantially

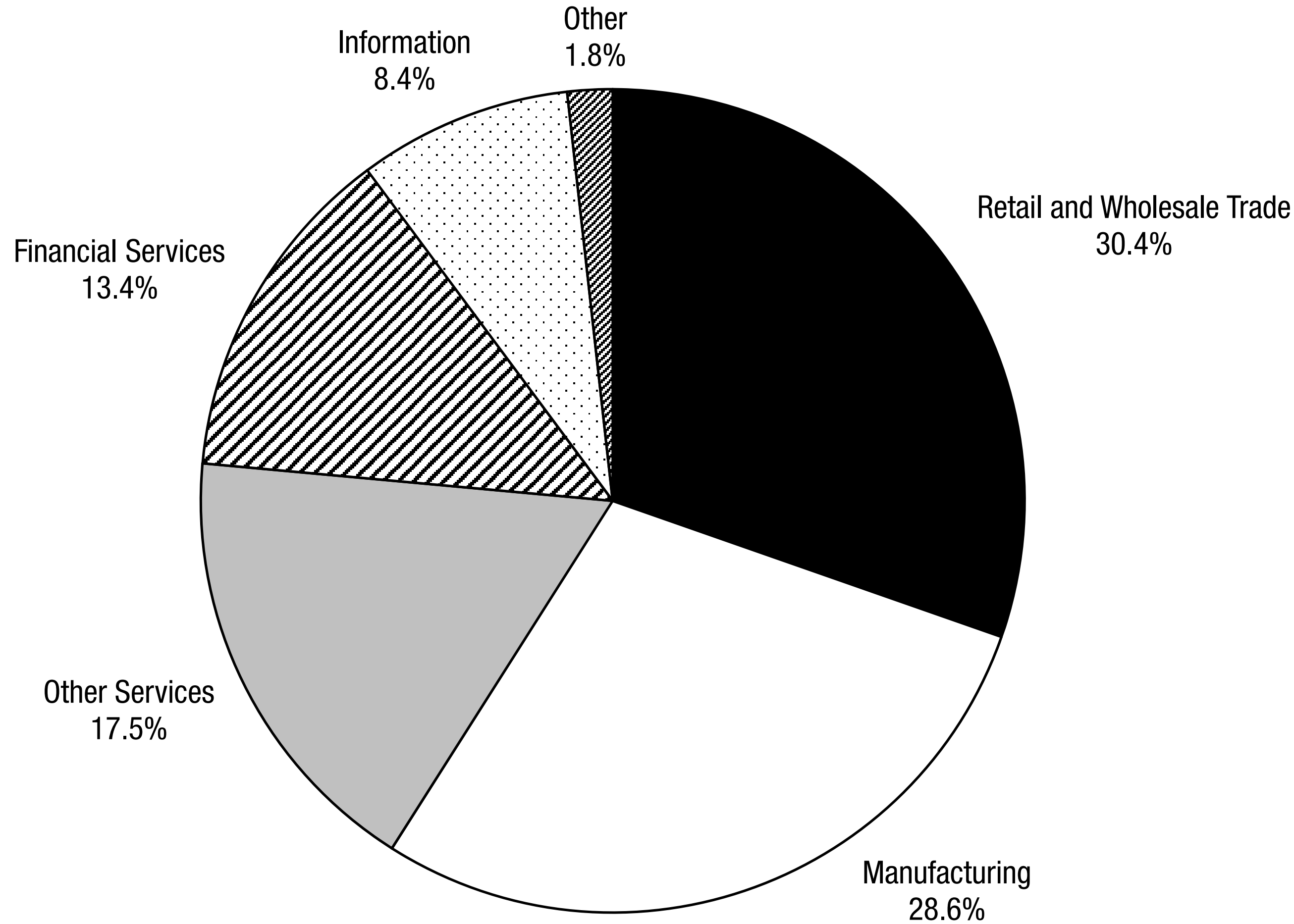


Source: Franchise Tax Board

CALIFORNIA BUDGET PROJECT

A Large Share of Enterprise Zone Tax Credits Go to Trade and Service Corporations Whose Location Decisions Are Unlikely To Be Influenced by Zone Tax Benefits

Trade and Service Corporations Claim the Majority of Enterprise Zone Tax Benefits



Share of Total Value of Enterprise Zone Hiring and Sales and Use Tax Credits Claimed, 2010

Note: "Other" includes agriculture, construction, mining, and unknown industries. Data exclude companies that file personal income tax returns. Percentages do not sum to 100 due to rounding.
Source: Franchise Tax Board

Recommendations for Restructuring EZs

- Improve the targeting of EZs:
  - Restrict zone designation and expansion to the most economically distressed communities;
  - Prioritize zone designation for areas with strong economic development/targeting strategies.
- Reform the Hiring Tax Credit:
  - Require net increase in employment;
  - Eliminate the ability to claim retroactive hiring credits.
- Reassess the program and zones regularly: terminate zones that are no longer in distressed areas and zones that willfully abuse program rules.

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Resources on Enterprise Zones

- California Budget Project reports available at www.cbp.org:
  - *California's Enterprise Zone Program: No Bang for the Buck* **(update forthcoming May 2013)**
  - *California's Enterprise Zones Miss the Mark*
- Public Policy Institute of California report available at www.ppic.org:
  - *Do California's Enterprise Zones Create Jobs?*
- Legislative Analyst's Office handout available at www.lao.ca.gov:
  - *California's Enterprise Zone Programs*

cbp CALIFORNIA BUDGET PROJECT

May 9, 2013

California's Enterprise Zone Programs

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Senate Budget and Fiscal Review Subcommittee No. 4
On State Administration and General Government

Hon. Richard Roth, Chair

Program Background

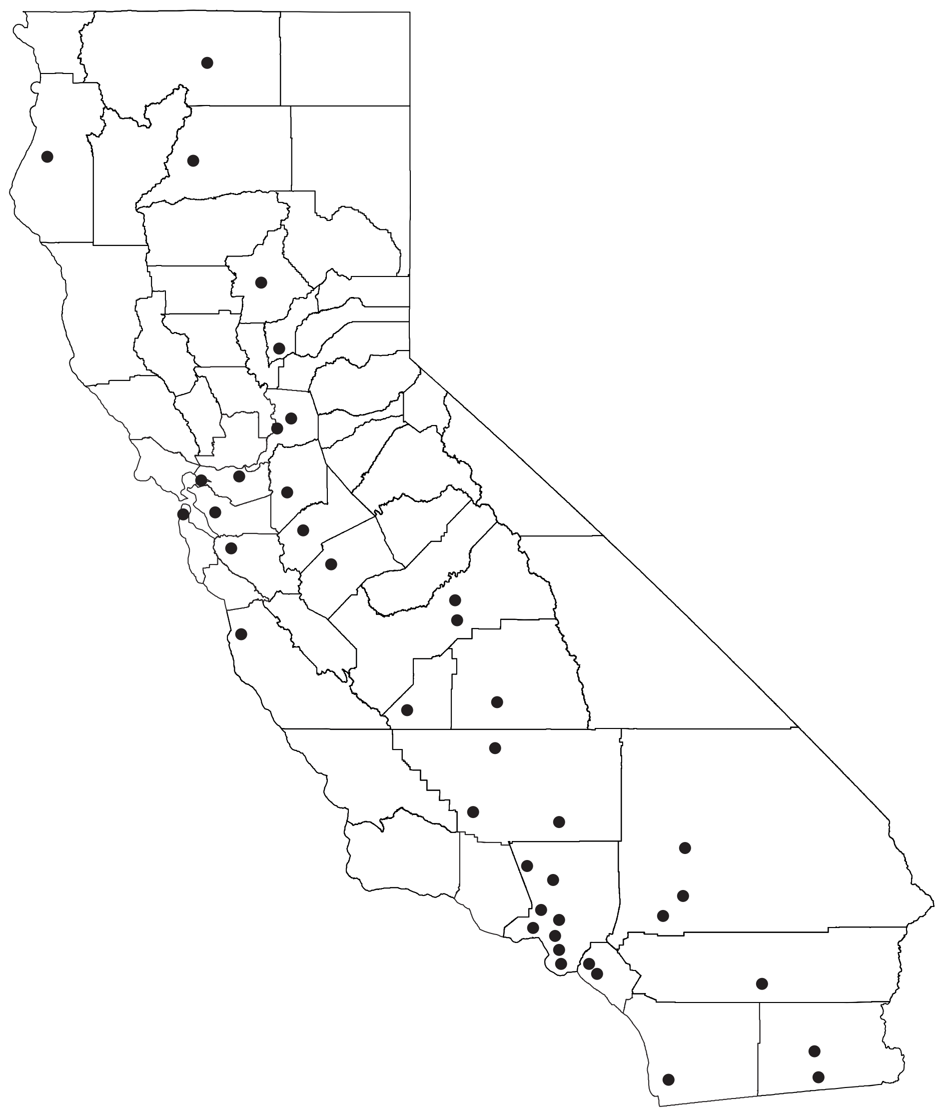
- ☑ ***Area Program Tax Benefits.*** About three decades ago, the Legislature began to use the state's tax code to benefit businesses and workers in areas that were deemed to be distressed. The intent was to mitigate the higher costs associated with doing business in those areas and to increase opportunities for certain people.

- ☑ ***Several Types of Areas.*** Tax incentive areas—Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Readjustment Areas (LAMBRAs)—were selected based largely on socioeconomic characteristics of the area and on the prevailing level of economic distress there. Legislation was enacted in 1984 for EZs, in 1998 for MEAs and the TTA, and in 1993 for LAMBRAs.

LAO
70 YEARS OF SERVICE

Enterprise Zones

As of June 2012



Source: Department of Housing and Community Development.

Does not display Tulare County targeted tax area, Brawley and Calexico manufacturing enhancement areas, or local military base recovery areas.

LAO
70 YEARS OF SERVICE

Program Characteristics

☑ ***Various Types of Tax Benefits.*** Extensive tax benefits are or were available for each of the areas as shown in the table.

- Overall, the hiring credits are by far the most important—and expensive—such benefit.
- EZ tax benefits are available for having employees who reside in a Targeted Employment Area.
- An employee can be claimed for a hiring credit for up to five years.
- There are benefits other than those listed below, such as preferential treatment for state contracts.

	Hiring Credit	Longer NOL Carryforward Period[a]	Sales and Use Tax Credit	Accelerated Depreciation	Lender Interest Deduction
Enterprise Zones	X	X	X	X	X
Targeted Tax Areas	X	X	X	X	
Local Agency Military Base Recovery Areas	X	X	X	X	
Manufacturing Enhancement Zones	X				

[a] Recent legislation lengthened carryforward periods for all taxpayers.

NOL = net operating loss.

Program Usage

☑ ***Rapid Growth in Use of Hiring Credits.*** The number of employees claimed to be employed on tax returns grew from 24,190 to 140,833 between 1999 and 2010. In 2010, over 54,000 were claimed as "new" employees.

- In 2010, the hiring and sales tax credits resulted in $698 million of reduced corporation and personal income tax revenues for the state. This amount has grown at an average annual rate of 18 percent since 2000—about six times faster than the rate of growth of the state budget over the same period.

☑ ***Substantial Benefits for Large Businesses.*** About 40 percent of the EZ hiring and sales tax credits goes to businesses that each had more than $1 billion in assets.

How to Evaluate Program Effectiveness

- The EZ programs are used extensively. Use, however, is not the same thing as effectiveness. In assessing these programs, the Legislature will need to consider:
  - Would more or fewer people have had jobs in the area if the state had used the money differently?
  - Were some or many of the jobs for which credits are claimed offset by losses elsewhere?
  - Did the programs reward decisions by firms and local governments that would have been made anyway?

LAO
70 YEARS OF SERVICE

Assessments of the Program's Effect on Job Growth

- ☑ ***Generally Not Shown to Be Effective.*** Most rigorous research has found that EZs do not create a net increase in jobs or increase the rate of job creation.

- ☑ ***Gains in Some Areas Likely Accompanied by Losses in Others.*** Even if an EZ results in more job growth in a particular locality, it is likely that some of the jobs were shifted from other parts of the region or state.

- ☑ ***Statewide Job Impact Probably Limited.*** Given the shortage of evidence that EZs create jobs locally and the possibility that gains in one area of the state are offset elsewhere, the impact of the EZ program on statewide employment is likely limited.

Potential Reasons for Program's Limited Effectiveness

- ☑ ***Statewide Program May Not Address Diverse Local Issues.*** There are varied reasons why investment is limited in certain areas or why people without jobs and job openings are not well matched. Uniform sets of statewide tax credits likely are not the best way to address the real and diverse problems certain people or places experience.

- ☑ ***Retroactive Credits Are Poor Incentives.*** The ability of taxpayers to amend past returns and claim hiring credits provides more of a reward than an incentive. Therefore, retroactive hiring credits are unlikely to promote increased job creation. (We recommend that this practice be eliminated.)

- ☑ ***May Change Composition of Employment but Not Number Employed.*** Hiring credits may increase employment for qualified workers but result in a loss of other jobs not targeted by the credits.

- ☑ ***Some EZ Benefits Work at Cross Purposes.*** The EZ tax benefits related to equipment and machinery purchases may encourage businesses to shift away from more labor-intensive activities.

Alternatives for Legislative Consideration

- ☑ ***Eliminating Enterprise Zone Programs.*** Because they are expensive and not shown to be effective, we recommend that the area programs be eliminated. Eliminating the programs could allow corporation tax rates statewide to be lowered by a part of a percentage point.

- ☑ ***Allowing Current Zones to Expire Over Time an Option.*** Options for eliminating the program include allowing currently designated zones to expire over a specified time line or preventing the extension of expiration dates for existing zones.

- ☑ ***Capping and Allocating Credits Also an Option.*** If the Legislature chooses not to eliminate the program, it could set a hard limit on the amount of tax benefits provided beginning in a future year. Businesses and/or zones could apply for these credits based on criteria specified in law. Alternatively, the credits could be awarded through a lottery.

EZ and Program AreaData

presented by Franchise Tax Board

State of California
Franchise Tax Board

EZ & Program Area Data

How much zone credits are claimed?

2010

	Corp	
5618 taxpayers		$450 million

2010

	PIT	
28,990 taxpayers		$291 million

Where are the credits claimed?

Los Angeles	37%
Central Coast and Valley	30%
Bay Area	21%
Coastal Southern CA	6%
Other Southern CA	3%
North Coast and Mountain	3%

What industries claim the credits?

Retail/Wholesale Trade	30%
Non-Durable Goods	15%
Durable Goods	14%
Financials	13%
Information	12%
Other	16%

What are the size of the taxpayers claiming zone credits?

Corp
(percent/Assets)

$1 billion +	65%
$100M-$1 billion	15%
<$10 M	6%

PIT
(percent/AGI)

$1 million +	64%
$500K-$1 million	16%
<$300K	10%

Has the use of the credits grown?

2000

PIT	2441	$33 million
Corp	144	$102 million

2010

PIT	29,174	$283 million
Corp	5415	$414 million

Increase

PIT	1,200%	1,250%
CORP	375%	400%

How many jobs are being credited?

2000
35,000 total employees claimed
15,000 new hires

2010
141,000 total employees claimed
54,000 new hires

What is the current and future estimate of credits ($ millions)?

	2010	2013	2016
Credits Claimed	$750	$800	$1,000
Available Carryovers	$2,300	$2,800	$4,450

Questions?

FRANCHISE TAX BOARD
Enterprise Zone/Program Area, LARZ , LAMBRA, TTA and MEA Tax Incentives Used
Corporations - Tax Year 2010

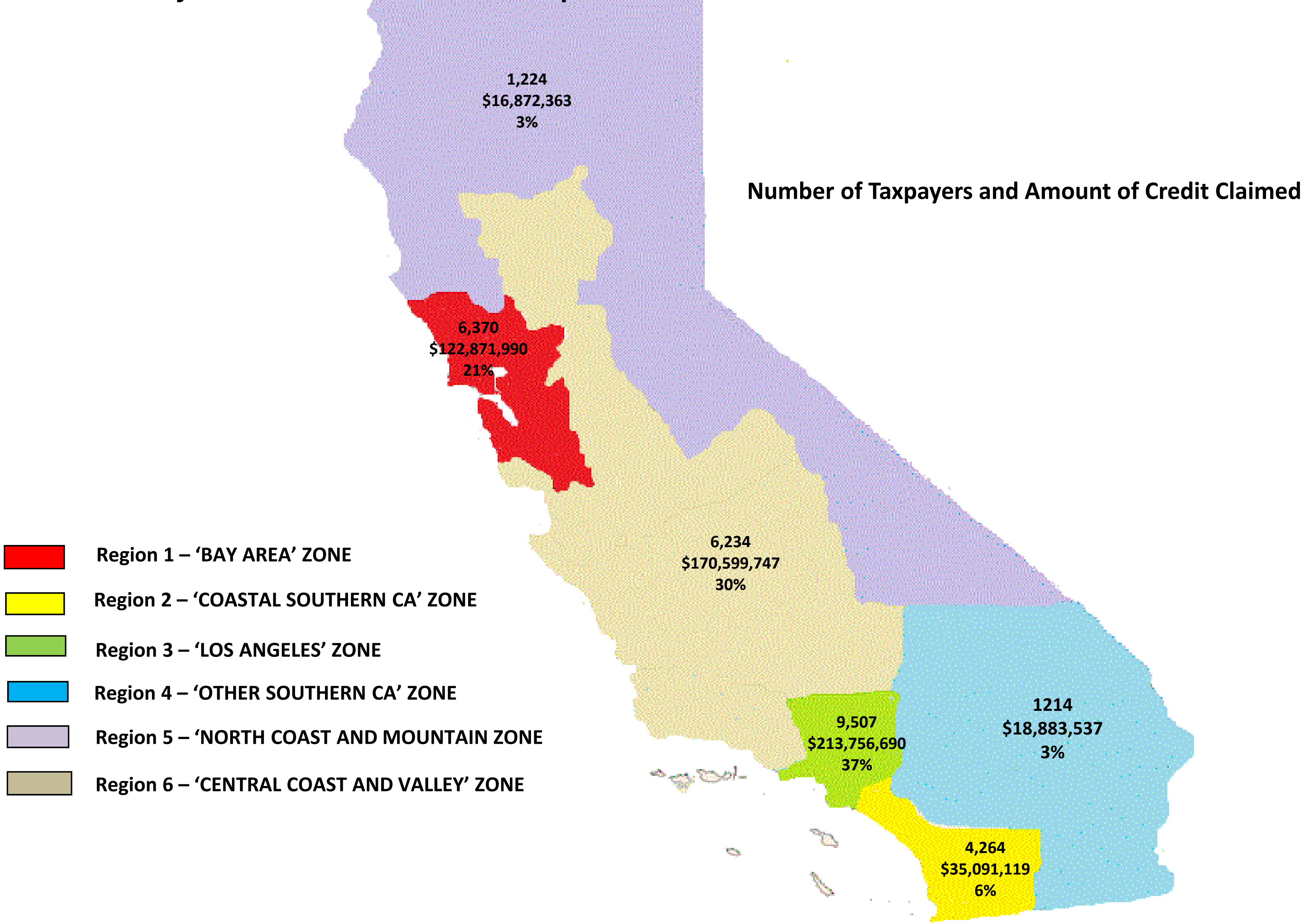
	Hiring, Sales and Use Tax Credit		NOL Used		Net Interest Deduction		Business Expense Deduction	
	Number of Returns	Amount	Number of NOLs	Tax Effect	Number of NIDs	Tax Effect	Number of BEDs	Tax Effect
Enterprise Zone	5,415	$ 414,167,556	115	$ 523,301	436	$ 22,986,343	354	$ 158,668
Local Area Military Base Recovery Act	22	$ 2,493,059	**	$ 190,871	0	$ -	**	$ 2,405
Targeted Tax Area	59	$ 6,693,186	0	$ -	0	$ -	**	$ 552
Manufacturing Enhancement Area	**	$ 11,227	0	$ -	0	$ -	0	$ -
Los Angeles Revitalization Zone	122	$ 3,146,510	**	$ 16,852	0	$ -	0	$ -
Total	**5,618**	**$ 426,511,538**		**$ 731,024**		**$ 22,986,343**		**$ 161,625**

**Omitted to preserve taxpayer confidentiality

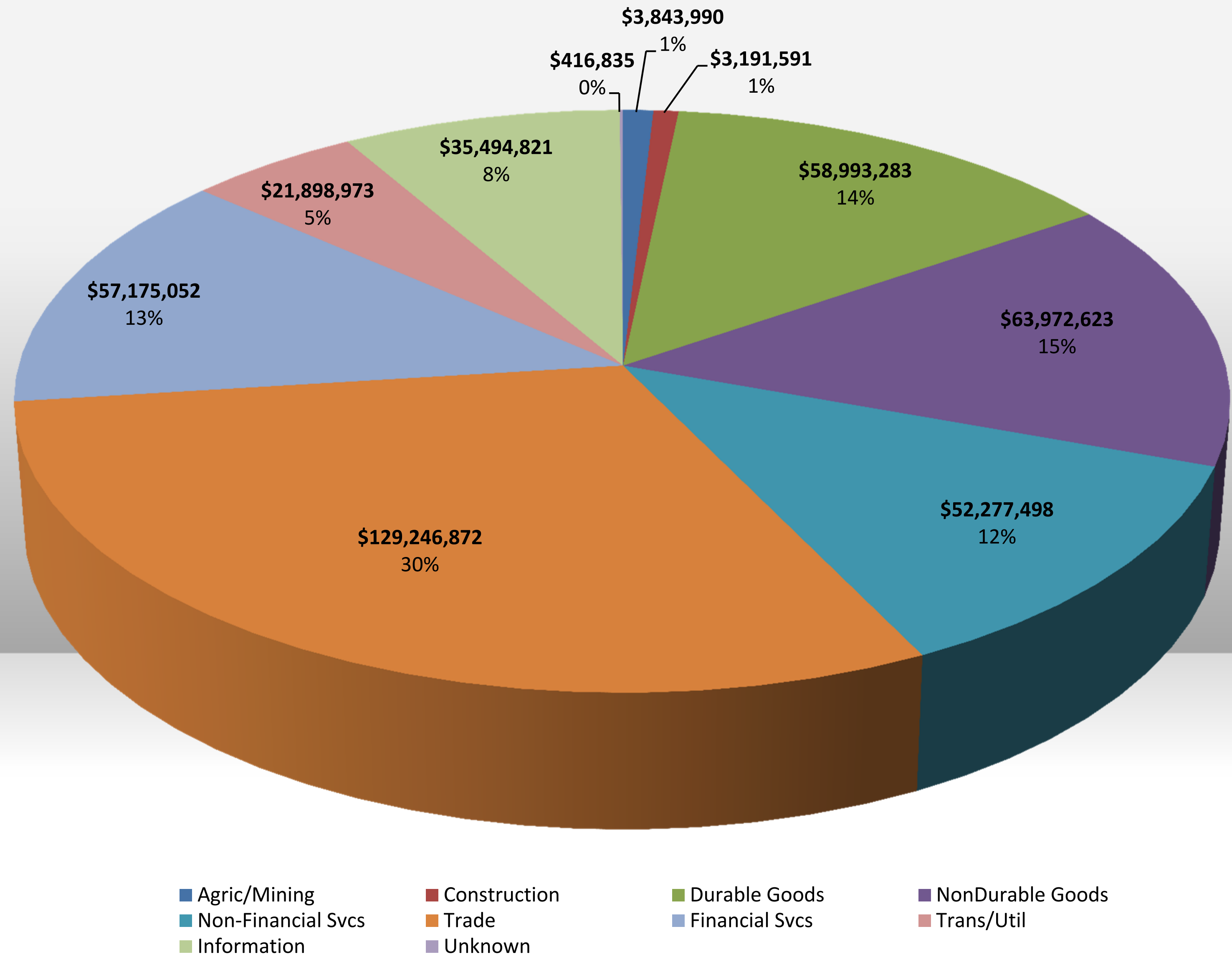
FRANCHISE TAX BOARD
Enterprise Zone/Program Area, LARZ , LAMBRA, TTA and MEA Tax Incentives Used
PIT - Tax Year 2010

	Hiring, Sales and Use Tax Credit		Employee Wage Credit	
	Volume	Amount	Volume	Amount
Enterprise Zone	28,578	$ 283,635,831	596	$ 139,013
Local Area Military Base Recovery Act	68	$ 511,264	0	$ -
Targeted Tax Area	188	$ 4,861,344	0	$ -
Manufacturing Enhancement Area	6	$ 62,173	0	$ -
Los Angeles Revitalization Zone	150	$ 2,015,728	0	$ -
Total	**28,990**	**$ 291,086,340**	**596**	**$ 139,013**

FRANCHISE TAX BOARD
Enterprise Zone/Program Area, LARZ , LAMBRA, TTA and MEA Tax Incentives Used by Region
PIT- Preliminary Tax Year 2011 and Final Corporation - Tax Year 2010



FRANCHISE TAX BOARD
Enterprise Zone/Program Area, LARZ , LAMBRA, TTA and MEA Tax Incentives Used
Corporate Credits by Industry, 2010

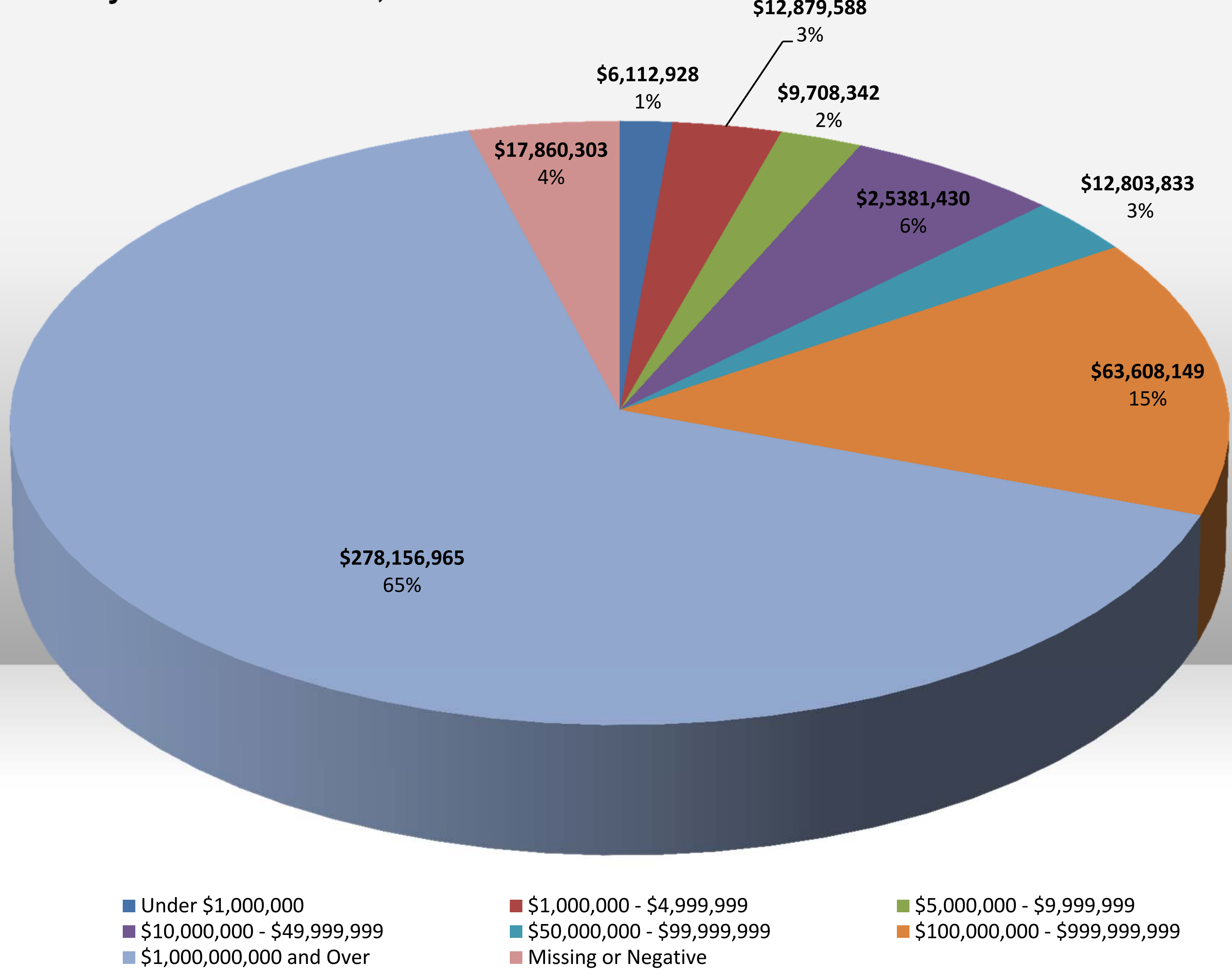


FRANCHISE TAX BOARD
Enterprise Zone/ Hiring, Sales and Use Tax Credit by PBA >$5M
Corporations -Tax Year 2010

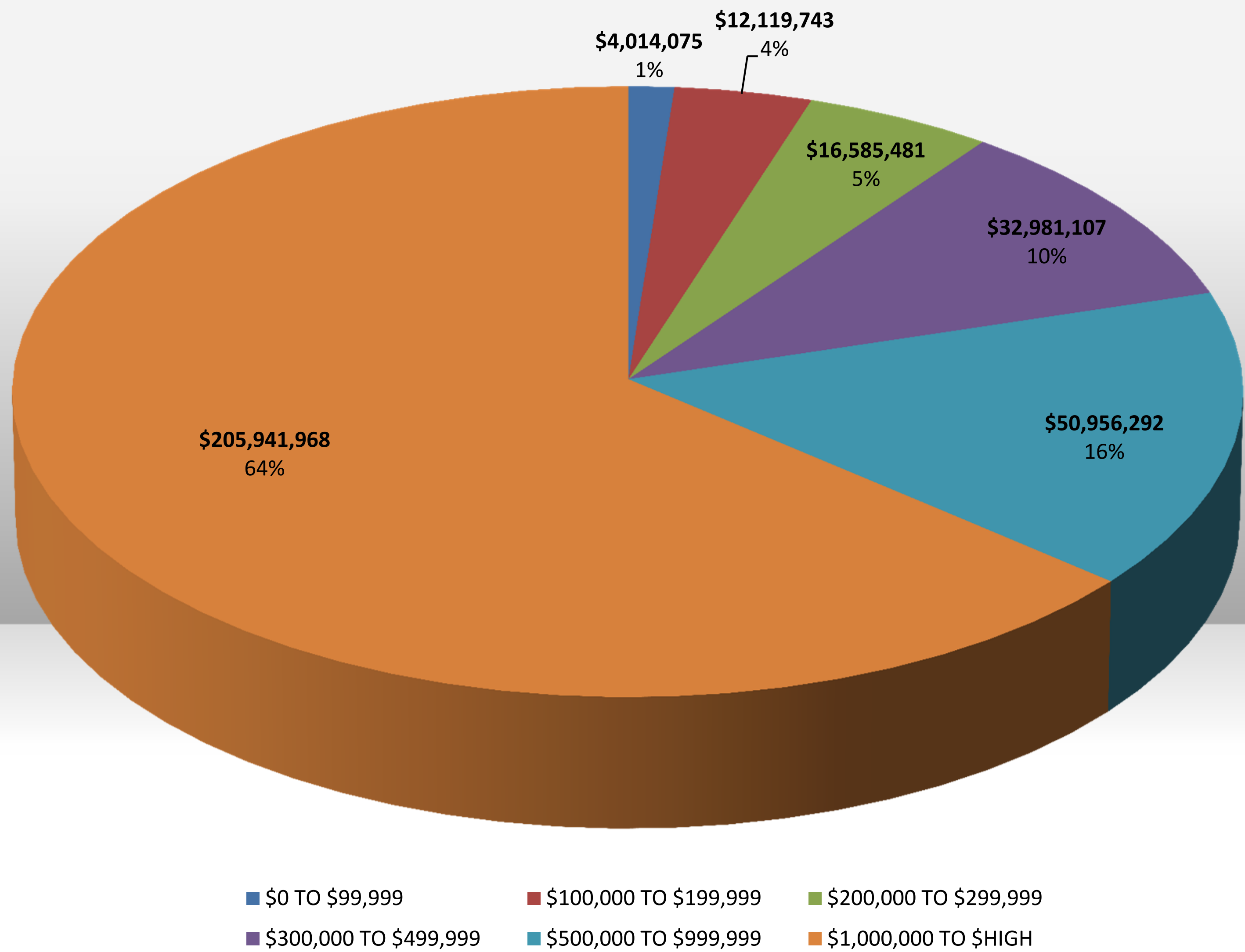
Principle Business Activity Description	Amount of Credit Claimed
General Merchandise Stores	$22,115,745
Management of Companies (Holding Companies)	$20,378,245
Telecommunications	$19,250,261
Beverage and Tobacco Product Manufacturing	$13,392,749
Ship & Boat Building	$12,898,706
Aerospace Products & Parts Manufacturing	$11,538,092
Food and Beverage Stores	$11,212,139
Building Material and Garden Equipment and Supplies Dealers	$9,451,486
Health and Personal Care Stores	$6,627,821
Chemical Manufacturing	$6,538,865
Food Manufacturing	$6,379,676
Clothing and Clothing Accessories Stores	$6,274,271
Other Information Services	$5,970,656
Educational Services	$5,771,763
Merchant Wholesaler, Nondurable Goods	$5,731,095
Motor Vehicle and Parts Dealers	$5,567,572
Mining	$5,512,978
Truck Transportation	$5,276,313
Total	**$ 179,888,433**

Represents 43% of total Credit Claimed

FRANCHISE TAX BOARD
Enterprise Zone/Program Area, LARZ , LAMBRA, TTA and MEA Tax Incentives Used
Corporate Credits by Year End Assets, 2010



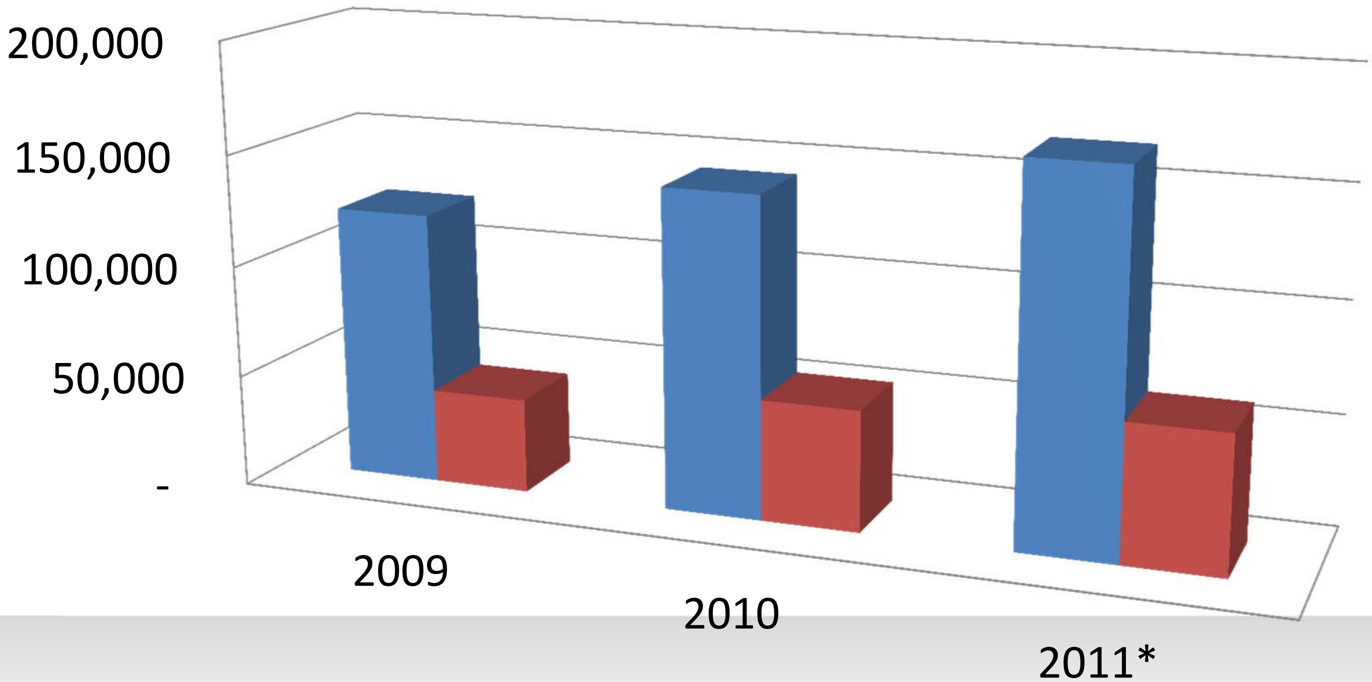
FRANCHISE TAX BOARD
Enterprise Zone/Program Area, LARZ , LAMBRA, TTA and MEA Tax Incentives Used
PIT Credits by CA Adjusted Income, 2010



FRANCHISE TAX BOARD
Enterprise Zone/ Hiring, Sales and Use Tax Credit
Corporations and PIT- Tax Year 2000-2010

	Corporation		PIT		Total	
Income Year	Number of Returns	Amount	Number of Returns	Amount	Total Returns	Total Amount
2000	1,447	$102,657,333	2,411	$33,660,157	3,858	$136,317,490
2001	1,607	$120,034,044	2,814	$48,940,031	4,421	$168,974,075
2002	2,012	$155,991,185	3,673	$66,320,838	5,685	$222,312,023
2003	2,455	$178,017,179	4,462	$80,081,672	6,917	$258,098,851
2004	2,718	$204,396,207	5,426	$119,985,171	8,144	$324,381,378
2005	2,988	$201,283,507	7,724	$135,913,584	10,712	$337,197,091
2006	3,263	$217,119,965	9,462	$145,482,871	12,725	$362,602,836
2007	3,824	$236,680,308	14,980	$171,216,891	18,804	$407,897,199
2008	4,257	$273,505,108	22,650	$171,120,875	26,907	$444,625,983
2009	4,531	$262,555,015	24,867	$196,353,728	29,398	$458,908,743
2010	5,415	$414,167,556	29,174	$283,774,844	34,589	$697,942,400

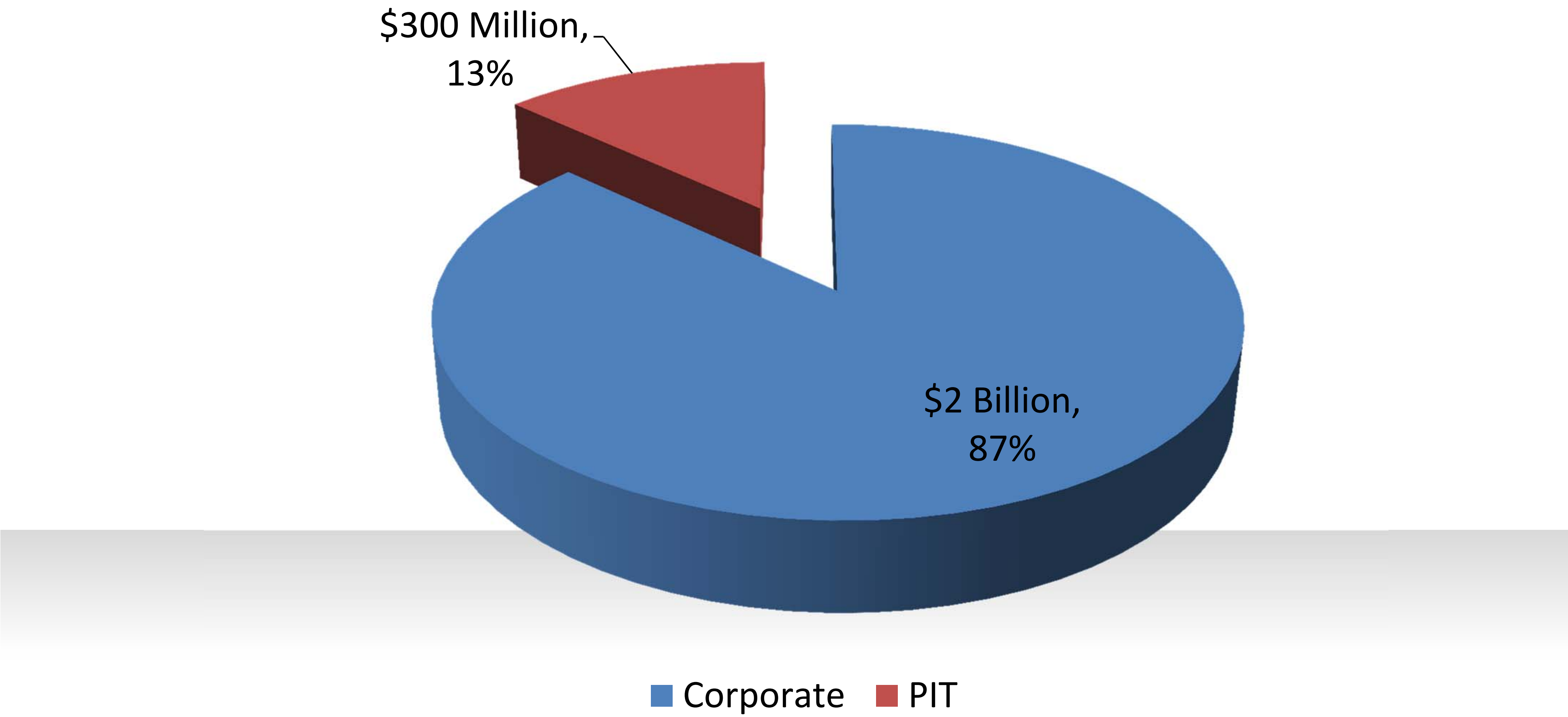
FRANCHISE TAX BOARD
Enterprise Zone/ Hiring, Sales and Use Tax Credit
Number of Employee's in Zones (as reported by Corporations)



	2009	2010	2011*
Total Employees	122,109	143,249	166,847
New Employees	42,229	54,145	61,560

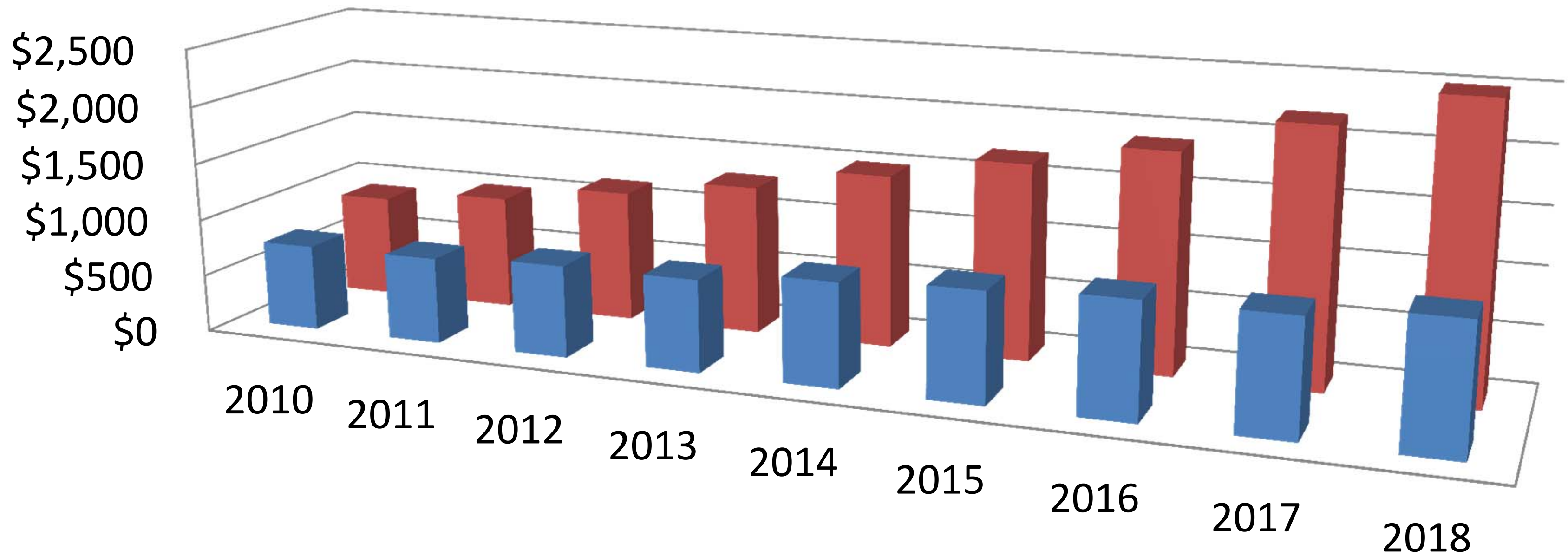
*Preliminary

FRANCHISE TAX BOARD
Enterprise Zone/Program Area, LARZ , LAMBRA, TTA and MEA Tax Incentives
Corporate and PIT Credits Carry Over, 2010



Total $2.3 Billion

FRANCHISE TAX BOARD
Enterprise Zone/ Hiring, Sales and Use Tax Credit
Corporations and PIT- Projected Credit Utilization for tax years 2011 to 2018
($, Millions)



	2010	2011	2012	2013	2014	2015	2016	2017	2018
Used	$750	$750	$800	$800	$900	$950	$1,000	$1,000	$1,100
Generated	$900	$1,000	$1,150	$1,300	$1,500	$1,700	$1,900	$2,200	$2,500
Carryovers	$2,300	$2,550	$2,900	$3,400	$4,000	$4,750	$5,650	$6,850	$8,250

Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Lois Wolk

Thursday, May 9, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Mark Ibele

Part A

State and Local Finance

ACTIONS

Perspective on Enterprise Zones: Economic and Fiscal Impacts 1

Franchise Tax Board
Legislative Analyst's Office
California Budget Project
Discussion item.

Proposed Vote-Only Calendar:

0984 California Secure Choice Retirement Savings Investment Board 11
Approved expenditure authority as budgeted. (2-0)
8885 Commission on State Mandates 12
Approved staff recommendation regarding mandate suspensions. (2-0)
7730 Franchise Tax Board 16
Approved enterprise data to revenue project as budgeted. (2-0)
0860 Board of Equalization.. 19
Approved enhanced e-services as budgeted. (2-0)

Proposed Discussion / Vote Calendar:

0860 / 7730 Board of Equalization / Franchise Tax Board.. 20
Adopted revised trailer bill on limiting attorney fees. (2-0)
7730 Franchise Tax Board 22
Adopted trailer bill on Section 1031 like-kind exchanges. (2-0)
0860 Board of Equalization.. 24
Held open accounts receivable growth program.

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-651-1505. Requests should be made one week in advance whenever possible.

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Lois Wolk
Senator Tom Berryhill

Thursday, May 9, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

Agenda Part B

Item Number and Title

0845	California Department of Insurance
0890	California Secretary of State
1701	Department of Business Oversight
2240	Department of Housing and Community Development
7760	Department of General Services
8940	California Military Department

(See Table of Contents on page 2 for a More Specific Listing of Issues)

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AGENDA – VOTE ONLY ITEMS

AGENDA – DISCUSSION/VOTE ITEMS

Department of Insurance

Issue 1 – Amendment to Budget Bill

Spring Finance Letter: The 2013-14 Governor's budget includes a request for an increase of $218,000 (Insurance Fund) in 2013-14 to address workload associated with AB 1083 (Chapter 852, Statutes of 2012) and SB 951 (Chapter 866, Statutes of 2012).

Background: AB 1083 gives the Department of Insurance (CDI) broad authority for emergency rulemaking in the small group market, for both grandfathered and non-grandfathered health insurance products. According to the Department of Insurance, the resources are necessary because the Department of Insurance currently has no additional capacity to absorb rulemaking procedures. To address the need for additional rulemaking capacity, the Department of Insurance is requesting $79,000 and one six-month limited-term position.

SB 951 has added a need for additional policy form review responsibilities and a necessity to promulgate emergency rulemaking regulations. To address the additional workload, the Department of Insurance has requested an additional $139,000 in expenditure authority from the Insurance Fund to promulgate regulations related to essential health benefit coverage, which was a requirement of SB 951.

Issue 2 – Health Insurance Reform

Governor's Budget Request: The California Department of Insurance (CDI) is requesting an increase in special fund expenditure authority of $865,000 in fiscal year 2013-14 and 2014-15 to address the ongoing workload associated with health insurance reform.

Background: The Patient Protection Act and Affordable Care Act (PPACA) was enacted in 2010. Many of the provisions in federal law have already come into effect, while most of the components, including the health insurance exchange, will become operational on January 1, 2014. PPACA will have a significant impact on the regulatory requirements of CDI as well as changes to the health insurance marketplace in California.

Issue 3 – Health Benefit Exchange

Governor's Budget Request: The California Department of Insurance (CDI) is requesting an increase of special fund authority of $834,000 to fund seven attorney positions (six limited-term, one permanent) to support implementation activities, policy form review, and enforcement actions related to the California Health Benefit Exchange (Exchange).

Background: SB 900 (Chapter 659, Statutes of 2010) created the Health Benefit Exchange, which is an independent public entity. The measure required that the Insurance Commissioner, in coordination with the Director of the Department of Managed Health Care, to review the federal Health and Human Services internet portal, prior to January 1, 2015, to determine whether it provides sufficient information to facilitate fair and affirmative marketing of all individual and small employer health insurance, particularly outside of the Exchange.

AB 1602 (Chapter 655, Statutes of 2010) enacted the California Patient Protection and Affordable Care Act (PPACA), and provided the Exchange with the operation authority, as well as the authority to implement the Exchange and navigator provisions of the Patient Protection Act by 2014.

Issue 4 – California Earthquake Authority

Governor's Budget Request: The Administration is requesting trailer bill language to be adopted that will remove the current cap of 25 civil service positions within the California Earthquake Authority (Earthquake Authority.

Background: The Earthquake Authority was created in 1996 by the State Legislature. The Earthquake Authority serves as a privately funded and publicly managed entity that writes earthquake policies to California's residents. Section 10089.7 of the Insurance Code caps the number of civil service positions within the Earthquake Authority at 25. However, the workload required of the Earthquake Authority often far exceeds the Earthquake Authority's personnel capacity and the Earthquake Authority is forced to rely on a more costly outside consulting process. As noted earlier, the fund source for the Earthquake Authority is derived primarily from private entities and it may reduce overall operating costs of the Earthquake Authority by allowing a greater amount of work to be conducted in-house rather than via external consultants.

Secretary of State

Issue 5 – Victims of Corporate Fraud Fund

Governor's Budget Request: The Governor's budget includes a request for one permanent position and Business Fees Fund spending authority of $123,000 in the budget year, and ongoing expenditure authority of the Business Fees Fund of $98,000.

Background: SB 1058 (Chapter 564, Statutes of 2012) provided a statutory framework for the Secretary of State's (SOS) management of the Victims of Corporate Fraud Compensation Fund (VCFCF), by codifying certain existing regulations promulgated by the SOS to administer the VCFCF, codifying changes to other existing regulations promulgated by the SOS, and adding new statutory language to facilitate the approval of valid claims from the VCFCF.

Department of Business Oversight

Issue 6 – Extension of Consumer Services Limited-Term Positions

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for the extension of three two-year limited-term positions within the Consumer Services Program of the Department of Business Oversight.

Background: The 2011-12 budget provided the Department of Financial Institutions (Department) with three two-year limited-term positions to address the growing number of inquiries derived from a slowing economic climate. The complaints received by the Department vary from inquiries related to overdraft fees to more complex inquiries related to mortgage loans and modifications. According to the department, the overall number of inquiries and complaints that have been received have increased by approximately 370 percent.

The resources provided in the 2011-12 Budget were a reflection of the increased workload. The department projects the number of inquiries to continue to increase in the budget year and have requested that the expiring limited-term resources be extended by another two years. The requested positions will be funded through the Financial Institutions Fund and Credit Union Fund.

Issue 7 - Implementation of the Homeowner Bill of Rights

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for six positions within the Department of Corporations Lender-Fiduciary Program and $911,000 (State Corporations Fund) to implement and enforce provisions of the Homeowner Bill of Rights in California pursuant to SB 900 and AB 278 (Chapter 87, Statutes of 2012 & Chapter 86 Statutes of 2012).

Background: In accordance with the California Finance Lenders Law (CFLL), the Department of Corporations is responsible for the licensing and regulation of consumer finance lenders, mortgage brokers, and mortgage loan originators. The department is also responsible for the regulation of mortgage bankers, mortgage servicers, and mortgage loan originators under the California Residential Mortgage Lending Act (CRMLA). The department estimates that nearly 35 percent of the residential mortgage loans in the state are serviced by a licensee under either the California Residential Mortgage Lending Act or the California Finance Lenders Law.

SB 900 and AB 278 modified several components of California's non-judicial foreclosure process to require various procedural requirements before a residential mortgage loan servicer can proceed with a foreclosure. According to the Department of Corporations, the additional resources have been requested to meet the increased workload associated with the reforms of regulatory examinations, and the resources will also serve to provide an adequate level of industry regulation and consumer protection in the state.

The foreclosure legislation set forth different requirements for companies with more than 175 foreclosures per year and with companies that have less than 175 foreclosures per year. According to the department, there were 61 mortgage servicers licensed under CFLL and 80 licensed under the CRMLA. The foreclosure legislation resulted in an increase in the need for examinations. Five of the six requested positions are proposed to be utilized to address the increased workload requirements stemming from the foreclosure legislation. The sixth position will be a staff counsel who will assist in interpreting regulatory notices, rulemaking, and conduct external outreach, as needed.

Department of Housing and Community Development

Issue 8 – Housing-Related Parks Program

Spring Finance Letter: The Governor's budget proposes a permanent baseline Local Assistance appropriation of $25 million for new awards, pursuant to Proposition 1C Housing Related Parks Program (HRPP).

Background: In 2006, voters approved Proposition 1C, authorizing the largest housing bond in the nation. The new bond measure authorized an additional $2.85 billion, most of which was used to support affordable housing efforts. The Housing-Related Parks Program, funded through Proposition 1C, was designed to encourage the construction of low-income housing units by providing funding to cities and counties that can be used for the development and renovation of parks for each qualified housing permit they issue. As of December 31, 2012, there is an estimated $166 million available for award.

While voters approved Proposition 1C in November 2006, the bond required the Legislature to adopt subsequent legislation to implement the Housing-Related Parks Program. AB 2494 (Chapter 641, Statutes of 2008) established the Housing-Related Parks Program, under the administration of the Department of Housing and Community Development.

It was originally anticipated that HCD would make roughly $25 million in awards per year starting with awards for the 2009 calendar year. However, local governments only qualified for $8.8 million in awards in 2010. HCD issued a Notice of Funding Availability (NOFA) again for the 2011 calendar year, and local governments qualified for only $11.3 million. More recently, the Legislature has made an attempt to streamline the awards process of the Housing-Related Parks Program.

Department of General Services

Issue 9 – Real Estate Services: High Speed Rail

Governor's Budget: The Governor's Budget includes a request for a permanent augmentation of $648,000 and five personnel years in order to assist the California High-Speed Rail Authority with real estate and legal services workload associated with property acquisition.

Background: On July 6, 2012, the Legislature approved construction financing for the initial stage of the California High Speed Rail project. The segment is to be completed by 2018 and completion of all four phases will be done by 2028. The Real Estate Services Division within the Department of General Services (DGS) has been tasked with assisting the California High-Speed Rail Authority with the transaction review, appraisal review, setting of just compensation, property acquisition review, relocation assistance plan review, state-owned leasing services, staff support for the State Public Works Board approval process, escrow closing process, resolution of title process, transfers of jurisdiction, easement, acquisition and granting, facilitating utility relocations, project consultation/coordination, Statewide Property Inventory reporting, disposition of excess property and legal consultation support from the DGS Office of Legal Services.

LAO Recommendation: The LAO has noted that the workload associated with this project is temporary. The process of acquiring Right-of-Way began in the current year and will continue through the 2015-16 Budget Year. LAO recommend that the workload associated with these positions be adjusted to two-year limited-term.

Staff Recommendation: Adopt LAO recommendation, to provide Real Estate Services with five two-year limited-term positions to the support California High-Speed Rail.

California Military Department

Issue 10 – Behavioral Health Action Team

Governor's Budget Request: The Governor's budget includes a request for five positions in order to to hire needed behavioral health officers. The Military Department is also requesting an $815,000 increase in expenditure authority to fund the behavioral health officer positions.

Background: Currently, the Military Department employs three permanent positions and two temporary positions to provide behavioral health services to the 21,262 members of the California National Guard. The Military Department is requesting to convert the two temporary positions to permanent status and hire an additional three licensed behavioral health staff. This will provide the Military Department with a total of eight licensed behavioral health staff. The Military Department estimates that the additional licensed staff will be able to provide a 75 percent increase in the Military Department's behavioral health capability statewide.

0845 CALIFORNIA DEPARTMENT OF INSURANCE (CDI)

Issue 1 – Health Premium Rate Review

Governor's Budget Request: The CDI is requesting a special fund expenditure authority increase of $1.2 million (Insurance Fund) in Fiscal Year 2013-14, and ongoing, and to convert nine limited-term positions to permanent to address workload associated with health insurance rate filings.

Background: SB 1163 (Chapter 661, Statutes of 2010) began the process of aligning California's laws with the federal health care reform. The passage of SB 1163 defined many of the roles that the CDI would have to take to implement health care reform. In Fiscal Year 2011-12, the Legislature approved nine two-year limited-term positions and one one-year limited-term position to address the workload associated with the review of health insurance rate filings and one-time rulemaking, as required by SB 1163.

The CDI has also utilized approximately $2.5 million in federal funding to assist with the implementation of health care reform. However, the use of the federal funds is limited to carrying out specific requirements required by per each federal grant, and funding is limited to four years.

Staff Comment: Upon review of available federal moneys CDI has brought to staff's attention that CDI's expenditure authority could be reduced by $576,000 in 2013-14. This will require an increase in federal fund authority of $136,000 in Fiscal Year 2013-14. The second grant provided to CDI does not expire until September 30, 2014.

Staff Recommendation: Augment Federal Trust Fund Authority by an additional $136,000 in Fiscal Year 2013-14. Decrease Insurance Fund expenditure authority by $576,000 in Fiscal Year 2013-14.

Vote:

1111 DEPARTMENT OF CONSUMER AFFAIRS

Issue 1 – Bureau of Private Postsecondary Education – Staffing Augmentation

Spring Finance Letter: The Administration, via a spring Finance Letter, has submitted a request to augment funding for the Bureau of Private Postsecondary Education (Bureau) by $853,000 in Fiscal Year 2013-14, and budget bill language that will temporarily suspend the maximum statutory limit of six months reserve in the fund balance for one year, and a proposed trailer bill language that will ensure that accredited institutions that voluntarily become licensed with the Bureau surrender their exemption status.

Background: The Bureau was created by the Private Postsecondary Act of 2009 (Chapter 310, Statutes of 2009) and became operational on January 1, 2010. The Bureau's primary role is to provide oversight and regulation of California's private postsecondary education institutions. The Bureau estimates that they currently provide oversight to 1,350 main locations and 450 branch locations.

Upon passage of the Private Postsecondary Act of 2009, the 63 authorized positions were allocated under the assumption that the workload would be similar to the Bureau's predecessor, The Bureau for Private Postsecondary and Vocational Education, which sunset in 2007. The workload estimates did not account for the number of non-accredited applicants. Accreditation is generally a quality assurance provided by a non-governmental agency. Licensing is a function performed by the Bureau that is separate and distinct from accreditation, and issued by the Bureau. The Bureau's primary focus in the issuance of a license and the approval process is to ensure that certain consumer protections are in place at each institution.

According to the Bureau, a significant licensing backlog remains. Institutions submitting an application may have to wait up to eight months for the Bureau to begin the review process. However, once the review process has begun, the amount of time required for an application to be processed by Bureau staff is approximately two weeks. The Bureau has cited a high vacancy rate as part of the reason for the growing backlog. The Bureau was unable to fill all vacant positions until May 2012.

The Bureau projects revenues for Fiscal Year 2013-14 to total approximately $11 million and expenditures for the year are expected to total $8.7 million. The Bureau's projected fund balance for fiscal year 2013-14 is projected to be $13.3 million, which is approximately an 18 reserve. The Bureau has attributed the large fund balance to the fact they were collecting fees well in advance of filling all of the 63 authorized positions within the Bureau. Due to current statute, California Education Code section § 94930, the Bureau cannot have a fund reserve greater than six months. The Bureau is seeking a one-year exemption to the fund balance cap, which will afford the Bureau the time to assess and right size the fee structure through the regulatory process. The requested budget bill language reads as follows:

Add the following provision to Item 1111-002-0305

> *2. The Private Postsecondary Education Administration fund reserve limit of six months of operating expenses pursuant to Education Code section 94930 (b) shall be suspended until June 30, 2014.*

This request also includes trailer bill language that would authorize an institution currently exempt from the Bureau's oversight to waive their exempt status and to voluntarily opt into the Bureau's oversight, to comply with federal regulations to ensure that students at the institution remain eligible for federal financial aid.

The requested trailer bill language is in response to recently adopted federal regulations that will require institutions participating in federal financial aid programs to be approved by the state in which they operate. The proposed trailer bill language will provide an opportunity for an institution that voluntarily surrenders its exemption status to receive a license from the Bureau.

Staff Comment: Staff notes that the eight requested positions will adequately address the workload requirements associated with the current backlog and the forecasted workload for the budget year. However, the Bureau has noted that there may be additional workload requirements stemming from the statutory changes made by the proposed trailer bill. At this time, it is uncertain what level of workload-related impact this will have on the Bureau, as only a limited number of institutions have signaled their intent to submit an application for licensure. The Bureau has noted that additional resource requirements needed due to the statutory changes will be addressed in a future Budget Change Proposal.

The Legislative Analyst's Office (LAO) has noted that the staffing request seems reasonable, and has not raised any concern with the proposed trailer bill or budget bill language. However, the LAO has suggested that incorporating an annual update on the application backlog could provide the Legislature with useful information in the future. This suggestion is consistent with previous actions taken by the Legislature to address backlog-related issues at other state entities and should be considered by the subcommittee.

Staff Recommendation: Approve requested funds per spring finance letter, approve budget bill language and adopt placeholder trailer bill language. Additionally, adopt Supplemental Reporting Language to request annual updates on the status of the backlog at the BPPE.

Vote:

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Lois Wolk
Senator Tom Berryhill

Thursday, May 9, 2013
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

Agenda Part B

OUTCOMES

Item Number and Title

0845	California Department of Insurance
0890	California Secretary of State
1701	Department of Business Oversight
2240	Department of Housing and Community Development
7760	Department of General Services
8940	California Military Department

(See Table of Contents on page 2 for a More Specific Listing of Issues)

AGENDA – VOTE ONLY ITEMS

Approved 2-0

AGENDA – DISCUSSION/VOTE ITEMS

Department of Insurance

Issue 1 – Amendment to Budget Bill

Spring Finance Letter: The 2013-14 Governor's budget includes a request for an increase of $218,000 (Insurance Fund) in 2013-14 to address workload associated with AB 1083 (Chapter 852, Statutes of 2012) and SB 951 (Chapter 866, Statutes of 2012).

Background: AB 1083 gives the Department of Insurance (CDI) broad authority for emergency rulemaking in the small group market, for both grandfathered and non-grandfathered health insurance products. According to the Department of Insurance, the resources are necessary because the Department of Insurance currently has no additional capacity to absorb rulemaking procedures. To address the need for additional rulemaking capacity, the Department of Insurance is requesting $79,000 and one six-month limited-term position.

SB 951 has added a need for additional policy form review responsibilities and a necessity to promulgate emergency rulemaking regulations. To address the additional workload, the Department of Insurance has requested an additional $139,000 in expenditure authority from the Insurance Fund to promulgate regulations related to essential health benefit coverage, which was a requirement of SB 951.

Issue 2 – Health Insurance Reform

Governor's Budget Request: The California Department of Insurance (CDI) is requesting an increase in special fund expenditure authority of $865,000 in fiscal year 2013-14 and 2014-15 to address the ongoing workload associated with health insurance reform.

Background: The Patient Protection Act and Affordable Care Act (PPACA) was enacted in 2010. Many of the provisions in federal law have already come into effect, while most of the components, including the health insurance exchange, will become operational on January 1, 2014. PPACA will have a significant impact on the regulatory requirements of CDI as well as changes to the health insurance marketplace in California.

Issue 3 – Health Benefit Exchange

Governor's Budget Request: The California Department of Insurance (CDI) is requesting an increase of special fund authority of $834,000 to fund seven attorney positions (six limited-term, one permanent) to support implementation activities, policy form review, and enforcement actions related to the California Health Benefit Exchange (Exchange).

Background: SB 900 (Chapter 659, Statutes of 2010) created the Health Benefit Exchange, which is an independent public entity. The measure required that the Insurance Commissioner, in coordination with the Director of the Department of Managed Health Care, to review the federal Health and Human Services internet portal, prior to January 1, 2015, to determine whether it provides sufficient information to facilitate fair and affirmative marketing of all individual and small employer health insurance, particularly outside of the Exchange.

AB 1602 (Chapter 655, Statutes of 2010) enacted the California Patient Protection and Affordable Care Act (PPACA), and provided the Exchange with the operation authority, as well as the authority to implement the Exchange and navigator provisions of the Patient Protection Act by 2014.

Issue 4 – California Earthquake Authority

Governor's Budget Request: The Administration is requesting trailer bill language to be adopted that will remove the current cap of 25 civil service positions within the California Earthquake Authority (Earthquake Authority.

Background: The Earthquake Authority was created in 1996 by the State Legislature. The Earthquake Authority serves as a privately funded and publicly managed entity that writes earthquake policies to California's residents. Section 10089.7 of the Insurance Code caps the number of civil service positions within the Earthquake Authority at 25. However, the workload required of the Earthquake Authority often far exceeds the Earthquake Authority's personnel capacity and the Earthquake Authority is forced to rely on a more costly outside consulting process. As noted earlier, the fund source for the Earthquake Authority is derived primarily from private entities and it may reduce overall operating costs of the Earthquake Authority by allowing a greater amount of work to be conducted in-house rather than via external consultants.

Secretary of State

Issue 5 – Victims of Corporate Fraud Fund

Governor's Budget Request: The Governor's budget includes a request for one permanent position and Business Fees Fund spending authority of $123,000 in the budget year, and ongoing expenditure authority of the Business Fees Fund of $98,000.

Background: SB 1058 (Chapter 564, Statutes of 2012) provided a statutory framework for the Secretary of State's (SOS) management of the Victims of Corporate Fraud Compensation Fund (VCFCF), by codifying certain existing regulations promulgated by the SOS to administer the VCFCF, codifying changes to other existing regulations promulgated by the SOS, and adding new statutory language to facilitate the approval of valid claims from the VCFCF.

Department of Business Oversight

Issue 6 – Extension of Consumer Services Limited-Term Positions

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for the extension of three two-year limited-term positions within the Consumer Services Program of the Department of Business Oversight.

Background: The 2011-12 budget provided the Department of Financial Institutions (Department) with three two-year limited-term positions to address the growing number of inquiries derived from a slowing economic climate. The complaints received by the Department vary from inquiries related to overdraft fees to more complex inquiries related to mortgage loans and modifications. According to the department, the overall number of inquiries and complaints that have been received have increased by approximately 370 percent.

The resources provided in the 2011-12 Budget were a reflection of the increased workload. The department projects the number of inquiries to continue to increase in the budget year and have requested that the expiring limited-term resources be extended by another two years. The requested positions will be funded through the Financial Institutions Fund and Credit Union Fund.

Issue 7 - Implementation of the Homeowner Bill of Rights

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for six positions within the Department of Corporations Lender-Fiduciary Program and $911,000 (State Corporations Fund) to implement and enforce provisions of the Homeowner Bill of Rights in California pursuant to SB 900 and AB 278 (Chapter 87, Statutes of 2012 & Chapter 86 Statutes of 2012).

Background: In accordance with the California Finance Lenders Law (CFLL), the Department of Corporations is responsible for the licensing and regulation of consumer finance lenders, mortgage brokers, and mortgage loan originators. The department is also responsible for the regulation of mortgage bankers, mortgage servicers, and mortgage loan originators under the California Residential Mortgage Lending Act (CRMLA). The department estimates that nearly 35 percent of the residential mortgage loans in the state are serviced by a licensee under either the California Residential Mortgage Lending Act or the California Finance Lenders Law.

SB 900 and AB 278 modified several components of California's non-judicial foreclosure process to require various procedural requirements before a residential mortgage loan servicer can proceed with a foreclosure. According to the Department of Corporations, the additional resources have been requested to meet the increased workload associated with the reforms of regulatory examinations, and the resources will also serve to provide an adequate level of industry regulation and consumer protection in the state.

The foreclosure legislation set forth different requirements for companies with more than 175 foreclosures per year and with companies that have less than 175 foreclosures per year. According to the department, there were 61 mortgage servicers licensed under CFLL and 80 licensed under the CRMLA. The foreclosure legislation resulted in an increase in the need for examinations. Five of the six requested positions are proposed to be utilized to address the increased workload requirements stemming from the foreclosure legislation. The sixth position will be a staff counsel who will assist in interpreting regulatory notices, rulemaking, and conduct external outreach, as needed.

Department of Housing and Community Development

Issue 8 – Housing-Related Parks Program

Spring Finance Letter: The Governor's budget proposes a permanent baseline Local Assistance appropriation of $25 million for new awards, pursuant to Proposition 1C Housing Related Parks Program (HRPP).

Background: In 2006, voters approved Proposition 1C, authorizing the largest housing bond in the nation. The new bond measure authorized an additional $2.85 billion, most of which was used to support affordable housing efforts. The Housing-Related Parks Program, funded through Proposition 1C, was designed to encourage the construction of low-income housing units by providing funding to cities and counties that can be used for the development and renovation of parks for each qualified housing permit they issue. As of December 31, 2012, there is an estimated $166 million available for award.

While voters approved Proposition 1C in November 2006, the bond required the Legislature to adopt subsequent legislation to implement the Housing-Related Parks Program. AB 2494 (Chapter 641, Statutes of 2008) established the Housing-Related Parks Program, under the administration of the Department of Housing and Community Development.

It was originally anticipated that HCD would make roughly $25 million in awards per year starting with awards for the 2009 calendar year. However, local governments only qualified for $8.8 million in awards in 2010. HCD issued a Notice of Funding Availability (NOFA) again for the 2011 calendar year, and local governments qualified for only $11.3 million. More recently, the Legislature has made an attempt to streamline the awards process of the Housing-Related Parks Program.

Department of General Services

Issue 9 – Real Estate Services: High Speed Rail

Governor's Budget: The Governor's Budget includes a request for a permanent augmentation of $648,000 and five personnel years in order to assist the California High-Speed Rail Authority with real estate and legal services workload associated with property acquisition.

Background: On July 6, 2012, the Legislature approved construction financing for the initial stage of the California High Speed Rail project. The segment is to be completed by 2018 and completion of all four phases will be done by 2028. The Real Estate Services Division within the Department of General Services (DGS) has been tasked with assisting the California High-Speed Rail Authority with the transaction review, appraisal review, setting of just compensation, property acquisition review, relocation assistance plan review, state-owned leasing services, staff support for the State Public Works Board approval process, escrow closing process, resolution of title process, transfers of jurisdiction, easement, acquisition and granting, facilitating utility relocations, project consultation/coordination, Statewide Property Inventory reporting, disposition of excess property and legal consultation support from the DGS Office of Legal Services.

LAO Recommendation: The LAO has noted that the workload associated with this project is temporary. The process of acquiring Right-of-Way began in the current year and will continue through the 2015-16 Budget Year. LAO recommend that the workload associated with these positions be adjusted to two-year limited-term.

Staff Recommendation: Adopt LAO recommendation, to provide Real Estate Services with five two-year limited-term positions to the support California High-Speed Rail.

California Military Department

Issue 10 – Behavioral Health Action Team

Governor's Budget Request: The Governor's budget includes a request for five positions in order to to hire needed behavioral health officers. The Military Department is also requesting an $815,000 increase in expenditure authority to fund the behavioral health officer positions.

Background: Currently, the Military Department employs three permanent positions and two temporary positions to provide behavioral health services to the 21,262 members of the California National Guard. The Military Department is requesting to convert the two temporary positions to permanent status and hire an additional three licensed behavioral health staff. This will provide the Military Department with a total of eight licensed behavioral health staff. The Military Department estimates that the additional licensed staff will be able to provide a 75 percent increase in the Military Department's behavioral health capability statewide.

0845 CALIFORNIA DEPARTMENT OF INSURANCE (CDI)

Issue 1 – Health Premium Rate Review

Governor's Budget Request: The CDI is requesting a special fund expenditure authority increase of $1.2 million (Insurance Fund) in Fiscal Year 2013-14, and ongoing, and to convert nine limited-term positions to permanent to address workload associated with health insurance rate filings.

Background: SB 1163 (Chapter 661, Statutes of 2010) began the process of aligning California's laws with the federal health care reform. The passage of SB 1163 defined many of the roles that the CDI would have to take to implement health care reform. In Fiscal Year 2011-12, the Legislature approved nine two-year limited-term positions and one one-year limited-term position to address the workload associated with the review of health insurance rate filings and one-time rulemaking, as required by SB 1163.

The CDI has also utilized approximately $2.5 million in federal funding to assist with the implementation of health care reform. However, the use of the federal funds is limited to carrying out specific requirements required by per each federal grant, and funding is limited to four years.

Staff Comment: Upon review of available federal moneys CDI has brought to staff's attention that CDI's expenditure authority could be reduced by $576,000 in 2013-14. This will require an increase in federal fund authority of $136,000 in Fiscal Year 2013-14. The second grant provided to CDI does not expire until September 30, 2014.

Staff Recommendation: Augment Federal Trust Fund Authority by an additional $136,000 in Fiscal Year 2013-14. Decrease Insurance Fund expenditure authority by $576,000 in Fiscal Year 2013-14.

Vote: Approved 2-0

1111 DEPARTMENT OF CONSUMER AFFAIRS

Issue 1 – Bureau of Private Postsecondary Education – Staffing Augmentation

Spring Finance Letter: The Administration, via a spring Finance Letter, has submitted a request to augment funding for the Bureau of Private Postsecondary Education (Bureau) by $853,000 in Fiscal Year 2013-14, and budget bill language that will temporarily suspend the maximum statutory limit of six months reserve in the fund balance for one year, and a proposed trailer bill language that will ensure that accredited institutions that voluntarily become licensed with the Bureau surrender their exemption status.

Background: The Bureau was created by the Private Postsecondary Act of 2009 (Chapter 310, Statutes of 2009) and became operational on January 1, 2010. The Bureau's primary role is to provide oversight and regulation of California's private postsecondary education institutions. The Bureau estimates that they currently provide oversight to 1,350 main locations and 450 branch locations.

Upon passage of the Private Postsecondary Act of 2009, the 63 authorized positions were allocated under the assumption that the workload would be similar to the Bureau's predecessor, The Bureau for Private Postsecondary and Vocational Education, which sunset in 2007. The workload estimates did not account for the number of non-accredited applicants. Accreditation is generally a quality assurance provided by a non-governmental agency. Licensing is a function performed by the Bureau that is separate and distinct from accreditation, and issued by the Bureau. The Bureau's primary focus in the issuance of a license and the approval process is to ensure that certain consumer protections are in place at each institution.

According to the Bureau, a significant licensing backlog remains. Institutions submitting an application may have to wait up to eight months for the Bureau to begin the review process. However, once the review process has begun, the amount of time required for an application to be processed by Bureau staff is approximately two weeks. The Bureau has cited a high vacancy rate as part of the reason for the growing backlog. The Bureau was unable to fill all vacant positions until May 2012.

The Bureau projects revenues for Fiscal Year 2013-14 to total approximately $11 million and expenditures for the year are expected to total $8.7 million. The Bureau's projected fund balance for fiscal year 2013-14 is projected to be $13.3 million, which is approximately an 18 reserve. The Bureau has attributed the large fund balance to the fact they were collecting fees well in advance of filling all of the 63 authorized positions within the Bureau. Due to current statute, California Education Code section § 94930, the Bureau cannot have a fund reserve greater than six months. The Bureau is seeking a one-year exemption to the fund balance cap, which will afford the Bureau the time to assess and right size the fee structure through the regulatory process. The requested budget bill language reads as follows:

Add the following provision to Item 1111-002-0305

> *2. The Private Postsecondary Education Administration fund reserve limit of six months of operating expenses pursuant to Education Code section 94930 (b) shall be suspended until June 30, 2014.*

This request also includes trailer bill language that would authorize an institution currently exempt from the Bureau's oversight to waive their exempt status and to voluntarily opt into the Bureau's oversight, to comply with federal regulations to ensure that students at the institution remain eligible for federal financial aid.

The requested trailer bill language is in response to recently adopted federal regulations that will require institutions participating in federal financial aid programs to be approved by the state in which they operate. The proposed trailer bill language will provide an opportunity for an institution that voluntarily surrenders its exemption status to receive a license from the Bureau.

Staff Comment: Staff notes that the eight requested positions will adequately address the workload requirements associated with the current backlog and the forecasted workload for the budget year. However, the Bureau has noted that there may be additional workload requirements stemming from the statutory changes made by the proposed trailer bill. At this time, it is uncertain what level of workload-related impact this will have on the Bureau, as only a limited number of institutions have signaled their intent to submit an application for licensure. The Bureau has noted that additional resource requirements needed due to the statutory changes will be addressed in a future Budget Change Proposal.

The Legislative Analyst's Office (LAO) has noted that the staffing request seems reasonable, and has not raised any concern with the proposed trailer bill or budget bill language. However, the LAO has suggested that incorporating an annual update on the application backlog could provide the Legislature with useful information in the future. This suggestion is consistent with previous actions taken by the Legislature to address backlog-related issues at other state entities and should be considered by the subcommittee.

Staff Recommendation: Approve requested funds per spring finance letter, approve budget bill language and adopt placeholder trailer bill language. Additionally, adopt Supplemental Reporting Language to request annual updates on the status of the backlog at the BPPE.

Vote: Approved 2-0

Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Norma Torres

Thursday, May 23, 2013
10:00 a.m.
Room 112

Consultant: Mark Ibele

Part A

State and Local Finance

Proposed Vote-Only Calendar:

Proposed Discussion / Vote Calendar:

Proposed Issues for Vote-Only:

#	Item	Issue	Amount/ Language	Fund Source	Staff Recommendation
1	**C.S. 12.00** State Appropriations Limit	Revision to appropriation limit	BBL	GF	Approve
2	**0100** State Legislature	Budget adjustment pursuant to appropriation limit	$12.1 million	GF	Approve
3	**8885** Commission on State Mandates	Interagency Child Abuse and Neglect Investigation Reports	NA	GF	Rescind prior action and reject mandate suspension.
4	**0950** State Treasurer's Office	Debt management system	$677,000	Bond Funds	Approve
5	**9210** Local Government Financing	Supplement for counties with insufficient ERAF	$1.9 million BBL	GF	Approve
6	**9620** Cash Management and Budgetary Loans	Decrease in amounts necessary for interest costs on borrowing	-$50.0 million	GF	Approve
7	**0985** California School Finance Authority	Transfer of Charter School Program	$105,000 BBL TBL	GF	Approve

Vote:

Proposed <u>Vote-Only</u> Calendar Issue Descriptions:

Control Section 12.00 State Appropriations Limit

Issue Proposed for <u>Vote-Only:</u>

1. **Revised State Appropriations Limit (Budget Bill Language).** The Administration requests that the budget bill be amended to reflect the updated change in the State Appropriations Limit (SAL). The revised limit of $89.716 billion is the result of applying the growth factor of 5.8 percent. The revised 2013-14 limit is $16.0 million above the $89.7 billion estimate in January.

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

   Staff Recommendation: Approve the revision to the State Appropriations Limit.

0100 State Legislature

Issue Proposed for <u>Vote-Only:</u>

2. **Legislative Budget (Constitutional Adjustment)** The Legislature's budget for 2013-14 was proposed in January to be $109.4 million for the Senate and $146.7 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 5.8 percent in the Governor's May Revision.

   Staff Comment. The Senate's budget was reduced in 2010-11 and has been held at the same level for the past three years. If the Senate's budget had been adjusted by SAL each year since 2010-11, the budget would have grown 7.39 percent or by over $8 million. These increases were forgone because of the state's budget constraints. The combined spending by the Senate and the Assembly is now well below the State Appropriations Limit. Current year spending is nearly $30 million below the limit.

   Staff Recommendation. Staff recommends that the Legislature's (Assembly and Senate) budget be adjusted as provided in the State Constitution resulting in a total increase of $12.1 million.

8885 Commission on State Mandates

Issue Proposed for <u>Vote-Only:</u>

3. **Interagency Child Abuse and Neglect Investigation Reports (Rescind Prior Committee Action and Reject Mandate Suspension).** In its hearing on May 9, the subcommittee discussed mandates proposed for suspension by the Administration in 2013-14. It approved suspending several mandates without cost estimates for suspension, including parts of the Child Abuse and Neglect Reporting Act (CANRA) that collectively form what is called the Interagency Child Abuse and Neglect Reporting (ICAN) mandate. Rescinding the suspension of this mandate would require local governments to continue the activities associated with the mandate and allow a work group to address issues associated with the mandate. This would conform to the Assembly action.

   Staff Recommendation: Rescind prior action to suspend the Child Abuse and Neglect Reporting Act mandate and reject the suspension of the mandate.

0950 State Treasurer's Office

Issue Proposed for <u>Vote-Only:</u>

4. **Debt Management System (May Revision Finance Letter).** The State Treasurer's Office (STO) proposes $677,000 (bond funds) and one position as part of its new debt management system. The amount includes funding for a procurement consultant and related vendor, oversight costs of California Technology Agency, and the permanent position. The system is necessary for debt administration, including duties associated with trustee, registrar and paying agent responsibilities, payment of debt service, disclosure and analysis of debt issuances. Given the increased legal and financial complexities in the debt markets, the STO indicates a need for a new system to administer outstanding debt, track and pay debt service and fees on outstanding debt, and track and validate the issuance of new debt. The existing system dates to 2004.

   Staff Comment. Staff has no concerns with this proposal.

   Staff Recommendation. Approve the budget proposal.

9210 Local Government Financing

Issue Proposed for Vote-Only:

5. **Subventions to Alpine, Amador and San Mateo Counties (Governor's Budget Proposal, May Revision Finance Letter and Budget Bill Language):** This issue was discussed at the subcommittee's April 25th hearing and held open pending receipt of final budget amount's from the Department of Finance. The Governor's Budget proposed a General Fund subvention of $1.8 million to backfill Amador and San Mateo counties due to circumstances that reduced property tax directed to those county governments, and cities within those counties, in 2011-12. These circumstances also occurred in Amador County last year, and the state provided a subvention. The revenue losses will likely continue into 2012-13 and likely beyond, but the Administration indicates it has not determined at this time whether its proposal is one-time or ongoing. The May Revision Finance Letter increases the required amount by $74,000 based on 2011-12 property tax revenues and includes the County of Alpine. Total proposed appropriations are $1,392,000 for Amador, $293,000 for San Mateo and $189,000 for Alpine.

   Background and Detail: Legislation enacted early in the Schwarzenegger Administration shifted local property tax from schools to cities and counties to accommodate two State fiscal initiatives. Schools were then backfilled with state funds for each of these initiatives. Overall, the fiscal changes resulted in a large net revenue gain for cities and counties as the replacement revenue streams have grown faster than the relinquished revenue streams. However, unique circumstances reportedly reversed this outcome in 2010-11 for Amador County and in 2011-12 for Amador and San Mateo counties, and it is possible this outcome could occur for a few additional counties in the future.

   In the 2004 primary election, voters approved Proposition 58, which allowed the state to sell Economic Recovery Bonds (ERBs) to pay its accumulated budget deficit. The local sales tax for cities and counties was reduced by one-quarter cent and the state sales tax was increased by one-quarter cent to create a dedicated funding source to repay the ERBs. Property tax was redirected from schools to cities and counties, and the state backfilled schools via the Proposition 98 funding guarantee. This financing mechanism is sometimes called the Triple Flip, and the process was intended to hold local governments harmless. At the time the ERBs are repaid (in 2016-17 or earlier), the local sales tax rate will be restored, and no flip—triple or otherwise—will be necessary.

   Also in 2004, the Legislature enacted the VLF Swap. The measure was designed to provide a more reliable funding mechanism to backfill cities and counties for the local revenue decrease resulting from the action that the reduced the VLF tax on motor vehicle from 2.0 percent of a vehicle's value to 0.65 percent of a vehicle's value. Here again, the state redirected property tax from schools to cities and counties to make up for the VLF cut and backfilled schools for the property tax loses with state funds.

The backfill for the Triple Flip and the VLF Swap must originate from property taxes either shifted from the Education Revenue Augmentation Fund (ERAF) or from non-basic aid K-12 and community college districts (but not from so-called 'basic aid' schools). This funding mechanism stopped fully working for Amador County reportedly in 2010-11 due to all the schools in those counties becoming basic aid schools. Basic aid schools receive sufficient local property tax to fully fund the per-student amounts required by the Proposition 98 guarantee, and therefore, the state's funding is minimal. Due to this 'basic aid' situation, current law will not provide backfill for such schools for any property tax shifted to cities and counties. County auditors have reportedly reduced or discontinued the shift of property tax from schools to those cities and counties.

Staff Comments and Questions: The financing shifts and educational financing provisions are complex, and perhaps not entirely relevant to making a determination on this budget request. The subcommittee may instead want to focus on some broader ideas and issues:

- The funding shifts included revenue growth uncertainty and risk, as the relative growth of various revenue streams over many years was unknown. On a statewide basis, data suggests most counties, have received a net benefit from the shifts.

- There was no backfill guaranteed in the original legislation, although the Amador and San Mateo outcomes were also not anticipated. The enacting legislation did not include provisions for the state to backfill locals with new subventions if the baseline funding mechanism proved to be insufficient.

- At the time of the legislation, stakeholders were likely aware of the risk of variable levels of growth for different revenue streams, but may not have anticipated that outcome of all schools within the county becoming basic aid.

The subcommittee may consider approving the budget request, with one-half the funding to be provided initially and the remainder to be disbursed upon a finding of necessity by the Department of Finance based on criteria established in budget bill language. Absent a finding by Department of Finance, the funds would revert to the General Fund.

LAO Perspective: LAO suggests that the state could reimburse cities and counties for all triple flip and VLF swap funding shortfalls, as proposed in the Governor's Budget or, in recognition of the significant fiscal benefits cities and counties receive under the VLF swap, reimburse cities and counties only where necessary to replace actual sales tax and VLF revenue losses. Under this latter approach, no state funding would be provided to Alpine, Amador and San Mateo counties for 2011-12 funding shortfalls. Either level of reimbursement could be accomplished through the budget or through a shift in property taxes. The former approach would be more revealing as to the cost, while the former would provide more revenue certainty for local governments.

Staff Recommendation: Adopt the budget request as revised by the May Revision Finance Letter and proposed budget bill language.

9620 Cash Management and Budgetary Loans

Issue Proposed for <u>Vote-Only</u>

6. **Reduction in Borrowing Costs (May Revision Finance Letter).** The Administration proses a reduction in the budget for the payment of debt service on cash flow borrowing. The proposal would reduce the amount necessary for interest costs on internal cash flow borrowing by $10.0 million, from $50.0 million to $40.0 million, and for interest costs on external borrowing by $40.0 million, from $100.0 million to $60.0 million. The reduction is made possible by the expectation of continued low prevailing interest rates in the financial markets.

   Staff Comment. Staff has no concerns with this proposal.

   Staff Recommendation: Approve the May Revision budget request.

0985 California School Finance Authority

Issue Proposed for <u>Vote-Only</u>

7. **One-Time Funding to Facilitate Charter School Program Transfer (May Revision Finance Letter, Budget Bill Language, and Trailer Bill Language).** The May Revision incorporates a request for $105,000 (General Fund) in one-time funding for the California School Finance Authority (CSFA) to facilitate the transfer of the Charter School Facility Grant Program (CSFGP) and the Charter School Loan Program (CSLP) from the State Department of Education to the CSFA. The funds will be used for administrative support and consulting services that will allow for the CSFA to review the revolving loan portfolio and to implement loan underwriting criteria. The request also includes accompanying budget bill language allowing the funds to be used for consulting services. The request also includes trailer bill language necessary to effectuate the transfer...

   Staff Comment. Staff has no concerns with this proposal. The activities and analysis related to the CSFGP and CSLP are better conducted by the STO and housed in that department.

Staff Recommendation: Approve the May Revision budget request, proposed budget bill language, and trailer bill language thus conforming to actions in Subcommittee #1 related to the charter school package.

Proposed Discussion / Vote Calendar:

0971 California Alternative Energy and Advanced Transportation Financing Authority

Issue Proposed for Discussion / Vote:

1. **Residential Home Energy Efficiency Projects (May Revision Finance Letter and Trailer Bill).** The Administration has proposed additional funding of $810,000 (special funds) for four positions (two permanent and two limited-term) to administer the home energy efficiency projects and $10.0 million (special funds) to establish a loss reserve fund for the program. The proposed trailer bill would allow for the establishment of the loss reserve.

   Background. The program is intended to facilitate energy efficiency investments by residents that may have inadequate access to attractive financing and enable them to undertake home energy improvements. The long-range intent is to help build transactions, attract capital efficiencies, and develop the payment history data needed to better inform risk, all with the objective of making energy retrofit financing more available and with more attractive terms. The Residential Property Assessed Clean Energy (PACE) mechanisms can finance residential energy retrofits be repaid as property tax assessments for up to 20 years, and thus obtain secure, low-interest terms and payment transferability to a new owner.

   Detail. The loss reserve is intended to address difficulties that arose with respect to the position of the loan if the residence had an existing mortgage on the property. The loss reserve will allow for the release of a program pause that was instituted by the Federal Housing Finance Agency (FHFA) based on its concern that that in the event of a home foreclosure or mortgage default, a PACE lien would be in a senior position to the federally-insured mortgage. The loss reserve was one of the risk mitigation measures allowed, and deemed by CAEATFA as being the appropriate.

   Staff Comment. The loss reserve is an effective means of continuing the functions of the program, while meeting the concerns of FHFA. The subcommittee may ask whether the source of the funds for the loss reserve is a suitable use of funds given the objectives of that program.

   Staff Recommendation. Approve May Revision Finance Letter and proposed trailer bill language.

   Vote:

7730 Franchise Tax Board

Issue Proposed for Discussion / Vote:

1. **Job Creation and Economic Development (Proposed Trailer Bill).** The Administration has proposed trailer bill that would reform the state's job creation and economic development incentives. The proposal is designed to be revenue neutral and focus on improving the performance of resources being used to better stimulate economic growth and the creation of jobs. The program is based on redeploying the resources currently committed to the Enterprise Zone programs and the New Jobs Credit. The May Revision proposes to modernize the state's job creation and economic development incentives by reshaping existing programs to meet the need of the current economy. This program would include the following: (1) hiring credit for businesses in specific areas with high unemployment and poverty rates; (2) sales tax exemption on manufacturing and biotech research and development equipment; and, (3) incentive fund to provide business tax credits in exchange for investments and employment expansion in California. The program would allow small businesses to easily obtain the manufacturing sales tax exemption, and will dedicate a portion of the hiring credit and the incentive fund solely to small businesses.

   Administration's Background Perspective. For over 25 years, California has created numerous Enterprise Zones, as well as other geographically-targeted economic development areas. Currently, there are 40 authorized Enterprise zones; this number is expected to continue to decline as authorizations expire and ongoing regulatory changes and audits are completed. These programs include many aspects, chief of which is a tax credit for new hires. In total, the tax benefits related to these programs currently cost the state about $750 million per year. In its current form, it fails to encourage the creation of new jobs and instead rewards moving jobs from one place to another within the state, according to unbiased economic research. This, along with California's persistently high unemployment rate, argues for changes to encourage economic development and increase the number of jobs in California.

   In 2009, the New Jobs Hiring Credit was created to support creation of new jobs through small businesses. To date approximately $160 million has been claimed resulting in annual costs of approximately $30 million to $40 million annually. Based on the lifetime cap for this program, approximately $240 million remains to be allocated.

   Under current law, California requires a sales tax to be paid by manufacturers on the purchase of manufacturing equipment. When taxes are applied to purchases of manufacturing equipment, the final goods produced by that equipment are effectively taxed at more than the statutory rate. This leads to different effective tax rates for different types of goods (and higher tax rates for goods produced in California versus those same products produced outside of California). California is one of the few states that impose a sales tax on the purchase of manufacturing equipment. California firms have to pay more for the same manufacturing equipment as their competitors in other states, just because of the sales tax. The state share of sales tax for these purchases is approximately $600 million annually.

Proposal Components. The Administration proposes to reshape the state's economic development tax programs by phasing out the current Enterprise Zone tax programs. Taxpayers would be allowed to continue using Enterprise Zone carryover credits for five years and would be able to continue to use generated hiring credits for employees under contract prior to January 1, 2014. The Administration's initiative would establish the following programs

- **Hiring Credit.** The hiring credit will be refocused to specific areas with high unemployment and poverty rates both inside and outside existing zones. This credit will be available for the hiring of long-term unemployed workers, unemployed veterans, and people receiving public assistance. Twenty-five percent of the funds will be targeted to small businesses. The credit would be equal to 35 percent of wages between 1.5 and 3.5 times the minimum wage for a period of five year and available only to businesses that have a net increase in jobs in the state. It is expected that this program component would provide $100 million in credits annually.

- **Sales Tax Exemption.** The existing sales tax exemption for businesses located in Enterprise Zones will be expanded to a statewide sales tax exemption on manufacturing or biotech research and development equipment purchases. A business will be allowed to exclude the first $200 million equipment purchases from the state share of sales tax (4.19%). Such exemptions from the sales tax would be subject to the regular routine audit process. The program component is estimated to provide sales tax exemptions worth over $400 million annually.

- **Investment Incentives.** The California Competes Recruitment and Retention Fund will be created and will be administered by the Governor's Office of Business and Economic Development (GO-Biz). Businesses will have the opportunity to compete for available funds based on specified criteria including the number of jobs to be created or retained, wages that are at least two times the minimum wage, and a set job retention period. GO-Biz will negotiate agreements to provide businesses tax credits in exchange for investments and employment expansion in California. Approval of any proposed incentive will be made by an allocation committee that may recapture the incentive if the business fails to fulfill the terms and conditions of the contract. A portion of the incentive funds will be awarded solely to small business. The program component would provide between $100 million and $200 million in credits annually.

LAO Perspective. There are numerous details to be fleshed out in the proposal, but LAO indicates that there are some positive parts of this proposal—specifically, scaling back the ineffective enterprise zone program and reducing certain manufacturing sales taxes. Such taxes are the result state tax provisions that create "tax pyramiding"—economically distortionary phenomenon whereby businesses pay sales tax on their equipment and their customers then pay additional sales tax on the final product itself. On the other hand, LAO indicates skepticism that the hiring credit and incentive fund can be designed in ways that achieve their stated goals without providing windfall gains to businesses for decisions they would have made even without the tax incentives. LAO's general advice, which has been consistent over time, is that the Legislature move toward state tax changes that spread the cost of public services over the broadest base possible, with fewer tax expenditures focused on select segments of the economy. By doing this, the state would have the option of lowering certain marginal tax rates and yet be able to collect approximately the same amount of tax revenue.

Staff Comment. At its May 9 hearing, the subcommittee held an overview of the Enterprise Zone incentive programs, including a discussion of their effectiveness and fiscal impacts. As discussed at that hearing, Enterprise Zone tax incentive programs have generally not been found to be effective tools for creating jobs in the state. In addition, the fiscal impact on the state has grown significantly over the last decade. The background paper for this discussion can be found on the Senate Budget and Fiscal Review website:

http://sbud.senate.ca.gov/sites/sbud.senate.ca.gov/files/SUB4/05092013Sub4PtAStateLocalFinance.pdf

Staff Recommendation. Hold issue open.

Vote:

0860 Board of Equalization

Issues Proposed for Discussion / Vote:

1. **Hazardous Waste Fee Collection Costs (May Revision Finance Letter).** The Board of Equalization (BOE) requests $1.3 million (reimbursement authority) and four positions to respond to expanded responsibilities under the Hazardous Waste Management Program. The requested resources will decline to $916,000 in 2014-15 and lesser amounts thereafter. The request in the initial year is higher due to the implementation of the expanded program and fixed investment costs.

   Background. The Department of Toxic Substances Control (DTSC) proposes to modify the hazardous waste fee structure in the Hazardous Waste Control Account to align the fees with public policy objectives, provide a long-term stable funding source for DTSC's Hazardous Waste Management Program, and align the fees with program objectives. BOE is assigned the responsibility of fee collection. The proposed reforms will have a direct impact on BOE's collection activities associated with the fees and result in an increased workload based on the expansion of the universe of businesses required to pay the fees and the quarterly reports required of the department to DTSC and the Legislature. The department indicates it cannot absorb the additional costs in its current budget.

   Staff Comment. For 2013-14, BOE has about 6,000 accounts for the program which, under the DTSC's proposal, will expand by almost 50 percent to over 9,000. The budget for the gram is $4.5 million, which under the proposal, would increase $1.3 million to $5.8 million in the initial year, before dropping to about $5.3 million annually. Given the increase in the universe of affected businesses, the costing of the proposal is reasonable.

   Staff Recommendation. Approve the May Revision Finance Letter budget request with the added provision that the position authority be for a two-year, limited term.

   Vote:

2. **Clarify Sales Tax on Software (May Revision Trailer Bill).** The Administration has requested the adoption of trailer bill language that would clarify that software delivered on media (such as discs, tapes, or other storage devises) is tangible personal property subject to sales tax provisions. The clarification would consist of an amendment to subdivision (a) of Revenue and Taxation Code section 6010.9 as well as in non-codified language in the bill. Currently, there is an exemption from the tax for custom computer software programs, whether in the form of written procedures (code) or in the form of storage media on which the program is recorded. The trailer bill is declaratory of existing law and will ensure

that retail sales of computer programs on storage media are taxed as tangible personal property.

Background. Unless specifically exempted, the sales of all tangible personal property are subject to the sales and use tax. The sales of services and intangibles are not subject to this tax. Software can be delivered to the end consumer over the internet or on some form of media such as a tape, a disk, or a cartridge. Sales of software or other products such as music and books that are delivered through the internet are considered intangibles, and are not subject to the sales and use tax. Sales of software delivered on media, however, are considered tangible personal property and, thus, are taxable.

Also in current law, for an otherwise taxable transaction, the value of any intangible personal property rights associated with a technology transfer agreement is not taxable. A technology transfer agreement is an agreement under which a right to a patent or copyright is transferred to the buyer in a transaction. BOE has been engaged in litigation with some taxpayers on what specifically constitutes a technology transfer agreement, and how to value those technology transfer agreements. In *Nortel v. Board of Equalization,* the Appeals Court sided with the taxpayer's contention that some significant transactions of the plaintiff in fact constituted technology transfer agreements.

Although this court did not directly address the issue of whether software delivered on media is tangible personal property, the decision in this case has been cited by some to argue that all software, even prepackaged software, is intangible, and thus not subject to tax. While current statute does not contain an explicit statement that software delivered on media is tangible personal property, it is amply clear from statute that the taxation of prepackaged software was intended by the Legislature. This trailer bill would clarify that intent and make it explicit.

Additionally, the courts, in two separate recent cases have clearly declared that software delivered on media is tangible personal property. The California Supreme Court in *Navistar v. Board of Equalization* stated in its decision that "A subsequent sale of that program …is a transfer of a tangible personal asset". In *Microsoft v. Franchise Tax Board,* the plaintiff, as part of its larger argument that their sales of software to computer manufacturers should be sourced outside of California, argued that "computer software is intangible personal property". The Court of Appeal rejected plaintiff's argument.

Staff Comment. The current structure of the Revenue and Taxation Code gives abundant evidence that the Legislature has intended that software delivered on media be considered tangible personal property. Section 6010.9 of the Revenue and Taxation Code specifically exempts the sales of custom software from the sales and use tax. If software on media was not considered tangible personal property, it would not be taxable, and there would then be no need to have created a specific exemption for custom software. This trailer bill simply ensures that the current state of law for the taxation of prepackaged software is maintained.

The proposed trailer bill will provide certainty for retailers and consumers as to the sales and use tax treatment of prepackaged software. Large retailers are currently and have been, for as long as there has been prepackaged software, collecting sales tax on pre-packaged software. BOE has estimated that the sales and use tax on prepackaged software generates revenue in the $100's of millions each year. As this proposed trailer bill language is simply clarifying current law, there is no revenue gain associated with it. However, if there were a subsequent court decision that determined that software delivered on media is not tangible personal property, the state, as well as local governments, would face significant revenue losses.

Staff Recommendation. Adopt the proposed trailer bill language.

Vote:

Control Section 8.56 Budget Adjustments Related to Federal Sequestration

Issue Proposed for <u>Discussion / Vote:</u>

1. **Control Language for Federal Funding Reductions Due to Sequestration and Other Federal Actions (May Revision Budget Bill Language).** The May Revision Calls for budget bill language that would address potential budget reductions as a result of federal sequestration. The language would allow the Director of Finance to reduce items of appropriation and associated positions. The exact funding implications of federal sequestration are unclear and federal agencies have not issued all necessary guidelines for such reductions. Given the uncertainty in the exact program reductions, the Administration has presented this control section to provide fle3xibility to decrease spending.

   The proposed language allows the Director of Finance to reduce items of appropriation and reduce positions upon 30 days' notice to the fiscal committees of the Legislature. The notification would include the amount of the appropriation adjustment, the program affected, and a description of the assumption used in making the adjustment.

   LAO Comment. The LAO notes that the Administration already has control sections to account for changes in federal funding in Control Sections 8.50 and 28.00. Their recommendation is for the new control section to be modeled after the exiting language in Control Section 28.00, which would provide for the Legislature to have some input as to how the reductions to items of appropriations would be made and require the Director of Finance to conform to those provisions.

   Staff Comment. Staff recognizes the necessity to address reductions in federal funding that will occur as a result of sequestration. The LAO alternative language preserves a measure of legislative input into the appropriation adjustment process. In addition, it would limit the adjustments in this section to those related to sequestration.

   Staff Recommendation. Reject May Revision proposed budget bill language and adopt alternative, based on approach developed by the Legislative Analyst's Office allowing for additional Legislative input, limiting the adjustments to those related to sequestration, and requiring an explanation of the adjustment.

   <u>Vote:</u>

Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Norma Torres

Thursday, May 23, 2013
10:00 a.m.
Room 112

Consultant: Mark Ibele

Part A

ACTIONS

State and Local Finance

Proposed Vote-Only Calendar:

See Page 2 for Record of Actions on Vote-Only Items

Approve Finance Letter and Trailer Bill Language for Energy Efficiency Projects: 2-1 (Berryhill no)

Job Creation and Economic Development Proposed Trailer Bill: Held Open

Issue 1: Approve Finance Letter Hazardous Waste Fee Collection Costs: 3-0

Issue 2: Clarify Sales Tax on Software Trailer Bill: Held Open

Approve Alternative Budget Bill Language: 2-0 (Torres absent)

Proposed Issues for Vote-Only:

#	Item	Issue	Amount/ Language	Fund Source	Staff Recommendation
1	**C.S. 12.00** State Appropriations Limit	Revision to appropriation limit	BBL	GF	Approve **Adopt Reco. 3-0**
2	**0100** State Legislature	Budget adjustment pursuant to appropriation limit	$12.1 million	GF	Approve **Adopt Reco. 3-0**
3	**8885** Commission on State Mandates	Interagency Child Abuse and Neglect Investigation Reports	NA	GF	Rescind prior action and reject mandate suspension. **Adopt Reco. 3-0**
4	**0950** State Treasurer's Office	Debt management system	$677,000	Bond Funds	Approve with SRL **Adopt Reco. 2-1 (Berryhill no)**
5	**9210** Local Government Financing	Supplement for counties with insufficient ERAF	$1.9 million BBL	GF	Approve **Adopt Reco. 3-0**
6	**9620** Cash Management and Budgetary Loans	Decrease in amounts necessary for interest costs on borrowing	-$50.0 million	GF	Approve **Adopt Reco. 3-0**
7	**0985** California School Finance Authority	Transfer of Charter School Program	$105,000 BBL TBL	GF	Approve **Adopt Reco. 3-0**

Vote:

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Norma Torres

Thursday, May 23, 2013
10 a.m.
Room 112
Consultant: Brady Van Engelen

PART B

Item Number and Title

0690	Office of Emergency Services
0840	State Controller's Office
0890	Secretary of State
1110	Department of Consumer Affairs
1690	Seismic Safety Commission
2240	Department of Housing and Community Development
7760	Department of General Services
7870	Victim Compensation and Government Claims Board
8955	California Department of Veterans Affairs

(See Table of Contents on page 1 for a More Specific Listing of Issues)

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-651-1505. Requests should be made one week in advance whenever possible.

AGENDA –VOTE ONLY ITEMS

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only – Issue Descriptions

Office of Emergency Services

Issue 1 – Sunset of the Disaster Response Account

Governor's Budget Request: The Governor's May Revise includes a request for trailer bill language that would extend the sunset date of the Disaster Response Emergency Operations Account through January 1, 2019.

Background: On April 11th the Senate Budget Subcommittee No. 4 took action on a request to reduce the 2013-14 General Fund contribution to the California Disaster Assistance Act by $10.0 million. This would provide the account with $39.1 million for 2013-14 and should not impact the state's ability to match the portion required for either a state or federally declared disaster.

Staff Comment: The requested change does not impact the state's matching requirements for local projects in the event of either a state or federally declared disaster.

Staff Recommendation: Adopt trailer bill language.

Department of Consumer Affairs

Issue 2 – BreEZe

Governor's Budget Request: The Governor's budget includes a request for $7.67 million in additional funding for continued support of the Department of Consumer Affairs, Consumer and Client Services Division's automated licensing and enforcement system. This request also includes a request for $4.188 million in additional funding for all boards and bureaus to fund credit card processing fees on behalf of users of credit card payments through the BreEZe project. The total project cost for 2013-14 will be $11.995 million.

Background: The Department of Consumer Affairs is the umbrella agency for 37 business and professional licensing entities (collectively referred to as boards and bureaus) that regulate over 2.7 million businesses and professionals, in over 250 license categories. The BreEZe project began with the approval of the Feasibility Study Report on November 30, 2009. In Fiscal Year 2010-11, the Department of Consumer Affairs gained approval of a Budget Change Proposal to redirect funding from the existing iLicensing Project, plus augment budgets for the BreEZe project to support the procurement and implementation of an integrated licensing and enforcement system, in support of the Department of Consumer Affair's Consumer Protection Enforcement Initiative. Additionally, in Fiscal Year 2011-12, the department gained approval to appropriate $1.2 million, on a one-time basis, to the BreEZe project. BreEZe is designed to bring all of the Department of Consumer Affairs' Boards and Bureaus into an integrated licensing and enforcement system.

Staff Comment: According to the most recent update to the Special Project Report (SPR), a number of defects occurred while conducting User Acceptance Testing. The reported defects that occurred during the User Acceptance Testing have caused a delay in the originally proposed timeline. The 2009 Feasibility Study Report estimated a project go-live date of July 2012, and the most recent update to the SPR noted that the vendor, Accenture has proposed a go-live date of May 2013.

Since initially hearing this item in the subcommittee, staff has had time to review additional details and is satisfied with the progress of this IT project.

Staff Recommendation: Approve as budgeted.

Issue 3 – Veterinary Medical Board

Background: Created in 1893, the Veterinary Medical Board (Board) licenses and regulates veterinarians, registered veterinary technicians (RVTs), RVT schools/programs and veterinary premises/hospitals, through the enforcement of the California Veterinary Medicine Practice Act.

The Board protects the public from the incompetent, unprofessional, and unlicensed practice of veterinary medicine. The Board requires adherence to strict licensure requirements for California veterinarians and RVTs. The pet-owning public expects that the providers of their pet's health care are well-trained and are competent to provide these services. The Board assures the public that veterinarians and RVTs possess the level of competence required to perform these services by developing and enforcing the standards for examinations, licensing, and hospital and school inspection.

The Board also conducts regular practice analyses to validate the licensing examinations for both veterinarians and RVTs. Additional eligibility pathways have also been approved for licensure of internationally trained veterinary graduates and certification of RVTs to allow qualified applicants from other states in the U .S. and countries around the world to come to California and to improve the provision of veterinary health care for consumers and their animals. The Board also states that its mission is to protect consumers and animals through the development and maintenance of professional standards; the licensing of veterinarians and registered veterinary technicians; and through diligent enforcement of the California Veterinary Medicine Practice Act.

Staff Comment: Over the past several years, the Board's workload has increased. This workload increase has led to a significant backlog in the intake cycle time, time required for cases requiring formal discipline, and the average number of days from receipt of a complaint to the closure of an investigation. However, there has only been a minimal increase in staffing at the Board over that same period of time. A lack of additional resources has led to a significant backlog at the Board. The number of licensed veterinarians has increased twelve percent and the number of registered veterinary technicians has increased twenty-five percent and there has been a 43 percent increase in the number of general complaints received by the Board.

To address the both the ongoing workload and the current backlog, staff recommends increasing the expenditure authority by $359,000 and providing two two-year limited-term and three permanent staff positions to the Board.

Staff Recommendation: Increase the Veterinary Medical Board expenditure authority by $359,000 and authorize a total of five staff positions; two two-year limited-term and three permanent to the Veterinary Medical Board.

Issue 4 – Bureau of Private Postsecondary Education

Background: At a May 9 hearing Senate Budget Subcommittee No. 4 adopted budget bill language that extended the amount of time that the Bureau of Private Postsecondary Education's fund reserve limit can be in excess of six months of operating costs through Fiscal Year 2013-14. It has been brought to staff's attention that the Bureau is up for sunset review during the 2014 calendar year. It may be more suitable to extend the current proposal an additional six months to January 1, 2015 in order to ensure that the policy committees are afforded the opportunity to make any adjustments that are brought to their attention during the sunset review process.

Staff Recommendation: Amend budget bill language to further extend their exemption from the fund balance cap until January 1, 2015.

Department of General Services

Issue 4 – Extension of Liquidation Period for Grant Funds

Governor's Budget Request: The Governor's May Revise includes a request to add an item to the budget bill that would authorize the extension of the liquidation period for $3.19 million in grant funds to construct alternative fuel stations. The Department of General Services entered into an agreement on September 30, 2010, with the California Energy Commission to administer a grant to construct the 75 E-85 ethanol fueling stations throughout California, and the agreement is set to expire on March 31, 2014. Authorization was originally provided in the Budget Act of 2010, which allowed the Department of General Services to provide reimbursement payments to the contractor for the design and construction of the program through June 30, 2013. There are currently 27 fueling stations in operation, the remaining fueling stations are in various stages of planning, permitting, property lease negotiations and design.

The proposed language that will be needed to ensure that the funds remain available throughout the completion of the program is below:

7760-491—Reappropriation, Department of General Services. Notwithstanding any other provision of law, the period to liquidate encumbrances of the following citations are extended to June 30, 2014:

0666—Service Revolving Fund
(1) Item 1760-001-0666, Budget Act of 2010 (Ch. 712, Statutes of 2010) for the balance of Reimbursement—CEC

Staff Comment: Staff has no issues with extending the liquidation period.

Staff Recommendation: Adopt proposed budget bill language.

Issue 5 – Special Repairs: Americans with Disabilities Act Compliance

Governor's Budget: The Governor's budget requests an augmentation of $11 million in Service Revolving Fund authority for special repair projects associated with Americans with Disability Act (ADA) compliance.

Background: Total repairs are projected to cost approximately $110 million and will be conducted over the next ten years. The augmentation will require an increase in the Building Rental Account and the Individual Rental Rate, which are managed by the DGS. In 2009, DGS conducted a survey of all of the buildings with ADA deficiencies, and the study found deficiencies in nearly every building in the DGS portfolio. DGS has calculated that the repairs will require $82 million and there is approximately $28 million in deferred maintenance that will need to be addressed, as well. DGS has identified a ten-year timeline to complete the work identified in the deficiencies study.

LAO Recommendation: The LAO recommends that the Legislature reject the proposal because a temporary, across-the-board $0.10 rate increase is an inappropriate way to fund special repairs across multiple facilities. The rental rates should be set at amounts sufficient to cover debt service, ongoing operations, and maintenance costs, as well as build up a reserve for the repair or replacement of building systems and equipment.

Accordingly, the LAO recommends that the Legislature direct DGS to adjust existing rates to meet each facility's individual needs over time. While more complex, such individual adjustments would result in rental rates that more accurately reflect the cost of operating and maintaining each building. For buildings with significant ADA compliance issues and deferred maintenance, the new building rate may need to include a temporary multi-year increase to cover these one-time costs, as well as an increase in the base rental rate to prevent the accumulation of additional deferred maintenance. For newer buildings, DGS also may determine that minor rate increases are needed to establish a sufficient reserve for future scheduled maintenance and special repairs.

Staff Comment: The Governor's proposal distributes the total cost for special repairs equally to all buildings. This approach recognizes that special repair needs will change from year to year based on emergency repairs, equipment and systems failures, and other factors in the prioritization of repairs. The LAO recommendation attempts to more accurately reflect the cost of operating and maintaining each building but does not account for unavoidable changes in priorities due to unforeseen events. Consequently, there is a continuous reprioritization of the items on the special repair list. A uniform rate increase gives DGS the flexibility to reprioritize as needed to react to unforeseen events. The Assembly has adopted this proposal as budgeted.

Staff Recommendation: Approve as budgeted.

Issue 6 – GS $mart

Governor's Budget: The Governor's May Revision includes a request for the addition of trailer bill language that would modify the GS $mart program, within the Department of General Services.

Background: The GS $mart program serves as the state's financial marketplace, providing state entities with lease purchasing opportunities. There are high-cost items, such as a $6 million dollar generator, or a $5 million airplane that agencies are not capable of purchasing in a single budget year. The program allows an agency to spread the cost of specified goods over several years versus paying for them all in one fiscal year at tax-exempt rates.

Staff Comment: The proposed trailer bill language would not generate any General Fund or Special Fund cost savings in the Budget Year, or future budget years. Additionally, the proposed trailer bill language does not include any mechanisms to ensure that the Legislature is aware of a state entity utilizing the GS $mart program. While there is a need to place the program in statute, a May Revision Finance Letter would not be the preferred approach. There are significant policy changes included in this May Revision Finance Letter and those changes merit a larger discussion than what can be provided in the limited time remaining.

Staff Recommendation: Reject proposed May Revision Finance Letter.

Department of Veterans Affairs

Issue 7 – Enterprise-wide Veterans Homes Information System (Ew-VHIS)

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for $1.8 million to fund the implementation of the Enterprise-wide Veterans Homes Information System (Ew-VHIS) at the Yountville Veterans Home.

Background: The Ew-VHIS is designed to provide an integrated level of care to all eight homes within the CDVA veterans home network. Prior to the original request made in 2007, CDVA operated three veterans homes that were semi-autonomous. According to the California Technology Agency, total project costs are estimated to be $36.7 million. The original Feasibility Study Report, submitted in 2007, estimated the total project cost to be $33.9 million.

The Ew-VHIS has now been installed, configured, and implemented at Headquarters and at the homes in Barstow, Chula Vista, West Los Angeles, Ventura, and Lancaster. Implementation at

Yountville, which has the largest resident population and staffing, represents the third wave. Funding to support the implementation of the Ew-VHIS was included in the proposal to support the opening of the Redding and Fresno veterans homes.

Prior to the acquisition and implementation of the Ew-VHIS, the veterans homes of California (Yountville, Barstow, and Chula Vista) utilized a software platform (Meditech) that did not have full functionality for Long-Term Care purposes, and the Meditech platform was only partially used at the Chula Vista and Barstow facilities. According to CDVA, the Meditech platform lacked the capability to develop a long-term care plan in an electronic format, and lacked a continuum of care account for each patient.

An additional concern raised by CDVA is the need for an integrated network that can be more closely monitored at CDVA's headquarters in Sacramento. According to CDVA, a new integrated network will provide headquarters with the opportunity to improve administrative procedures, business processes, and will provide a greater level of clinical data management capabilities within the network.

Staff Comment: Senate Budget Subcommittee No. 4 originally heard this item on April 11th and the item was held open.

Staff Recommendation: Approve as budgeted.

Issue 8 – Adjustment to Federal Per Diem for Veterans Homes

Governor's Budget Request: The Governor's May Revise includes a request to decrease the General Fund contribution to the California Department of Veterans Affairs and increase the Federal Fund expenditure authority by $625,000.

Background: The federal government pays a per diem rate for every resident that is housed in the state's veterans homes. This $625,000 augmentation is the net change to federal reimbursements, resulting from a decrease in the projected number of residents housed in the state's veterans homes in fiscal year 2013-14, and an increase in the per diem rate.

Staff Comment: Staff has no issues with this request as it results in a net zero difference in overall expenditures within the Department.

Issue 9 – Current Year and Budget Year Savings

Governor's Budget Request: The Governor's May Revise includes a request for a one-time reduction of $12 million General Fund in current year 2012-13, and $5.5 million General Fund in budget year 2013-14.

Background: This request is due to the delay in opening the skilled nursing facility at the West Los Angeles veterans home, and the just-in-time hiring being conducted at the Redding and Fresno Veterans homes. The skilled nursing facility was originally budgeted to begin admittance in February 2012, however admittance did not begin until later in the fall of 2012. The delay in admittance was due to licensing issues related to providing food services to the skilled nursing facility residents. This delay has pushed the ramp-up of staff beyond the original 2010 hiring plan, which has generated one-time savings in the current year and budget year.

Staff Comment: Staff does not have any issues with the request.

Staff Recommendation: Adopt May Revise request.

Issues Proposed for Discussion / Vote

0840 CALIFORNIA STATE CONTROLLER

Issue 1 – Integrated Data Management System

Governor's Budget Request: The Governor's May Revise includes a request for $3.018 million ($651,000 General Fund) in Fiscal Year 2013-14 and $3.48 million ($751,000 General Fund) in 2014-15 through 2017-18, for costs associated with the Integrated Data Management System technology services.

Background: The Integrated Data Management System (IDMS) is comprised of a suite of software products that run on the mainframe housed at the Office of Technology Services. The systems are wholly integrated and allow for direct interface and/or provide for files to be passed between each unique system. The Controller's Office is highly dependent on IDMS applications, and use the business functions for personnel, payroll, fiscal, and audits. There are a total of fifteen unique IDMS supported applications that the SCO utilizes.

The increased costs are associated with the fact that SCO is now one of only two state entities (California Highway Patrol is the other) that utilize IDMS applications and, therefore, are paying for a much higher share of the costs than before when the costs could be distributed across multiple agencies. IDMS related costs in the 2011-12 budget year were $185,000 and have increased substantially due to the continued migration of other departments that are no longer reliant on IDMS.

Staff Comment: IDMS applications perform a number of functions that are assumed to be replaced by either the 21st Century Project or FI$Cal. Therefore, it would not be cost effective to identify an intermediate platform until 21st Century and FI$Cal are implemented and able to replace the IDMS applications.

A five-year contract was recently negotiated with the IDMS vendor. Annual costs for the SCO to continue to use IDMS are reflected in the May Revise request. However, as previously noted, if the other user of IDMS were to leave, costs would increase to $4.6 million annually. Given that there is a possibility of a requested future cost increase associated with the California Highway Patrol migrating to another platform, it may be worth considering approving the requested amount for 2013-14. Future requests, which may include the additional costs associated with the other user migrating, will be considered in subsequent budget years. This will also afford the Legislature the opportunity to hear regular progress reports on the migration process.

Staff Recommendation: Approve requested $3.018 million for Fiscal Year 2013-14 in May Revise Letter.

Vote:

Issue 2 – Unclaimed Property Division

Governor's Budget Request: The Governor's May Revise includes a request to revise the existing provisional language for Item 0840-001-0970 to better define the expenditures paid from that account.

Background: Administration of the Unclaimed Property Program is a responsibility of the SCO, per Code of Civil Procedure § 1300-1615. The Code of Civil Procedure provides the SCO with a continuous appropriation to carry out and enforce the Unclaimed Property Law. In addition to the continuous appropriation currently in statute, there is an item in the budget bill that provides the SCO with an appropriation for $35.06 million for the administration of the Unclaimed Property Program, as it relates to the administration of the program. The proposed budget bill language is below:

Provisional language for Item 0840-001-0970

The funding provided in Item 0840-001-0970 shall cover costs for personal services and related operating expenses and equipment (including legal costs that are not related to enforcing the recovery of property, and system related costs) for the Unclaimed Property Program. Continuous appropriations form the Unclaimed Fund are allowed for other program costs authorized under Section 1584(b) and Section 1325 of the Code of Civil Procedure. These continuous appropriations shall not be used to cover spending authorized under Item 0840-001-0970.

Staff Comment: It appears the proposed amendments to the provisional language would more clearly delineate which appropriations are supposed to pay for specific costs assumed by the SCO's Unclaimed Property Division. Staff recognizes the need for a clear delineation between the direct appropriation provided in statute and the appropriation provided in budget bill language. However, it may be more appropriate to review both, the language in statute, and the budget bill language, in order to make a more informed decision. Staff believes that there could be more value added to a thorough review of both the appropriation provided in statute and the budget bill language. Unfortunately, the late nature of this proposal has not provided the subcommittee with the time necessary to conduct that level of review. Therefore, it is in the subcommittee's best interest to reject the proposed budget bill language

Staff Recommendation: Reject proposed budget bill language without prejudice. This issue may be reconsidered in the 2014-15.

Vote:

Issue 3 – 21st Century Project

Governor's Budget Request: The Governor's May Revise includes a request for 40 positions and $14.556 million ($11.92 million General Fund) for a one-year limited-term in 2013-14, to support multiple efforts related to the suspension of MyCalPAYS and the 21st Century Project.

Background: The State Controller's Office (SCO) is responsible for disbursement of pay to the state's 249,000 employees. In 2004 the Department of Finance (DOF) approved the justification documents, submitted by the SCO, requesting an updated payroll system that would provide a greater level of integration. The SCO procured Commercial Off the Shelf (COTS) software in 2005 and intended on utilizing that COTS software to update the state's payroll system.

The Department of General Services (DGS) awarded the second contract to a different vendor on February 2, 2010. An updated Special Project Report (SPR 4), that was issued prior to the contract being awarded, identified the method that would eventually be utilized to implement the new MyCalPAYS system. The first, and smallest phase, would consist of converting payroll for the approximately 1,300 SCO staff to the new payroll system.

The initial pilot, which was deployed in June of 2012, revealed a significant volume of errors. The SCO issued a cure letter in October of 2012 to the vendor, SAP, requesting that the vendor deliver the resources necessary to correct the identified errors. SCO was not satisfied with the response provided by the vendor and subsequently terminated the contract for MyCalPAYS in February 2013. Due to the contract being terminated, the Technology Agency had little choice but to suspend the 21st Century Project.

SCO's request is broken into multiple segments, which include continued lease obligations, consulting contracts for both internal and external consultants, costs associated with legal proceedings for the likely legal dispute between the vendor and SCO, and data center costs. Including the proposed Control Section 25.25, the costs associated with this request total $14.55 million. A more specific cost breakdown is provided below:

- $3.985 million for the 40.0 one-year limited-term positions within the payroll services division.

- $1.615 million for lease obligations which extend through May 31, 2014.

- $453,000 for interdepartmental consulting which includes funding to support project oversight provided by the Technology Department and labor relations support provided by CalHR.

- $3.58 million for external consulting services which includes costs associated with seeking outside legal counsel, external payroll reconciliation consultants and project management consultants.

- $4.93 million for data center service costs and Information Technology costs which represents the funds necessary to receive data center services and infrastructure requirements.

- $2.268 million is also a requested and represented by the addition of a Control Section. The added Control Section would allow SCO to augment their budget to pay for additional Office of Technology Service Costs if the SCO is unable to accelerate suspension efforts.

In addition to the funding requests, the SCO has requested the addition of provisional item under 0840-001-0001. The provisional item would allow a further augmentation SCO's budget by $2.266 million from all fund sources for payment of data center costs to the Office of Technology related to the suspension of the 21st Century Project. The requested language includes a 30-day notification to the Joint Legislative Budget Committee.

Staff Comment: The 21st Century Project has suffered multiple cost-overruns and timeline setbacks, which led to the termination of the contract with the first vendor, Bearing Point, in 2009. This project has received increased scrutiny from the Legislature in prior years and was subject to quarterly reporting requirements.

Staff recognizes that there is a need to conduct payroll reconciliation for the 1,300 staff at the SCO that were impacted by the initial phase of the 21st Century Project. This request should be viewed under the premise that is the only function that the SCO will be performing. When viewed under that premise, this request should raise several flags. While the firm lease term obligations are through May 31, 2014 it's unclear what, if any, effort has been made to relieve the state of the $1.6 million requested in this May Revise Letter. Furthermore, the 40.0 requested positions seem to be excessive. There are a number of legal related positions requested in the May Revise Letter that seem to have more to do with what will be a pending legal case with the vendor of the 21st Century Project rather than SCO staff payroll reconciliation. Given that, it may be necessary to reduce the number of staff included in order to reduce the General Fund expenses as the state has already assumed a large cost burden for this project with little to no return.

There are a number of complex IT related functions that the state currently does not have the capacity to perform, and the external consultants requested in this May Revise Letter are expected to perform those functions. In the interest of ensuring that SCO staff receive the pay and benefits owed to them, staff believes the $2.58 million of the external costs requested may be justified. Included in this portion of the request, is $1.0 million for external legal consultants. It is unclear to staff what value external legal consultants will provide in the payroll reconciliation process. Particularly, when you take into account that this May Revise request includes a $215,00 internal contract with CalHR. Presumably, CalHR is advising SCO payroll reconciliation efforts on pay and benefits-related matters.

Furthermore, staff would not recommend that either the requested provisional language or the requested Control Section be adopted, in its current form. Any language that the Legislature agrees to should include not only a notification to the Joint Legislative Budget Committee, but also an authorization. This will ensure that the Legislature continues to play an active role in the payroll reconciliation process throughout the fiscal year.

Senate Budget Subcommittee No. 4 still intends on conducting a very in-depth oversight hearing related to the suspension of the 21st Century Project. The project was suspended after dedicated over $254 million towards its implementation. Prior to its suspension, total project costs were estimated to be $373 million per the Special Project Report 5 (SPR5). Given that the oversight hearing has still not been conducted it may be wise to provide only the funding necessary until the prospective hearing date. The remainder of the funds will be available upon Joint Legislative Budget Committee authorization.

Staff Recommendation: Reduce position authority to 30.8 for project administration and "Do the Math." Redirect $2.0 million related to outside legal services, and savings associated with the 9.2 postions requested in the proposal. This funding will support an assessment that shall be conducted. The report, at a minimum, should include the issues referenced in LAO's March Budget Recommendation. Funding shall be available for two months. The remainder of the requested funds for shall be available upon Joint Legislative Budget Committee notification. Notification will be related to project updates that will be determined at a later date. Amend budget bill language to include authorization from Joint Legislative Budget Committee.

Vote:

0890 CALIFORNIA SECRETARY OF STATE

Issue 1 – Business Programs Divisions Backlog

Governor's Budget Request: The Governor's May Revise includes a request to increase Business Fees expenditure authority by $5.68 million. The requested funds will provide the business programs division with an additional 56 three-year limited-term positions.

Background: The Governor recently signed AB 113 (Chapter 3, Statutes of 2013), which appropriated $1.6 million in business fees funds in the current year, to address the business filings backlog at the Secretary of State's office. At the time, it was estimated that there were 123,000 business filings in the backlog. The requested funds are anticipated to support the same number of positions in the Business Programs Division within the Secretary of State's office that the funds in AB 113 supported. It is the Secretary of State's goal to achieve and maintain a five-day processing time for business filings until an automated system can be fully implemented.

Additionally, the Governor's May Revise includes a request that budget bill language be added to Item 0890-001-0228 to require the Secretary of State to report to the Department of Finance and the Joint Legislative Budget Committee on the Business Program Division's efforts in maintaining the five business day processing time and its management of staff and resources.

Provisions:

1. *The Secretary of State shall report to the Department of Finance and the Joint Legislative Budget Committee on performance of its Business Filings Division (BPD). The report shall include a summary of performance over the preceding quarter including average processing time, number of filings processed, the number of expedited filings, total outstanding filings, a summary of number of staff in the BPD, the number of vacant positions and vacancy rate, the hours of overtime worked, number of temporary workers, and hours they worked.*

2. *The report required in Provision 1 shall be made for each month through December 2013 and quarterly thereafter (January, March, April, June). However, if the December 2013 or any subsequent report indicates that the average processing time for business filings is more than 5 days, the Secretary shall include a plan to come in compliance with the 5-day standard and shall provide monthly reports until it is in compliance. The reports in this section shall be due on the 15th of the month following the reporting period.*

Staff Comment: It is worth noting that Senate Budget and Fiscal Review Subcommittee No. 4 approved a request of an increase of $3.27 million in reimbursement authority for the Secretary of State's office to continue the development of the Business Connect Project. The Business Connect Project will allow for real-time filing of business records, allow government agencies to access information about businesses in a timely manner, and allow for more secure and timely processing of payments. The project is anticipated to reach full implementation in June 2016.

Staff Recommendation: Approve May Revise request.

Vote:

1110 DEPARTMENT OF CONSUMER AFFAIRS

Issue 1 – Controlled Substance Utilization and Review System (CURES)

Background: The Controlled Substance Utilization and Review System (CURES), is an electronic database of prescription drugs issued by doctors. In 1996, the Legislature initiated the development of the CURES system in an attempt to identify solutions addressed while utilizing an antiquated system of triplicate copying.

The implementation of CURES represented a significant improvement over the state's prior utilization of a triplicate copying system, however, it did not address the need for providing healthcare practitioners and pharmacists with access to timely information to proactively diminish and deter the use of controlled substances. To address this issue with CURES, the DOJ initiated the Prescription Drug Monitoring Program (PDMP), which allows prescribers and dispensers to access data at the point of care. The PDMP system is utilized by the DOJ to collect and store data on the prescription of controlled substances (Schedule II through Schedule IV). State law mandates that the DOJ assist law enforcement and regulatory agencies with the diversion, and resultant abuse, of controlled substances.

The California Budget Act of 2011 eliminated all General Fund support of CURES/PDMP, which included funding for system support, staff support and related operating expenses. To perform the minimum critical functions, and to avoid shutting down the program, the DOJ opted to assign five staff to perform temporary dual job assignments on a part-time basis. Currently, there are five healing arts boards within the Department of Consumer Affairs that provide the Department of Justice funding to manage the CURES program. Funding to support the program is derived from fees assessed on the boards which support the operation and maintenance costs of the CURES program, which is maintained at the DOJ.

Staff Comment. The current CURES database is significantly underutilized. The DOJ estimates that only 3.6 percent of licensed prescribers are utilizing the system in the state. However, it is worth noting that the DOJ does not believe that the current software platform could accommodate the additional 236,000 registrants that are in the state. The Department of Justice is redirecting resources to support the operation of CURES/PDMP. The redirection is not sustainable for the long-term.

According to the DOJ, modernization costs will be approximately $2.1 million for an upgraded CURES database. The modernization would occur over a two-year period and the costs associated with maintaining the current system, while the modernization occurs, would be $1.8 million. Total modernization costs would be approximately $3.9 million.

To address the build out of a new system, it may be worth considering splitting the estimated $3.9 million cost to build the new CURES database among the following boards that currently either prescribe or dispense controlled substances: The Medical Board, the Pharmacy Board, the Dental Board, the Board of Registered Nursing, the Osteopathic Medical Board, the Veterinary Medical Board, the Physician Assistance Board, the Optometry Board, the Podiatric Board, and the Naturopathic Board. The $3.9 million would be split over the lifecycle of the development of the new database, which is currently estimated at two years. The contribution from each board would be determined by the number of schedule II through IV licensees within each respective board.

Staff recommends directing the Department of Finance to coordinate with the Department of Consumer Affairs to identify appropriate amounts for each respective board that either dispenses or prescribes controlled substances. The identified amounts should total approximately $3.35 million for fiscal years 2013-14 and 2014-15. The $3.35 million dollar figure takes into account the annual contribution of $296,000 provided to the DOJ to manage the CURES database from the Medical Board, Dental Board, Board of Pharmacy, Board of Registered Nursing, and the Osteopathic Board. The increased expenditure authority will support the development of an updated CURES database. Senate Budget Subcommittee No. 5 will recommend an increased reimbursement authority for the DOJ, so the funds can be distributed towards the modernization of the CURES database.

To ensure a higher level of participation by the end-user, which is comprised of the ten boards contributing to the development of a new CURES database, staff recommends including budget bill language that generates participation from the Department of Consumer Affairs during the development phase of the new CURES database. The proposed budget bill language should include that it is the Legislature's intent that the CURES database be jointly developed by the Department of Consumer Affairs and the Department of Justice in order to meet the needs of the boards funding the system. The language should also reference that, prior to any reimbursements being provided to the Department of Justice, an interagency agreement shall be reached between the Department of Justice and the Department of Consumer Affairs regarding the development and implementation of an upgraded CURES database and approval of a Feasibility Study Report by the Department of Technology.:

Staff Recommendation: Increase expenditure authority for the ten boards within the Department of Consumer Affairs, to total $3.941 million. This will take into account the current appropriation of $296,000 annually provided by Department of Consumer Affairs Boards for fiscal years 2013-14 and 2014-15. The actual augmentation will amount to $3.35 million over two budget years. Adopt proposed budget bill language.

Vote:

Issue 2 – California State Athletic Commission

Governor's Budget Request: The Governor's May Revise includes a request for the inclusion of budget bill language that would authorize the California State Athletic Commission (Commission) with up to $200,000 in order to adequately staff events and provide biannual Athletic Inspector training, as per Business and Professions Code § 18615.

Background: Senate Budget Subcommittee No. 4 has already taken action to reduce the commission's budget by $814,000. The reduction results in the commission's 2013-14 budget being revised to $1.19 million. Action taken by the committee was in response to lingering solvency concerns of the Athletic Commission Fund. The Commission has requested that language be included that provide for the Commission to meet the requirements of Business and Professions Code § 18615, which requires semiannual training of inspectors that are assigned to regulate events by the Commission.

Staff Comment: According to the Commission, the estimated cost of semiannually training of the state's inspectors is $155,000. The $200,000 augmentation would provide for the necessary funds for Athletic Inspectors at sporting events, or for the required semiannual athletic inspector training. The proposed budget bill language is below:

Item 1110-001-0326……

Provisions:

1. The amount appropriated in this item may include revenues derived from the assessment of fines and penalties imposed as specified in Section 13332.18 of the Government Code.

2. <u>*Provided that sufficient funds are available and upon request by the Department of Consumer Affairs, the Department of Finance may augment this item by up to $200,000 not sooner than 30 days after notification in writing is provided to the chairpersons of the fiscal committees in each house of the Legislature and the Chairperson of the Joint Legislative Budget Committee. This augmentation shall only be provided for additional funding needed for Athletic Inspectors at sporting events or for Athletic Inspector training.*</u>

Staff Recommendation: Staff has no issues with this request as it ensures compliance with Business and Professions Code § 18615 and ensures the fund will remain solvent. Adopt proposed budget bill language.

Vote:

1690 SEISMIC SAFETY COMMISSION

Governor's Budget Request: The Governor's May Revise includes a request via trailer bill language to establish the Seismic Safety Account within the Insurance Fund. The Seismic Safety Account would then be utilized, at the discretion of the Legislature, to fund Seismic Safety Commission related activities.

Background: The Seismic Safety Commission was originally created in 1975 and was supported by the General Fund. The Commission's mission is to investigate earthquakes, research earthquake related activities and recommend to the Governor and the Legislature policies and programs needed to reduce earthquake risk. Additionally, the Commission is responsible for managing *California's Earthquake Loss Reduction Plan 2007-2011.*

The Commission currently has one office that houses 6.4 positions and supports the Commissions activities including the bi-monthly meetings at various sites statewide. The use of the Insurance Fund for the Commission was designed to be a short term solution. However, the ongoing budget concerns in the state have forced the Commission to utilize the Insurance Fund as a more permanent source of funding.

Staff Comment: The Governor's January 2012-13 Budget included a request to fund the Seismic Safety Commission with direct support from the Insurance Fund. However, when reviewing the January submission to re-approve the use of the Insurance Fund as a funding source it was brought to the Legislature's attention that use of the Insurance Fund as originally structured by the Commission would be unconstitutional. Specifically, Article XIII, Section 28 (f) of the California Constitution specifies that, with limited exceptions, the state's insurance tax shall be in lieu of all other state and local taxes. This seismic safety assessment imposed on the gross receipts of insurers of commercial and residential properties is a tax under the provisions of Proposition 26.

The Commission, with technical assistance from the Department of Finance, has submitted a revision to their original request that would have the Department of Insurance calculate an annual assessment not to exceed $0.15 on commercial and residential property policy holders to be collected by insurers. According to Legislative Counsel the proposed trailer bill language does not raise the constitutional concerns referenced above but, in accordance with Proposition 26, is subject to a supermajority vote.

In addition to the proposed trailer bill is a request to loan $1.122 million General Fund to the Insurance Fund in order to support the costs associated with the operation of the Seismic Safety Commission for Fiscal Year 2013-14.

Staff Recommendation: Reject proposed trailer bill language. Approve $1.122 million direct appropriation from the General Fund to the Seismic Safety Commission for Fiscal Year 13-14 on a one-time basis. Remove budget bill language referencing General Fund under Department of Insurance budget item.

Vote:

2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

Issue 1 – Housing Element Review

Governor's Budget Request: The Governor's 2013-14 budget includes a request for $649,000 to fund five two-year limited-term positions from the Air Pollution Control Fund. This request is necessary to implement the state's only oversight role in reviewing and approving regional and local governments' housing land-use.

Background: State law requires each city and county to adopt a general plan containing at least seven mandatory elements, including housing. Unlike the other general plan elements, the housing element is subject to detailed statutory requirements and mandatory review by a state agency, the California Department of Housing and Community Development (Department). Housing elements have been mandatory portions of local general plans since 1969. This reflects the statutory recognition that housing is a matter of statewide importance, and cooperation between government and the private sector is critical to attainment of the State's housing goals.

In 2007, the Legislature enacted SB 375 (Chapter 728, Statues of 2007), which sought to help the state achieve greenhouse gas emission goals, outlined in AB 32 (Chapter 488, Statutes of 2006), by reducing vehicle emissions. SB 375 requires regional greenhouse gas reduction targets, requires regional agencies to prepare land use plans for the regions that will help achieve the greenhouse gas reduction targets (known as a Sustainable Communities Strategy), and provides incentives for high-density, transit-oriented housing projects.

SB 375 links, for the first time, regional planning efforts for transportation and housing. Under the bill, all transportation and housing planning processes are put on the same eight-year schedule; housing plans must be updated once every eight years, which will now align with two 4-year Regional Transportation Plan planning cycles. The single largest sector of greenhouse gas emitters are cars and light trucks. While greenhouse gas emissions can be reduced by creating more fuel efficient vehicles, it is also a necessity to reduce the number of miles traveled to achieve the state's standards. Specifically, SB 375 integrated and aligned planning for housing, land use, transportation and greenhouse gas emissions.

This change in timing will have a dramatic impact on HCD. Instead of receiving housing elements on a staggered schedule, SB 375 changes require that 85 percent of the state's 539 cities and counties will be submitting housing elements in calendar years 2013 and 2014. According to HCD, most jurisdictions submit a draft nine months prior to their due date. HCD spends, on average, 120 hours of staff time per element review. Further compounding time requirements spent on each jurisdictional review, is the fact that most local governments submit at least four drafts prior to final submission of an element review.

Staff Comment: HCD serves as the only state entity with the capacity to ensure that local governments are conforming to land-use strategies that will locate their higher density and infill housing closer to jobs, services and transportation modes. A reduction in overall vehicle trips and vehicle miles travelled are critical components of achieving Greenhouse Gas emission reduction targets. Furthermore, HCD's element review process supports removal of regulatory barriers implementing the streamlining, intended by SB 375.

Staff Recommendation: Approve as budgeted.

Vote:

7870 CALIFORNIA VICTIM COMPENSATION AND GOVERNMENT CLAIMS BOARD (VCGCB)

Issue 1 – Trauma Recovery Center

Background: The California Victim Compensation Program (CalVCP), administered by the VCGCB, provides compensation for victims who suffer physical or emotional injury, or the threat of physical injury, as a direct result of a violent crime. Crimes covered by the program include domestic violence, child abuse, sexual and physical assault, homicide, human trafficking, robbery, and vehicular manslaughter.

Subject to specified eligibility criteria, CalVCP compensates eligible victims for various crime-related expenses that are not covered by other sources. Services covered include medical and dental care, mental health services, income loss, funeral expenses, home security, rehabilitation and relocation. Funding for the program is provided by the Restitution Fund, which derives its revenue from restitution fines and orders, diversion fees, and penalty assessments levied on persons convicted of crimes and traffic offenses. CalVCP also receives federal grant monies from the Victims of Crime Act (VOCA).

In order to receive compensation, victims must apply and provide specified documentation. The waiting period to receive indication of application for compensation has been documented to take up to three months or more to receive.

Staff Comment: The subcommittee may want to consider expanding the TRC model, which has been very successful at providing victim's services more cost effectively than individual reimbursements to victims for seeking their own mental health and medical services. In addition to the cost containment for each individual victim that occurs when TRC as the provider is paid by VCGCB (because it seeks to serve as many people as possible, as opposed to a victim potentially incurring more expensive services elsewhere), the TRC has served many more victims in need of mental health services than the entire panel of San Francisco fee-for-service providers. The TRC provides services more efficiently, and is able to reach more people (which often mitigate cost savings).

Staff Recommendation: Adopt draft trailer bill that establishes a grant program to be administered by the Victim Compensation and Government Claims Board (VCGCB) which will provide for the creation and funding of Trauma Recovery Centers (TRCs) across the state.

Increase expenditure authority for the VCGCB by $2.0 million for the administration of the grant program.

VOTE:

8955 CALIFORNIA DEPARTMENT OF VETERANS AFFAIRS (CDVA)

Issue 1 – Central Coast Veterans Cemetery at Ford Ord

Background: In 1991, Fort Ord was announced for closure by the United States Base Realignment and Closure Commission. Upon closure, the Fort Ord Reuse Authority (FORA) Base Reuse Plan was established to oversee the process of converting the land from military to civilian use. FORA set aside 178 acres for a veterans cemetery. Legislation enacted in 2006 (AB 3035 Laird, Chapter 291, Statutes of 2006), created an endowment fund to allow local veterans to raise money to finance the initial planning and design process, as well as the ten percent matching funds, required by the U.S. Department of Veterans Affairs (USDVA), for beginning the construction project. The balance of the construction costs will be repaid through reimbursements by the USDVA. Public Law 105-368, which went into effect in 1999, authorized USDVA to provide up to 100 percent of the development cost for an approved project.

August 15, 2013 is the federally-imposed (USDVA) deadline for the state's grant application, including a certification of matching funds signed by a senior state official. In order to achieve this deadline, approximately $2.5 million is needed in the Endowment Fund in early July for the Department of Finance to approve the project, per statute requirements.

Staff Comment: There is existing authority (Chapter 22, Statutes of 2011) for the endowment fund to transfer funds, when available, from the endowment fund to the operation fund for the purposes of completing the preliminary plan phase of the capital outlay project. However, there is no cash in the endowment fund available for transfer. While the intent has been for the local community to raise the necessary funds, the economic situation, existing since at least 2006, has preempted options available to the community to raise funds for the endowment. In order to move forward, an option needs to be developed that will provide the cash to proceed with planning, while maintaining the initial intent that this project have no General Fund impact.

Staff Recommendation: Staff recommends including the following language in the Budget Act of 2013.

> *8955-011-0001—For transfer by the Controller, upon order of the Director of Finance, from the General Fund to the California Central Coast State Veterans Cemetery at Fort Ord Endowment Fund ……….. 2,500,000*
>
> *Provisions:*
> *1. The funds appropriated in this item shall be reimbursed by the California Central Coast State Veterans Cemetery at*

Fort Ord Endowment Fund from the proceeds of any construction grant received from the State Veterans Cemetery Construction Grant Program for the purposes of constructing the California Central Coast Veterans Cemetery.

2. Funds shall be reimbursed to the full extent of the grant award no later than 24 months after construction is completed.

3. The Secretary of Veterans Affairs shall report annually, by January 10 of each year, commencing on January 10, 2015, to the Director of Finance, the Chairperson of the Joint Legislative Budget Committee, and the chairpersons of the fiscal committees of each house of the Legislature on all expenditures made pursuant to Provision 1 to include progress on reimbursing the General Fund pursuant to Provision 2.

The proposed budget bill language will provide the Fort Ord Endowment Fund with the necessary funds to begin the construction of the California Central Coast Cemetery. Budget bill should include spending authority related to this project. The funds are expected to be repaid in full by the U.S. Department of Veterans Affairs.

Vote:

Issue 2 – Conversion of Skilled Nursing Facility to Domiciliary Care at West Los Angeles Veterans Home

Governor's Budget Request: The Governor's May Revise includes a request for a reduction of 35.6 positions and $3.2 million General Fund in 2013-14. The reduction will total 67 positions, and $5.1 million ongoing, to accurately reflect the conversion of two units in the West Los Angeles home from skilled nursing to domiciliary care.

Background: The West Los Angeles facility was originally designed and constructed to provide 396 beds, consisting of 84 residential care facility for the elderly and 313 skilled nursing facility level of care beds. The proposal will result in a reduction of 84 skilled nursing facility level of care beds and will result in a total of 228 skilled nursing facility beds at the West Los Angeles home.

Currently, there are no domiciliary level of care beds available for the estimated 676,219 veterans in any of the greater Los Angeles area veterans homes. This proposal will also provide the estimated 9,419 homeless veterans in the region with some form of either long-term care or supportive housing.

Staff Comment: As of April 4, 2013, there were 65 residents approved for admission in the Skilled Nursing Facility. The scheduled reduction in skilled nursing beds would not displace any veterans at the facility and would provide veterans, in need of a home, with a bed that has a respectable level of privacy. Furthermore, the conversion of the skilled nursing beds into domiciliary level of care units, would be in alignment with both federal and state goals. Governor

Davis issued Executive Order D-53-02, which addressed the need for greater resources to support the state's homeless veterans population.

Staff Recommendation: Adopt proposed May Revise request.

Vote:

Issue 3 – Veterans Claims and Rights

Background: In California, both the state Department of Veterans Affairs (Cal Vet) and County Veterans Service Offices (CVSOs) work to assist veterans in receiving federal benefits they are owed, including medical care, education, burial, and compensation and pension benefits. According to internal USDVA documents obtained and published by the Center for Investigative Reporting, California veterans filing claims for the first time face extremely long waits before their claims are processed. This can lead to disabled veterans suffering from severe health issues, unemployment or other problems waiting more than a year for federal assistance.

The table below shows the average processing times for the three USDVA offices in California and the national average. Nationally, it is taking nearly one year to process new claims; and in two of California's offices, the processing time is closer to two years.

Office	Average Processing Time - Days
Los Angeles	619.4
Oakland	617.8
San Diego	283.3
National Average	349.6

Some states have sought to address the USDVA's claims backlog. Texas, for example, has committed $1.5 million to create "State Strike Force Teams" to work with federal officials in processing requests for claims. The teams consist of claims counselors who work inside federal veterans offices to help expedite claims' processing. The state has signed a Memorandum of Understanding with the federal government to allow the strike force teams to work with USDVA officials. Between July and 2012 and January 2013, the state workers assisted more than 10,000 veterans whose claims were stuck in the backlog and forwarded 2,950 cases to the federal government for approval.

Cal Vet provided a plan to the subcommittee last week, although the plan was not included in the Governor's May Revise. The plan includes:

- California Veterans Service Representative Academy. Cal Vet proposes to conduct several week-long workshops across the state to better train CVSOs and others who assist veterans in accessing claims. Training will include curriculum related to handling more complicated claims, including assisting veterans with Post-Traumatic Stress Disorder, Traumatic Brain Injury and Military Sexual Trauma. Cal Vet states that it has restructured some administrative costs that allow it to conduct these trainings without new funding.

- Strike Teams. Cal Vet states that it has held discussions with the federal VA offices in Oakland, Los Angeles and San Diego regarding a limited-term collaboration that would allow state employees to work in regional offices to address the California backlog. The department's plan would be to deploy two employees to each office, with one addressing backlog issues and one working to ensure that new claims coming in to the federal office have been properly developed. The department states that it intends to hire individuals with claim filing or adjudication experience so that little new training is required. The department also notes that these new state workers currently could only assist on claims developed by CVSOs or the state; claims developed by other veterans organization such as the American Legion and Veterans of Foreign Wars could not be addressed. Thus the department proposes to work with those groups to enter into agreements that would allow the state employees to assist with those claims as well.

Staff Recommendation: Provide $500,000 General Fund and six three-year limited-term positions to the CDVA to establish strike teams that will assist in alleviating the current number of claims backlogged at the USDVA. CDVA may utilize additional General Fund resources if any General Fund savings materialize from this effort during the 2013-14 Budget Year. In addition, require the department to prepare a report due March 1, 2014, and annually for the next two years, to describe the implementation of this plan and its outcomes.

Vote

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Norma Torres

Thursday, May 23, 2013
10 a.m.
Room 112
Consultant: Brady Van Engelen

PART B

OUTCOMES

Item Number and Title

0690	Office of Emergency Services
0840	State Controller's Office
0890	Secretary of State
1110	Department of Consumer Affairs
1690	Seismic Safety Commission
2240	Department of Housing and Community Development
7760	Department of General Services
7870	Victim Compensation and Government Claims Board
8955	California Department of Veterans Affairs

(See Table of Contents on page 1 for a More Specific Listing of Issues)

AGENDA –VOTE ONLY ITEMS

All items approved 2-0

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only – Issue Descriptions

Office of Emergency Services

Issue 1 – Sunset of the Disaster Response Account

Governor's Budget Request: The Governor's May Revise includes a request for trailer bill language that would extend the sunset date of the Disaster Response Emergency Operations Account through January 1, 2019.

Background: On April 11th the Senate Budget Subcommittee No. 4 took action on a request to reduce the 2013-14 General Fund contribution to the California Disaster Assistance Act by $10.0 million. This would provide the account with $39.1 million for 2013-14 and should not impact the state's ability to match the portion required for either a state or federally declared disaster.

Staff Comment: The requested change does not impact the state's matching requirements for local projects in the event of either a state or federally declared disaster.

Staff Recommendation: Adopt trailer bill language.

Department of Consumer Affairs

Issue 2 – BreEZe

Governor's Budget Request: The Governor's budget includes a request for $7.67 million in additional funding for continued support of the Department of Consumer Affairs, Consumer and Client Services Division's automated licensing and enforcement system. This request also includes a request for $4.188 million in additional funding for all boards and bureaus to fund credit card processing fees on behalf of users of credit card payments through the BreEZe project. The total project cost for 2013-14 will be $11.995 million.

Background: The Department of Consumer Affairs is the umbrella agency for 37 business and professional licensing entities (collectively referred to as boards and bureaus) that regulate over 2.7 million businesses and professionals, in over 250 license categories. The BreEZe project began with the approval of the Feasibility Study Report on November 30, 2009. In Fiscal Year 2010-11, the Department of Consumer Affairs gained approval of a Budget Change Proposal to redirect funding from the existing iLicensing Project, plus augment budgets for the BreEZe project to support the procurement and implementation of an integrated licensing and enforcement system, in support of the Department of Consumer Affair's Consumer Protection Enforcement Initiative. Additionally, in Fiscal Year 2011-12, the department gained approval to appropriate $1.2 million, on a one-time basis, to the BreEZe project. BreEZe is designed to bring all of the Department of Consumer Affairs' Boards and Bureaus into an integrated licensing and enforcement system.

Staff Comment: According to the most recent update to the Special Project Report (SPR), a number of defects occurred while conducting User Acceptance Testing. The reported defects that occurred during the User Acceptance Testing have caused a delay in the originally proposed timeline. The 2009 Feasibility Study Report estimated a project go-live date of July 2012, and the most recent update to the SPR noted that the vendor, Accenture has proposed a go-live date of May 2013.

Since initially hearing this item in the subcommittee, staff has had time to review additional details and is satisfied with the progress of this IT project.

Staff Recommendation: Approve as budgeted.

Issue 3 – Veterinary Medical Board

Background: Created in 1893, the Veterinary Medical Board (Board) licenses and regulates veterinarians, registered veterinary technicians (RVTs), RVT schools/programs and veterinary premises/hospitals, through the enforcement of the California Veterinary Medicine Practice Act.

The Board protects the public from the incompetent, unprofessional, and unlicensed practice of veterinary medicine. The Board requires adherence to strict licensure requirements for California veterinarians and RVTs. The pet-owning public expects that the providers of their pet's health care are well-trained and are competent to provide these services. The Board assures the public that veterinarians and RVTs possess the level of competence required to perform these services by developing and enforcing the standards for examinations, licensing, and hospital and school inspection.

The Board also conducts regular practice analyses to validate the licensing examinations for both veterinarians and RVTs. Additional eligibility pathways have also been approved for licensure of internationally trained veterinary graduates and certification of RVTs to allow qualified applicants from other states in the U .S. and countries around the world to come to California and to improve the provision of veterinary health care for consumers and their animals. The Board also states that its mission is to protect consumers and animals through the development and maintenance of professional standards; the licensing of veterinarians and registered veterinary technicians; and through diligent enforcement of the California Veterinary Medicine Practice Act.

Staff Comment: Over the past several years, the Board's workload has increased. This workload increase has led to a significant backlog in the intake cycle time, time required for cases requiring formal discipline, and the average number of days from receipt of a complaint to the closure of an investigation. However, there has only been a minimal increase in staffing at the Board over that same period of time. A lack of additional resources has led to a significant backlog at the Board. The number of licensed veterinarians has increased twelve percent and the number of registered veterinary technicians has increased twenty-five percent and there has been a 43 percent increase in the number of general complaints received by the Board.

To address the both the ongoing workload and the current backlog, staff recommends increasing the expenditure authority by $359,000 and providing two two-year limited-term and three permanent staff positions to the Board.

Staff Recommendation: Increase the Veterinary Medical Board expenditure authority by $359,000 and authorize a total of five staff positions; two two-year limited-term and three permanent to the Veterinary Medical Board.

Issue 4 – Bureau of Private Postsecondary Education

Background: At a May 9 hearing Senate Budget Subcommittee No. 4 adopted budget bill language that extended the amount of time that the Bureau of Private Postsecondary Education's fund reserve limit can be in excess of six months of operating costs through Fiscal Year 2013-14. It has been brought to staff's attention that the Bureau is up for sunset review during the 2014 calendar year. It may be more suitable to extend the current proposal an additional six months to January 1, 2015 in order to ensure that the policy committees are afforded the opportunity to make any adjustments that are brought to their attention during the sunset review process.

Staff Recommendation: Amend budget bill language to further extend their exemption from the fund balance cap until January 1, 2015.

Department of General Services

Issue 4 – Extension of Liquidation Period for Grant Funds

Governor's Budget Request: The Governor's May Revise includes a request to add an item to the budget bill that would authorize the extension of the liquidation period for $3.19 million in grant funds to construct alternative fuel stations. The Department of General Services entered into an agreement on September 30, 2010, with the California Energy Commission to administer a grant to construct the 75 E-85 ethanol fueling stations throughout California, and the agreement is set to expire on March 31, 2014. Authorization was originally provided in the Budget Act of 2010, which allowed the Department of General Services to provide reimbursement payments to the contractor for the design and construction of the program through June 30, 2013. There are currently 27 fueling stations in operation, the remaining fueling stations are in various stages of planning, permitting, property lease negotiations and design.

The proposed language that will be needed to ensure that the funds remain available throughout the completion of the program is below:

7760-491—Reappropriation, Department of General Services. Notwithstanding any other provision of law, the period to liquidate encumbrances of the following citations are extended to June 30, 2014:

0666—Service Revolving Fund
(1) Item 1760-001-0666, Budget Act of 2010 (Ch. 712, Statutes of 2010) for the balance of Reimbursement—CEC

Staff Comment: Staff has no issues with extending the liquidation period.

Staff Recommendation: Adopt proposed budget bill language.

Issue 5 – Special Repairs: Americans with Disabilities Act Compliance

Governor's Budget: The Governor's budget requests an augmentation of $11 million in Service Revolving Fund authority for special repair projects associated with Americans with Disability Act (ADA) compliance.

Background: Total repairs are projected to cost approximately $110 million and will be conducted over the next ten years. The augmentation will require an increase in the Building Rental Account and the Individual Rental Rate, which are managed by the DGS. In 2009, DGS conducted a survey of all of the buildings with ADA deficiencies, and the study found deficiencies in nearly every building in the DGS portfolio. DGS has calculated that the repairs will require $82 million and there is approximately $28 million in deferred maintenance that will need to be addressed, as well. DGS has identified a ten-year timeline to complete the work identified in the deficiencies study.

LAO Recommendation: The LAO recommends that the Legislature reject the proposal because a temporary, across-the-board $0.10 rate increase is an inappropriate way to fund special repairs across multiple facilities. The rental rates should be set at amounts sufficient to cover debt service, ongoing operations, and maintenance costs, as well as build up a reserve for the repair or replacement of building systems and equipment.

Accordingly, the LAO recommends that the Legislature direct DGS to adjust existing rates to meet each facility's individual needs over time. While more complex, such individual adjustments would result in rental rates that more accurately reflect the cost of operating and maintaining each building. For buildings with significant ADA compliance issues and deferred maintenance, the new building rate may need to include a temporary multi-year increase to cover these one-time costs, as well as an increase in the base rental rate to prevent the accumulation of additional deferred maintenance. For newer buildings, DGS also may determine that minor rate increases are needed to establish a sufficient reserve for future scheduled maintenance and special repairs.

Staff Comment: The Governor's proposal distributes the total cost for special repairs equally to all buildings. This approach recognizes that special repair needs will change from year to year based on emergency repairs, equipment and systems failures, and other factors in the prioritization of repairs. The LAO recommendation attempts to more accurately reflect the cost of operating and maintaining each building but does not account for unavoidable changes in priorities due to unforeseen events. Consequently, there is a continuous reprioritization of the items on the special repair list. A uniform rate increase gives DGS the flexibility to reprioritize as needed to react to unforeseen events. The Assembly has adopted this proposal as budgeted.

Staff Recommendation: Approve as budgeted.

Issue 6 – GS $mart

Governor's Budget: The Governor's May Revision includes a request for the addition of trailer bill language that would modify the GS $mart program, within the Department of General Services.

Background: The GS $mart program serves as the state's financial marketplace, providing state entities with lease purchasing opportunities. There are high-cost items, such as a $6 million dollar generator, or a $5 million airplane that agencies are not capable of purchasing in a single budget year. The program allows an agency to spread the cost of specified goods over several years versus paying for them all in one fiscal year at tax-exempt rates.

Staff Comment: The proposed trailer bill language would not generate any General Fund or Special Fund cost savings in the Budget Year, or future budget years. Additionally, the proposed trailer bill language does not include any mechanisms to ensure that the Legislature is aware of a state entity utilizing the GS $mart program. While there is a need to place the program in statute, a May Revision Finance Letter would not be the preferred approach. There are significant policy changes included in this May Revision Finance Letter and those changes merit a larger discussion than what can be provided in the limited time remaining.

Staff Recommendation: Reject proposed May Revision Finance Letter.

Department of Veterans Affairs

Issue 7 – Enterprise-wide Veterans Homes Information System (Ew-VHIS)

Governor's Budget Request: The Governor's 2013-14 Budget includes a request for $1.8 million to fund the implementation of the Enterprise-wide Veterans Homes Information System (Ew-VHIS) at the Yountville Veterans Home.

Background: The Ew-VHIS is designed to provide an integrated level of care to all eight homes within the CDVA veterans home network. Prior to the original request made in 2007, CDVA operated three veterans homes that were semi-autonomous. According to the California Technology Agency, total project costs are estimated to be $36.7 million. The original Feasibility Study Report, submitted in 2007, estimated the total project cost to be $33.9 million.

The Ew-VHIS has now been installed, configured, and implemented at Headquarters and at the homes in Barstow, Chula Vista, West Los Angeles, Ventura, and Lancaster. Implementation at

Yountville, which has the largest resident population and staffing, represents the third wave. Funding to support the implementation of the Ew-VHIS was included in the proposal to support the opening of the Redding and Fresno veterans homes.

Prior to the acquisition and implementation of the Ew-VHIS, the veterans homes of California (Yountville, Barstow, and Chula Vista) utilized a software platform (Meditech) that did not have full functionality for Long-Term Care purposes, and the Meditech platform was only partially used at the Chula Vista and Barstow facilities. According to CDVA, the Meditech platform lacked the capability to develop a long-term care plan in an electronic format, and lacked a continuum of care account for each patient.

An additional concern raised by CDVA is the need for an integrated network that can be more closely monitored at CDVA's headquarters in Sacramento. According to CDVA, a new integrated network will provide headquarters with the opportunity to improve administrative procedures, business processes, and will provide a greater level of clinical data management capabilities within the network.

Staff Comment: Senate Budget Subcommittee No. 4 originally heard this item on April 11th and the item was held open.

Staff Recommendation: Approve as budgeted.

Issue 8 – Adjustment to Federal Per Diem for Veterans Homes

Governor's Budget Request: The Governor's May Revise includes a request to decrease the General Fund contribution to the California Department of Veterans Affairs and increase the Federal Fund expenditure authority by $625,000.

Background: The federal government pays a per diem rate for every resident that is housed in the state's veterans homes. This $625,000 augmentation is the net change to federal reimbursements, resulting from a decrease in the projected number of residents housed in the state's veterans homes in fiscal year 2013-14, and an increase in the per diem rate.

Staff Comment: Staff has no issues with this request as it results in a net zero difference in overall expenditures within the Department.

Issue 9 – Current Year and Budget Year Savings

Governor's Budget Request: The Governor's May Revise includes a request for a one-time reduction of $12 million General Fund in current year 2012-13, and $5.5 million General Fund in budget year 2013-14.

Background: This request is due to the delay in opening the skilled nursing facility at the West Los Angeles veterans home, and the just-in-time hiring being conducted at the Redding and Fresno Veterans homes. The skilled nursing facility was originally budgeted to begin admittance in February 2012, however admittance did not begin until later in the fall of 2012. The delay in admittance was due to licensing issues related to providing food services to the skilled nursing facility residents. This delay has pushed the ramp-up of staff beyond the original 2010 hiring plan, which has generated one-time savings in the current year and budget year.

Staff Comment: Staff does not have any issues with the request.

Staff Recommendation: Adopt May Revise request.

Issues Proposed for Discussion / Vote

0840 CALIFORNIA STATE CONTROLLER

Issue 1 – Integrated Data Management System

Governor's Budget Request: The Governor's May Revise includes a request for $3.018 million ($651,000 General Fund) in Fiscal Year 2013-14 and $3.48 million ($751,000 General Fund) in 2014-15 through 2017-18, for costs associated with the Integrated Data Management System technology services.

Background: The Integrated Data Management System (IDMS) is comprised of a suite of software products that run on the mainframe housed at the Office of Technology Services. The systems are wholly integrated and allow for direct interface and/or provide for files to be passed between each unique system. The Controller's Office is highly dependent on IDMS applications, and use the business functions for personnel, payroll, fiscal, and audits. There are a total of fifteen unique IDMS supported applications that the SCO utilizes.

The increased costs are associated with the fact that SCO is now one of only two state entities (California Highway Patrol is the other) that utilize IDMS applications and, therefore, are paying for a much higher share of the costs than before when the costs could be distributed across multiple agencies. IDMS related costs in the 2011-12 budget year were $185,000 and have increased substantially due to the continued migration of other departments that are no longer reliant on IDMS.

Staff Comment: IDMS applications perform a number of functions that are assumed to be replaced by either the 21st Century Project or FI$Cal. Therefore, it would not be cost effective to identify an intermediate platform until 21st Century and FI$Cal are implemented and able to replace the IDMS applications.

A five-year contract was recently negotiated with the IDMS vendor. Annual costs for the SCO to continue to use IDMS are reflected in the May Revise request. However, as previously noted, if the other user of IDMS were to leave, costs would increase to $4.6 million annually. Given that there is a possibility of a requested future cost increase associated with the California Highway Patrol migrating to another platform, it may be worth considering approving the requested amount for 2013-14. Future requests, which may include the additional costs associated with the other user migrating, will be considered in subsequent budget years. This will also afford the Legislature the opportunity to hear regular progress reports on the migration process.

Staff Recommendation: Approve requested $3.018 million for Fiscal Year 2013-14 in May Revise Letter.

Vote: **Approve Staff recommendation 3-0**

Issue 2 – Unclaimed Property Division

Governor's Budget Request: The Governor's May Revise includes a request to revise the existing provisional language for Item 0840-001-0970 to better define the expenditures paid from that account.

Background: Administration of the Unclaimed Property Program is a responsibility of the SCO, per Code of Civil Procedure § 1300-1615. The Code of Civil Procedure provides the SCO with a continuous appropriation to carry out and enforce the Unclaimed Property Law. In addition to the continuous appropriation currently in statute, there is an item in the budget bill that provides the SCO with an appropriation for $35.06 million for the administration of the Unclaimed Property Program, as it relates to the administration of the program. The proposed budget bill language is below:

Provisional language for Item 0840-001-0970

The funding provided in Item 0840-001-0970 shall cover costs for personal services and related operating expenses and equipment (including legal costs that are not related to enforcing the recovery of property, and system related costs) for the Unclaimed Property Program. Continuous appropriations form the Unclaimed Fund are allowed for other program costs authorized under Section 1584(b) and Section 1325 of the Code of Civil Procedure. These continuous appropriations shall not be used to cover spending authorized under Item 0840-001-0970.

Staff Comment: It appears the proposed amendments to the provisional language would more clearly delineate which appropriations are supposed to pay for specific costs assumed by the SCO's Unclaimed Property Division. Staff recognizes the need for a clear delineation between the direct appropriation provided in statute and the appropriation provided in budget bill language. However, it may be more appropriate to review both, the language in statute, and the budget bill language, in order to make a more informed decision. Staff believes that there could be more value added to a thorough review of both the appropriation provided in statute and the budget bill language. Unfortunately, the late nature of this proposal has not provided the subcommittee with the time necessary to conduct that level of review. Therefore, it is in the subcommittee's best interest to reject the proposed budget bill language

Staff Recommendation: Reject proposed budget bill language without prejudice. This issue may be reconsidered in the 2014-15.

Vote: **Approve Staff recommendation 3-0**

Issue 3 – 21st Century Project

Governor's Budget Request: The Governor's May Revise includes a request for 40 positions and $14.556 million ($11.92 million General Fund) for a one-year limited-term in 2013-14, to support multiple efforts related to the suspension of MyCalPAYS and the 21st Century Project.

Background: The State Controller's Office (SCO) is responsible for disbursement of pay to the state's 249,000 employees. In 2004 the Department of Finance (DOF) approved the justification documents, submitted by the SCO, requesting an updated payroll system that would provide a greater level of integration. The SCO procured Commercial Off the Shelf (COTS) software in 2005 and intended on utilizing that COTS software to update the state's payroll system.

The Department of General Services (DGS) awarded the second contract to a different vendor on February 2, 2010. An updated Special Project Report (SPR 4), that was issued prior to the contract being awarded, identified the method that would eventually be utilized to implement the new MyCalPAYS system. The first, and smallest phase, would consist of converting payroll for the approximately 1,300 SCO staff to the new payroll system.

The initial pilot, which was deployed in June of 2012, revealed a significant volume of errors. The SCO issued a cure letter in October of 2012 to the vendor, SAP, requesting that the vendor deliver the resources necessary to correct the identified errors. SCO was not satisfied with the response provided by the vendor and subsequently terminated the contract for MyCalPAYS in February 2013. Due to the contract being terminated, the Technology Agency had little choice but to suspend the 21st Century Project.

SCO's request is broken into multiple segments, which include continued lease obligations, consulting contracts for both internal and external consultants, costs associated with legal proceedings for the likely legal dispute between the vendor and SCO, and data center costs. Including the proposed Control Section 25.25, the costs associated with this request total $14.55 million. A more specific cost breakdown is provided below:

- $3.985 million for the 40.0 one-year limited-term positions within the payroll services division.

- $1.615 million for lease obligations which extend through May 31, 2014.

- $453,000 for interdepartmental consulting which includes funding to support project oversight provided by the Technology Department and labor relations support provided by CalHR.

- $3.58 million for external consulting services which includes costs associated with seeking outside legal counsel, external payroll reconciliation consultants and project management consultants.

- $4.93 million for data center service costs and Information Technology costs which represents the funds necessary to receive data center services and infrastructure requirements.

- $2.268 million is also a requested and represented by the addition of a Control Section. The added Control Section would allow SCO to augment their budget to pay for additional Office of Technology Service Costs if the SCO is unable to accelerate suspension efforts.

In addition to the funding requests, the SCO has requested the addition of provisional item under 0840-001-0001. The provisional item would allow a further augmentation SCO's budget by $2.266 million from all fund sources for payment of data center costs to the Office of Technology related to the suspension of the 21st Century Project. The requested language includes a 30-day notification to the Joint Legislative Budget Committee.

Staff Comment: The 21st Century Project has suffered multiple cost-overruns and timeline setbacks, which led to the termination of the contract with the first vendor, Bearing Point, in 2009. This project has received increased scrutiny from the Legislature in prior years and was subject to quarterly reporting requirements.

Staff recognizes that there is a need to conduct payroll reconciliation for the 1,300 staff at the SCO that were impacted by the initial phase of the 21st Century Project. This request should be viewed under the premise that is the only function that the SCO will be performing. When viewed under that premise, this request should raise several flags. While the firm lease term obligations are through May 31, 2014 it's unclear what, if any, effort has been made to relieve the state of the $1.6 million requested in this May Revise Letter. Furthermore, the 40.0 requested positions seem to be excessive. There are a number of legal related positions requested in the May Revise Letter that seem to have more to do with what will be a pending legal case with the vendor of the 21st Century Project rather than SCO staff payroll reconciliation. Given that, it may be necessary to reduce the number of staff included in order to reduce the General Fund expenses as the state has already assumed a large cost burden for this project with little to no return.

There are a number of complex IT related functions that the state currently does not have the capacity to perform, and the external consultants requested in this May Revise Letter are expected to perform those functions. In the interest of ensuring that SCO staff receive the pay and benefits owed to them, staff believes the $2.58 million of the external costs requested may be justified. Included in this portion of the request, is $1.0 million for external legal consultants. It is unclear to staff what value external legal consultants will provide in the payroll reconciliation process. Particularly, when you take into account that this May Revise request includes a $215,00 internal contract with CalHR. Presumably, CalHR is advising SCO payroll reconciliation efforts on pay and benefits-related matters.

Furthermore, staff would not recommend that either the requested provisional language or the requested Control Section be adopted, in its current form. Any language that the Legislature agrees to should include not only a notification to the Joint Legislative Budget Committee, but also an authorization. This will ensure that the Legislature continues to play an active role in the payroll reconciliation process throughout the fiscal year.

Senate Budget Subcommittee No. 4 still intends on conducting a very in-depth oversight hearing related to the suspension of the 21st Century Project. The project was suspended after dedicated over $254 million towards its implementation. Prior to its suspension, total project costs were estimated to be $373 million per the Special Project Report 5 (SPR5). Given that the oversight hearing has still not been conducted it may be wise to provide only the funding necessary until the prospective hearing date. The remainder of the funds will be available upon Joint Legislative Budget Committee authorization.

Staff Recommendation: Reduce position authority to 30.8 for project administration and "Do the Math." Redirect $2.0 million related to outside legal services, and savings associated with the 9.2 postions requested in the proposal. This funding will support an assessment that shall be conducted. The report, at a minimum, should include the issues referenced in LAO's March Budget Recommendation. Funding shall be available for two months. The remainder of the requested funds for shall be available upon Joint Legislative Budget Committee notification. Notification will be related to project updates that will be determined at a later date. Amend budget bill language to include authorization from Joint Legislative Budget Committee.

Vote: Approve Staff recommendation 3-0

0890 CALIFORNIA SECRETARY OF STATE

Issue 1 – Business Programs Divisions Backlog

Governor's Budget Request: The Governor's May Revise includes a request to increase Business Fees expenditure authority by $5.68 million. The requested funds will provide the business programs division with an additional 56 three-year limited-term positions.

Background: The Governor recently signed AB 113 (Chapter 3, Statutes of 2013), which appropriated $1.6 million in business fees funds in the current year, to address the business filings backlog at the Secretary of State's office. At the time, it was estimated that there were 123,000 business filings in the backlog. The requested funds are anticipated to support the same number of positions in the Business Programs Division within the Secretary of State's office that the funds in AB 113 supported. It is the Secretary of State's goal to achieve and maintain a five-day processing time for business filings until an automated system can be fully implemented.

Additionally, the Governor's May Revise includes a request that budget bill language be added to Item 0890-001-0228 to require the Secretary of State to report to the Department of Finance and the Joint Legislative Budget Committee on the Business Program Division's efforts in maintaining the five business day processing time and its management of staff and resources.

Provisions:

1. *The Secretary of State shall report to the Department of Finance and the Joint Legislative Budget Committee on performance of its Business Filings Division (BPD). The report shall include a summary of performance over the preceding quarter including average processing time, number of filings processed, the number of expedited filings, total outstanding filings, a summary of number of staff in the BPD, the number of vacant positions and vacancy rate, the hours of overtime worked, number of temporary workers, and hours they worked.*

2. *The report required in Provision 1 shall be made for each month through December 2013 and quarterly thereafter (January, March, April, June). However, if the December 2013 or any subsequent report indicates that the average processing time for business filings is more than 5 days, the Secretary shall include a plan to come in compliance with the 5-day standard and shall provide monthly reports until it is in compliance. The reports in this section shall be due on the 15th of the month following the reporting period.*

Staff Comment: It is worth noting that Senate Budget and Fiscal Review Subcommittee No. 4 approved a request of an increase of $3.27 million in reimbursement authority for the Secretary of State's office to continue the development of the Business Connect Project. The Business Connect Project will allow for real-time filing of business records, allow government agencies to access information about businesses in a timely manner, and allow for more secure and timely processing of payments. The project is anticipated to reach full implementation in June 2016.

Staff Recommendation: Approve May Revise request.

Vote: Approve Staff Recommendation and adopt placeholder trailer bill requiring 5 day turnaround time in statute, which conforms to assembly 3-0

1110 DEPARTMENT OF CONSUMER AFFAIRS

Issue 1 – Controlled Substance Utilization and Review System (CURES)

Background: The Controlled Substance Utilization and Review System (CURES), is an electronic database of prescription drugs issued by doctors. In 1996, the Legislature initiated the development of the CURES system in an attempt to identify solutions addressed while utilizing an antiquated system of triplicate copying.

The implementation of CURES represented a significant improvement over the state's prior utilization of a triplicate copying system, however, it did not address the need for providing healthcare practitioners and pharmacists with access to timely information to proactively diminish and deter the use of controlled substances. To address this issue with CURES, the DOJ initiated the Prescription Drug Monitoring Program (PDMP), which allows prescribers and dispensers to access data at the point of care. The PDMP system is utilized by the DOJ to collect and store data on the prescription of controlled substances (Schedule II through Schedule IV). State law mandates that the DOJ assist law enforcement and regulatory agencies with the diversion, and resultant abuse, of controlled substances.

The California Budget Act of 2011 eliminated all General Fund support of CURES/PDMP, which included funding for system support, staff support and related operating expenses. To perform the minimum critical functions, and to avoid shutting down the program, the DOJ opted to assign five staff to perform temporary dual job assignments on a part-time basis. Currently, there are five healing arts boards within the Department of Consumer Affairs that provide the Department of Justice funding to manage the CURES program. Funding to support the program is derived from fees assessed on the boards which support the operation and maintenance costs of the CURES program, which is maintained at the DOJ.

Staff Comment. The current CURES database is significantly underutilized. The DOJ estimates that only 3.6 percent of licensed prescribers are utilizing the system in the state. However, it is worth noting that the DOJ does not believe that the current software platform could accommodate the additional 236,000 registrants that are in the state. The Department of Justice is redirecting resources to support the operation of CURES/PDMP. The redirection is not sustainable for the long-term.

According to the DOJ, modernization costs will be approximately $2.1 million for an upgraded CURES database. The modernization would occur over a two-year period and the costs associated with maintaining the current system, while the modernization occurs, would be $1.8 million. Total modernization costs would be approximately $3.9 million.

To address the build out of a new system, it may be worth considering splitting the estimated $3.9 million cost to build the new CURES database among the following boards that currently either prescribe or dispense controlled substances: The Medical Board, the Pharmacy Board, the Dental Board, the Board of Registered Nursing, the Osteopathic Medical Board, the Veterinary Medical Board, the Physician Assistance Board, the Optometry Board, the Podiatric Board, and the Naturopathic Board. The $3.9 million would be split over the lifecycle of the development of the new database, which is currently estimated at two years. The contribution from each board would be determined by the number of schedule II through IV licensees within each respective board.

Staff recommends directing the Department of Finance to coordinate with the Department of Consumer Affairs to identify appropriate amounts for each respective board that either dispenses or prescribes controlled substances. The identified amounts should total approximately $3.35 million for fiscal years 2013-14 and 2014-15. The $3.35 million dollar figure takes into account the annual contribution of $296,000 provided to the DOJ to manage the CURES database from the Medical Board, Dental Board, Board of Pharmacy, Board of Registered Nursing, and the Osteopathic Board. The increased expenditure authority will support the development of an updated CURES database. Senate Budget Subcommittee No. 5 will recommend an increased reimbursement authority for the DOJ, so the funds can be distributed towards the modernization of the CURES database.

To ensure a higher level of participation by the end-user, which is comprised of the ten boards contributing to the development of a new CURES database, staff recommends including budget bill language that generates participation from the Department of Consumer Affairs during the development phase of the new CURES database. The proposed budget bill language should include that it is the Legislature's intent that the CURES database be jointly developed by the Department of Consumer Affairs and the Department of Justice in order to meet the needs of the boards funding the system. The language should also reference that, prior to any reimbursements being provided to the Department of Justice, an interagency agreement shall be reached between the Department of Justice and the Department of Consumer Affairs regarding the development and implementation of an upgraded CURES database and approval of a Feasibility Study Report by the Department of Technology.:

Staff Recommendation: Increase expenditure authority for the ten boards within the Department of Consumer Affairs, to total $3.941 million. This will take into account the current appropriation of $296,000 annually provided by Department of Consumer Affairs Boards for fiscal years 2013-14 and 2014-15. The actual augmentation will amount to $3.35 million over two budget years. Adopt proposed budget bill language.

Vote: Approve Staff recommendation 2-1

Issue 2 – California State Athletic Commission

Governor's Budget Request: The Governor's May Revise includes a request for the inclusion of budget bill language that would authorize the California State Athletic Commission (Commission) with up to $200,000 in order to adequately staff events and provide biannual Athletic Inspector training, as per Business and Professions Code § 18615.

Background: Senate Budget Subcommittee No. 4 has already taken action to reduce the commission's budget by $814,000. The reduction results in the commission's 2013-14 budget being revised to $1.19 million. Action taken by the committee was in response to lingering solvency concerns of the Athletic Commission Fund. The Commission has requested that language be included that provide for the Commission to meet the requirements of Business and Professions Code § 18615, which requires semiannual training of inspectors that are assigned to regulate events by the Commission.

Staff Comment: According to the Commission, the estimated cost of semiannually training of the state's inspectors is $155,000. The $200,000 augmentation would provide for the necessary funds for Athletic Inspectors at sporting events, or for the required semiannual athletic inspector training. The proposed budget bill language is below:

Item 1110-001-0326……

Provisions:

1. The amount appropriated in this item may include revenues derived from the assessment of fines and penalties imposed as specified in Section 13332.18 of the Government Code.

2. *Provided that sufficient funds are available and upon request by the Department of Consumer Affairs, the Department of Finance may augment this item by up to $200,000 not sooner than 30 days after notification in writing is provided to the chairpersons of the fiscal committees in each house of the Legislature and the Chairperson of the Joint Legislative Budget Committee. This augmentation shall only be provided for additional funding needed for Athletic Inspectors at sporting events or for Athletic Inspector training.*

Staff Recommendation: Staff has no issues with this request as it ensures compliance with Business and Professions Code § 18615 and ensures the fund will remain solvent. Adopt proposed budget bill language.

Vote: **Approve Staff recommendation 3-0**

1690 SEISMIC SAFETY COMMISSION

Governor's Budget Request: The Governor's May Revise includes a request via trailer bill language to establish the Seismic Safety Account within the Insurance Fund. The Seismic Safety Account would then be utilized, at the discretion of the Legislature, to fund Seismic Safety Commission related activities.

Background: The Seismic Safety Commission was originally created in 1975 and was supported by the General Fund. The Commission's mission is to investigate earthquakes, research earthquake related activities and recommend to the Governor and the Legislature policies and programs needed to reduce earthquake risk. Additionally, the Commission is responsible for managing *California's Earthquake Loss Reduction Plan 2007-2011.*

The Commission currently has one office that houses 6.4 positions and supports the Commissions activities including the bi-monthly meetings at various sites statewide. The use of the Insurance Fund for the Commission was designed to be a short term solution. However, the ongoing budget concerns in the state have forced the Commission to utilize the Insurance Fund as a more permanent source of funding.

Staff Comment: The Governor's January 2012-13 Budget included a request to fund the Seismic Safety Commission with direct support from the Insurance Fund. However, when reviewing the January submission to re-approve the use of the Insurance Fund as a funding source it was brought to the Legislature's attention that use of the Insurance Fund as originally structured by the Commission would be unconstitutional. Specifically, Article XIII, Section 28 (f) of the California Constitution specifies that, with limited exceptions, the state's insurance tax shall be in lieu of all other state and local taxes. This seismic safety assessment imposed on the gross receipts of insurers of commercial and residential properties is a tax under the provisions of Proposition 26.

The Commission, with technical assistance from the Department of Finance, has submitted a revision to their original request that would have the Department of Insurance calculate an annual assessment not to exceed $0.15 on commercial and residential property policy holders to be collected by insurers. According to Legislative Counsel the proposed trailer bill language does not raise the constitutional concerns referenced above but, in accordance with Proposition 26, is subject to a supermajority vote.

In addition to the proposed trailer bill is a request to loan $1.122 million General Fund to the Insurance Fund in order to support the costs associated with the operation of the Seismic Safety Commission for Fiscal Year 2013-14.

Staff Recommendation: Reject proposed trailer bill language. Approve $1.122 million direct appropriation from the General Fund to the Seismic Safety Commission for Fiscal Year 13-14 on a one-time basis. Remove budget bill language referencing General Fund under Department of Insurance budget item.

Vote: Approve Staff recommendation 3-0

2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

Issue 1 – Housing Element Review

Governor's Budget Request: The Governor's 2013-14 budget includes a request for $649,000 to fund five two-year limited-term positions from the Air Pollution Control Fund. This request is necessary to implement the state's only oversight role in reviewing and approving regional and local governments' housing land-use.

Background: State law requires each city and county to adopt a general plan containing at least seven mandatory elements, including housing. Unlike the other general plan elements, the housing element is subject to detailed statutory requirements and mandatory review by a state agency, the California Department of Housing and Community Development (Department). Housing elements have been mandatory portions of local general plans since 1969. This reflects the statutory recognition that housing is a matter of statewide importance, and cooperation between government and the private sector is critical to attainment of the State's housing goals.

In 2007, the Legislature enacted SB 375 (Chapter 728, Statues of 2007), which sought to help the state achieve greenhouse gas emission goals, outlined in AB 32 (Chapter 488, Statutes of 2006), by reducing vehicle emissions. SB 375 requires regional greenhouse gas reduction targets, requires regional agencies to prepare land use plans for the regions that will help achieve the greenhouse gas reduction targets (known as a Sustainable Communities Strategy), and provides incentives for high-density, transit-oriented housing projects.

SB 375 links, for the first time, regional planning efforts for transportation and housing. Under the bill, all transportation and housing planning processes are put on the same eight-year schedule; housing plans must be updated once every eight years, which will now align with two 4-year Regional Transportation Plan planning cycles. The single largest sector of greenhouse gas emitters are cars and light trucks. While greenhouse gas emissions can be reduced by creating more fuel efficient vehicles, it is also a necessity to reduce the number of miles traveled to achieve the state's standards. Specifically, SB 375 integrated and aligned planning for housing, land use, transportation and greenhouse gas emissions.

This change in timing will have a dramatic impact on HCD. Instead of receiving housing elements on a staggered schedule, SB 375 changes require that 85 percent of the state's 539 cities and counties will be submitting housing elements in calendar years 2013 and 2014. According to HCD, most jurisdictions submit a draft nine months prior to their due date. HCD spends, on average, 120 hours of staff time per element review. Further compounding time requirements spent on each jurisdictional review, is the fact that most local governments submit at least four drafts prior to final submission of an element review.

Staff Comment: HCD serves as the only state entity with the capacity to ensure that local governments are conforming to land-use strategies that will locate their higher density and infill housing closer to jobs, services and transportation modes. A reduction in overall vehicle trips and vehicle miles travelled are critical components of achieving Greenhouse Gas emission reduction targets. Furthermore, HCD's element review process supports removal of regulatory barriers implementing the streamlining, intended by SB 375.

Staff Recommendation: Approve as budgeted.

Vote: Item held open

7870 CALIFORNIA VICTIM COMPENSATION AND GOVERNMENT CLAIMS BOARD (VCGCB)

Issue 1 – Trauma Recovery Center

Background: The California Victim Compensation Program (CalVCP), administered by the VCGCB, provides compensation for victims who suffer physical or emotional injury, or the threat of physical injury, as a direct result of a violent crime. Crimes covered by the program include domestic violence, child abuse, sexual and physical assault, homicide, human trafficking, robbery, and vehicular manslaughter.

Subject to specified eligibility criteria, CalVCP compensates eligible victims for various crime-related expenses that are not covered by other sources. Services covered include medical and dental care, mental health services, income loss, funeral expenses, home security, rehabilitation and relocation. Funding for the program is provided by the Restitution Fund, which derives its revenue from restitution fines and orders, diversion fees, and penalty assessments levied on persons convicted of crimes and traffic offenses. CalVCP also receives federal grant monies from the Victims of Crime Act (VOCA).

In order to receive compensation, victims must apply and provide specified documentation. The waiting period to receive indication of application for compensation has been documented to take up to three months or more to receive.

Staff Comment: The subcommittee may want to consider expanding the TRC model, which has been very successful at providing victim's services more cost effectively than individual reimbursements to victims for seeking their own mental health and medical services. In addition to the cost containment for each individual victim that occurs when TRC as the provider is paid by VCGCB (because it seeks to serve as many people as possible, as opposed to a victim potentially incurring more expensive services elsewhere), the TRC has served many more victims in need of mental health services than the entire panel of San Francisco fee-for-service providers. The TRC provides services more efficiently, and is able to reach more people (which often mitigate cost savings).

Staff Recommendation: Adopt draft trailer bill that establishes a grant program to be administered by the Victim Compensation and Government Claims Board (VCGCB) which will provide for the creation and funding of Trauma Recovery Centers (TRCs) across the state. Increase expenditure authority for the VCGCB by $2.0 million for the administration of the grant program.

VOTE: **Approve Staff recommendation 2-1**

8955 CALIFORNIA DEPARTMENT OF VETERANS AFFAIRS (CDVA)

Issue 1 – Central Coast Veterans Cemetery at Ford Ord

Background: In 1991, Fort Ord was announced for closure by the United States Base Realignment and Closure Commission. Upon closure, the Fort Ord Reuse Authority (FORA) Base Reuse Plan was established to oversee the process of converting the land from military to civilian use. FORA set aside 178 acres for a veterans cemetery. Legislation enacted in 2006 (AB 3035 Laird, Chapter 291, Statutes of 2006), created an endowment fund to allow local veterans to raise money to finance the initial planning and design process, as well as the ten percent matching funds, required by the U.S. Department of Veterans Affairs (USDVA), for beginning the construction project. The balance of the construction costs will be repaid through reimbursements by the USDVA. Public Law 105-368, which went into effect in 1999, authorized USDVA to provide up to 100 percent of the development cost for an approved project.

August 15, 2013 is the federally-imposed (USDVA) deadline for the state's grant application, including a certification of matching funds signed by a senior state official. In order to achieve this deadline, approximately $2.5 million is needed in the Endowment Fund in early July for the Department of Finance to approve the project, per statute requirements.

Staff Comment: There is existing authority (Chapter 22, Statutes of 2011) for the endowment fund to transfer funds, when available, from the endowment fund to the operation fund for the purposes of completing the preliminary plan phase of the capital outlay project. However, there is no cash in the endowment fund available for transfer. While the intent has been for the local community to raise the necessary funds, the economic situation, existing since at least 2006, has preempted options available to the community to raise funds for the endowment. In order to move forward, an option needs to be developed that will provide the cash to proceed with planning, while maintaining the initial intent that this project have no General Fund impact.

Staff Recommendation: Staff recommends including the following language in the Budget Act of 2013.

> *8955-011-0001—For transfer by the Controller, upon order of the Director of Finance, from the General Fund to the California Central Coast State Veterans Cemetery at Fort Ord Endowment Fund ……... 2,500,000*

Provisions:
1. The funds appropriated in this item shall be reimbursed by the California Central Coast State Veterans Cemetery at Fort Ord Endowment Fund from the proceeds of any construction grant received from the State Veterans Cemetery Construction Grant Program for the purposes of constructing the California Central Coast Veterans Cemetery.

2. Funds shall be reimbursed to the full extent of the grant award no later than 24 months after construction is completed.

3. The Secretary of Veterans Affairs shall report annually, by January 10 of each year, commencing on January 10, 2015, to the Director of Finance, the Chairperson of the Joint Legislative Budget Committee, and the chairpersons of the fiscal committees of each house of the Legislature on all expenditures made pursuant to Provision 1 to include progress on reimbursing the General Fund pursuant to Provision 2.

The proposed budget bill language will provide the Fort Ord Endowment Fund with the necessary funds to begin the construction of the California Central Coast Cemetery. Budget bill should include spending authority related to this project. The funds are expected to be repaid in full by the U.S. Department of Veterans Affairs.

Vote: Approve Staff recommendation 3-0 and include further provisional language that provides the state with control of operations of the facility

Issue 2 – Conversion of Skilled Nursing Facility to Domiciliary Care at West Los Angeles Veterans Home

Governor's Budget Request: The Governor's May Revise includes a request for a reduction of 35.6 positions and $3.2 million General Fund in 2013-14. The reduction will total 67 positions, and $5.1 million ongoing, to accurately reflect the conversion of two units in the West Los Angeles home from skilled nursing to domiciliary care.

Background: The West Los Angeles facility was originally designed and constructed to provide 396 beds, consisting of 84 residential care facility for the elderly and 313 skilled nursing facility level of care beds. The proposal will result in a reduction of 84 skilled nursing facility level of care beds and will result in a total of 228 skilled nursing facility beds at the West Los Angeles home.

Currently, there are no domiciliary level of care beds available for the estimated 676,219 veterans in any of the greater Los Angeles area veterans homes. This proposal will also provide the estimated 9,419 homeless veterans in the region with some form of either long-term care or supportive housing.

Staff Comment: As of April 4, 2013, there were 65 residents approved for admission in the Skilled Nursing Facility. The scheduled reduction in skilled nursing beds would not displace any veterans at the facility and would provide veterans, in need of a home, with a bed that has a respectable level of privacy. Furthermore, the conversion of the skilled nursing beds into domiciliary level of care units, would be in alignment with both federal and state goals. Governor Davis issued Executive Order D-53-02, which addressed the need for greater resources to support the state's homeless veterans population.

Staff Recommendation: Adopt proposed May Revise request.

Vote: **Approve Staff recommendation 3-0**

Issue 3 – Veterans Claims and Rights

Background: In California, both the state Department of Veterans Affairs (Cal Vet) and County Veterans Service Offices (CVSOs) work to assist veterans in receiving federal benefits they are owed, including medical care, education, burial, and compensation and pension benefits. According to internal USDVA documents obtained and published by the Center for Investigative Reporting, California veterans filing claims for the first time face extremely long waits before their claims are processed. This can lead to disabled veterans suffering from severe health issues, unemployment or other problems waiting more than a year for federal assistance.

The table below shows the average processing times for the three USDVA offices in California and the national average. Nationally, it is taking nearly one year to process new claims; and in two of California's offices, the processing time is closer to two years.

Office	Average Processing Time - Days
Los Angeles	619.4
Oakland	617.8
San Diego	283.3
National Average	349.6

Some states have sought to address the USDVA's claims backlog. Texas, for example, has committed $1.5 million to create "State Strike Force Teams" to work with federal officials in processing requests for claims. The teams consist of claims counselors who work inside federal veterans offices to help expedite claims' processing. The state has signed a Memorandum of Understanding with the federal government to allow the strike force teams to work with USDVA officials. Between July and 2012 and January 2013, the state workers assisted more than 10,000 veterans whose claims were stuck in the backlog and forwarded 2,950 cases to the federal government for approval.

Cal Vet provided a plan to the subcommittee last week, although the plan was not included in the Governor's May Revise. The plan includes:

- California Veterans Service Representative Academy. Cal Vet proposes to conduct several week-long workshops across the state to better train CVSOs and others who assist veterans in accessing claims. Training will include curriculum related to handling more complicated claims, including assisting veterans with Post-Traumatic Stress

Disorder, Traumatic Brain Injury and Military Sexual Trauma. Cal Vet states that it has restructured some administrative costs that allow it to conduct these trainings without new funding.

- Strike Teams. Cal Vet states that it has held discussions with the federal VA offices in Oakland, Los Angeles and San Diego regarding a limited-term collaboration that would allow state employees to work in regional offices to address the California backlog. The department's plan would be to deploy two employees to each office, with one addressing backlog issues and one working to ensure that new claims coming in to the federal office have been properly developed. The department states that it intends to hire individuals with claim filing or adjudication experience so that little new training is required. The department also notes that these new state workers currently could only assist on claims developed by CVSOs or the state; claims developed by other veterans organization such as the American Legion and Veterans of Foreign Wars could not be addressed. Thus the department proposes to work with those groups to enter into agreements that would allow the state employees to assist with those claims as well.

Staff Recommendation: Provide $500,000 General Fund and six three-year limited-term positions to the CDVA to establish strike teams that will assist in alleviating the current number of claims backlogged at the USDVA. CDVA may utilize additional General Fund resources if any General Fund savings materialize from this effort during the 2013-14 Budget Year. In addition, require the department to prepare a report due March 1, 2014, and annually for the next two years, to describe the implementation of this plan and its outcomes.

Vote: **Approve Staff recommendation 3-0**

California State Senate

MEMBERS:
TOM BERRYHILL
NORMA TORRES

CONSULTANTS:
MARK IBELE
BRADY VAN ENGELEN

(916) 651-4103

COMMITTEE
ON
BUDGET AND FISCAL REVIEW
SUBCOMMITTEE NO. 4 ON
STATE ADMINISTRATION AND GENERAL GOVERNMENT

ROOM 2054, STATE CAPITOL
SACRAMENTO, CA 95814
(916) 651-4007

SENATOR
RICHARD D. ROTH
CHAIR

OVERSIGHT HEARING

State Controller's Office
Thursday, August 15, 2013
State Capitol, Room 112
Upon Adjournment of Session

- Chair, Senator Richard Roth
- Vice Chair, Senator Tom Berryhill

AGENDA
Introductory Remarks

History/Overview of the 21st Century Project

Legislative Analyst's Office

- *Chas Alamo*, Consultant
- *Lourdes Morales*, Consultant

California State Controller's Office

- *Lisa Crowe*, Chief, Personnel and Payroll Services Division
- *Tony Davidson*, Project Director, 21st Century Project
- *Jim Lombard*, Chief Administrative Officer
- *Jan Ross*, Chief Information Officer
- *Tom Yowell*, Chief, Administration and Disbursements Division

California Department of Technology

- *Carlos Ramos*, Secretary, Department of Technology

**State of California Task Force on
Re-Engineering IT Procurement for Success**

- *Dr. Rosio Alvarez*, Chair
- *David Kraus,* Member

Public Comment

Closing Comments

Attachments

- Committee Background
- LAO Background on the 21st Century Project
- 21st Century Project timeline
- 21st Century Project Summary Chart

Background on the 21st Century Project

Background: The State Controller's Office (SCO) is responsible for the payment of salaries and wages to approximately 294,000 employees, including state civil service, California State University and Judicial Council employees, judges and elected officials. The payroll system currently utilized by the SCO is a legacy system developed in the 1970s. The need for an updated payroll system was underscored by the decreasing number of information technology personnel that could understand the language utilized to develop and/or modify this antiquated system. In 2004, the SCO identified a solution that would integrate different components of the existing statewide human resources management system. The intent was to improve management processes and fulfill payroll and reporting obligations in a timely fashion. The project to replace the outdated software platform was defined in a Feasibility Study Report (FSR) as the 21st Century Project. In 2005, the Legislature approved the project with an estimated total cost of $130 million.

Originally, the SCO utilized a two-phased procurement process. One vendor would provide the software package and another vendor would be responsible for system integration. In April 2005, SAP Public Services was selected to provide the software package. The software package was sold as commercial-off-the-shelf (COTS). The second vendor (primary vendor) was to integrate the software package to meet the business needs of the state. BearingPoint was awarded the primary vendor contract as the system integrator.

Shortly after awarding the prime vendor contract to BearingPoint, the SCO identified a number of issues related to the work product of BearingPoint. BearingPoint countered that the software platform was designed to meet the requirements, as specified in the contract. In October 2007, SCO issued a breach-of-contract notice to BearingPoint. A resolution was finally agreed to, however, the 21st Century Project was now delayed significantly and the estimated overall project cost had risen to $180 million. On January 6, 2009, SCO formally terminated the prime vendor contract with BearingPoint and the prime vendor related workload related to the 21st Century Project came to a halt. One of the primary driving forces for the termination of the prime vendor contract with Bearing Point was the inability to develop accurate, reliable data conversion programs, scripts and computer instructions that would allow the new SAP software to incorporate and use all of the historical data stored in the SCO's legacy system.

In May 2009, the third Special Project Report (SPR) was released and the scope of the project had changed to no longer include the 54,000 employees at the California State University payroll system. The legacy system would still manage payroll disbursement for CSU employees until a revised system for CSU employees was fully developed. The SCO cited the lower amount of risk and complexity that would be associated with the project since the 21st Century Project now did not include the payroll processing of CSU employees. Overall project cost estimates were reduced to $126 million and the project completion date was estimated to be June 2010.

The Department of General Services (DGS), which then served as the state's lead IT procurement entity, issued a Request for Proposal (RFP) in March 2009 for a new system integrator. At this point, SCO and DGS utilized a multi-stage procurement process, with Stage consisting of (1) the selection of contractors to evaluate work done to date, and, (2) gaining a better understanding of workload requirements. Two vendors qualified in Stage I (Accenture and SAP) and again only two vendors submitted bids in Stage II. The contract was awarded to SAP in February 2010, and project costs and timeline estimates were revised. Project costs were upwardly revised to $305 million and the final implementation date was set to be September 2012.

Upon the contract being awarded to SAP, an implementation schedule was established. The project would be rolled out in five phases. Pilots I and II would be a limited rollout impacting only a small number of state employees. Subsequent waves I, II, and III would integrate more employees into the software platform on a graduated scale of complexity. Pilots I and II were to convert 15,000 state employees to the new MyCalPays user system in 2013. Wave III would follow shortly thereafter and convert another 74,000 state employees to the MyCalPays system. Waves IV and V were 85,000 and 65,000 individuals respectively and were set to be transitioned to the MyCalPays system during the 2014-15 fiscal year.

Data conversion continued to represent a significant challenge for the vendor, and project management staff issued a cure notice in August 2011 to SAP as the primary vendor. The cure notice specified that various issues surrounding data conversion would need to be addressed. SCO representatives made no mention of the cure notice before a Little Hoover Commission oversight hearing related to the progress of the 21st Century Project, nor was it mentioned in the September 2011 progress report issued quarterly to the Legislature. In response to the first cure letter, the primary vendor, SAP, agreed to hire a subcontractor (BackOffice Associates) to manage the data conversion component of the contract. SCO seemed satisfied with the agreement reached regarding hiring a subcontractor to manage the data conversion component and approved continuation of the project.

In June 2012 SCO began the implementation of Pilot I. Pilot I was designed to be a small scale rollout; producing payroll, benefits, timekeeping, and regular disbursement related activities for SCO's 1300 employees. The small number of employees in Pilot I was by design, and would afford the SCO and the vendor the opportunity to address any defects prior to progressing. However, the sheer scale and impact of the defects was unanticipated. For example, pay was incorrectly deducted from SCO staff and, in some cases, medical benefits were denied to staff and dependents. Attempts to correct the issues identified by SCO staff further compounded issues in the subsequent payroll cycle and the SCO chose to delay the implementation of Pilot II in order to address the defects. Pilot II was initially delayed until March 2013.

The SCO issued a second cure letter to SAP on October 25, 2012. The cure letter raised issue with the resources SAP put forward to address the defects and questioned SAP's ability to successfully implement the system. SCO identified thirteen separate points of contention with the vendor and requested that the issues be addressed prior to November 30, 2012, and prior to the contract moving forward. In its response to the cure notice, SAP did not assume responsibility for the issues identified and, according the SCO, did little to correct any of the grievances raised by the SCO's cure letter.

SAP's contract to provide system integration for SAP software was terminated by the SCO on February 8, 2013, and the California Technology Agency has suspended the 21st Century Project until further notice. As of January 1, 2013, total project costs were estimated to be $255 million, and overall costs project at full implementation were estimated to be $371 million. The total amount spent on the 21st Century Project is nearly triple the original estimates as identified in the May 2004 Feasibility Study Report (FSR). General Fund contributions for the 21st Century Project have totaled $180 million. The SCO has returned to its legacy payroll disbursement system that it had used prior to the failed rollout of MyCalPays.

LAO
70 YEARS OF SERVICE

August 15, 2013

State Controller's Office: 21st Century Project

LEGISLATIVE ANALYST'S OFFICE

Presented to:
Senate Budget and Fiscal Review Subcommittee No. 4
On State Administration and General Government
Hon. Richard Roth, Chair

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Project Description and Budget

☑ What Is the 21st Century Project?

- The 21st Century Project (TFC) is an information technology project that would replace existing human resources and payroll management systems with a single statewide system.
- The existing systems are old and inflexible, cannot meet the needs and demands of the state, and are at risk of failure.
- The new system, to be called MyCalPAYS, would improve payroll, benefits administration, and timekeeping and include self-service access by employees and managers, among other capabilities.

☑ 2013-14 Budget

- The *2013-14 Budget Act* includes $14.6 million ($11.9 million General Fund) in 2013-14 for:
  - Reconciliation to ensure State Controller's Office (SCO) employees and vendors received accurate payments and information during the pilot period.
  - Archive the pilot system for record-keeping purposes.
  - Prepare for contractually mandated mediation and potential legal proceedings with SAP Public Services, Inc. (SAP).
- The budget limits funding for these activities to the first two months of the fiscal year—$2.4 million ($2 million General Fund)—which correspond with this legislative oversight hearing.
- Funding for the remainder of the fiscal year—$12.1 million ($9.9 million General Fund)—will be available no sooner than September 1, 2013, pending this legislative oversight hearing.

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Project Description and Budget *(Continued)*

☑ **Project Expenditures**

- At the time of the contract termination, the state had spent $262 million of the $373 million estimated total project cost.

Project Timeline and Status

☑ **Timeline**

- **May 2004**—The Department of Finance approves the TFC project's Feasibility Study Report and the project begins. The estimated cost of the project is $130 million and full implementation is scheduled for July 2009.
- **April 2005**—The TFC project procures the SAP software solution for the new system and begins a second procurement for an integration vendor to design, develop, and deploy the solution.
- **June 2006**—The TFC project contracts with BearingPoint, the winning integration vendor.
- **October 2007**—Following multiple schedule delays, the TFC project issues a breach-of-contract notice to BearingPoint. The system integrator and the TFC project go on to reach a plan to address project challenges and integration continues.
- **May 2008**—Estimated cost increases to $180 million while full implementation is extended to June 2010.
- **January 2009**—After experiencing serious vendor problems, the state issues a notice of default to BearingPoint and terminates the contract.
- **February 2010**—After completing a second vendor procurement, the TFC project contracts with SAP to complete the new system. With the start of the SAP system integration contract, the TFC project updates its costs and schedule to $283 million and October 2012.
- **Spring 2011**—Initial data conversion tests between the state's existing payroll system and the new system are problematic. The TFC project staff identify additional implementation challenges.

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Project Timeline and Status *(Continued)*

- **August 2011**—The TFC project issues the first cure notice to the new system integrator, SAP, requiring SAP to improve data conversion, among other requests. The SAP subcontracts with BackOffice Associates to remedy the cure notice, and the project continues.
- **November 2011**—The TFC project staff and SAP review data conversion and replan timeline, delaying the first pilot test by nine months. The TFC project updates its cost estimate to $373 million and extends the project to September 2013.
- **June 2012**—Pilot 1 goes live, processing payroll for 1,400 SCO employees.
- **August 2012**—The TFC project staff report significant errors during the go-live payroll, including overpayments, incorrect deductions, and leave balance discrepancies. Staff tentatively delay Pilot 2 from September to March 2013.
- **October 25, 2012**—The TFC project issues a second cure notice to the system integrator, SAP, requiring SAP to increase personnel on the project, reschedule project milestones, and stabilize the software so that the subsequent deployments of the system (Pilot 2 and Waves 3, 4, and 5) may go forward, among other requests.
- **November 30, 2012**—The SAP issues its response to SCO's cure notice, denying responsibility for the Pilot 1 payroll inconsistencies and timeline delay. In addition, project staff indicate that SAP denies that their actions breach the original vendor contract.
- **February 8, 2013**—The SCO terminates its vendor contract with SAP and returns Pilot 1 employee payroll to the existing payroll system. At the same time, the California Technology Agency suspends the TFC project, citing the vendor's failure to finish the project and unwillingness to remedy the issues SCO presented in the cure notice.

Project Timeline and Status *(Continued)*

- **March 2013**—The SCO begins efforts to run parallel payrolls on the new system and the existing system to identify inaccuracies in the previous eight months of payroll (the period the new system was operational) and ensure that no pay or benefit discrepancies are left unresolved, a process referred to as reconciliation.

- **June 2013**—Contractually mandated mediation between SCO and SAP begins.

☑ Current Status

- The TFC project is reconciling payroll by comparing the pay and benefits processed using the new system to what employees should have been compensated using data from the existing system as a comparison point. This effort is expected to be complete by January 2014.

- The TFC project is also engaged in contractually mandated mediation.

Project Timeline

July 2003 – State chief information officer approves feasibility study for nation's largest payroll/human resources modernization to be known as the 21st Century Project.

May 2004 – Department of Finance approves feasibility study. Project begins with initial cost estimate of **$132 million** and **mid-2009** completion date.

April 26, 2005 – Project contracts with SAP Public Services, Inc. for software, begins search for "integration vendor" to design, develop and deploy the software.

June 2006 – Controller Steve Westly signs contract with BearingPoint to serve as system integrator.

January 2007 – John Chiang sworn in as new State Controller. Replaces Steve Westly.

Oct. 19, 2007 – SCO issues "cure notice" to BearingPoint, declaring the system integrator in breach of contract and threatening termination.

Oct. 26, 2007 – BearingPoint responds with letter indicating that SCO is responsible for the project's delays and cost over-runs.

May 2008 –SCO, Department of General Services and BearingPoint agree to "rebaseline" the project, adding twelve months to the schedule. Cost increases to **$179 million**, completion date pushed back a year, to **June 2010**.

January 2009 –SCO terminates BearingPoint contract.

February 2010 – Project restarts with SAP as system integrator, and is rescaled to eliminate California State University's 54,000 employees from project. Cost increases to **$305 million,** completion date pushed back two more years, to **September 2012**.

Spring 2011 – Data conversion difficulties and other serious implementation issues emerge.

May 18, 2011 – SCO initiates "problem escalation process" for SAP's alleged failure to resolve "contractually material issues."

August 19, 2011 – SCO sends "cure notice" to SAP identifying primary problem as stalled data conversion.

Aug. 21, 2011 – SAP cure notice response notes "disagreement between SAP and the SCO as to the contractual responsibility for data conversion."

Aug. 25, 2011 – Little Hoover Commission oversight hearing includes progress report on 21st Century Project. No mention of Aug. 19 cure notice.

Sept. 1, 2011 – Previously scheduled "go live" date can't be met and is pushed back to March 2012.

Sept. 7, 2011 – SCO and SAP enter into confidential negotiations to resolve differences outlined in the August cure notice and SAP's response.

Nov. 17, 2011 – Confidential negotiations between SCO and SAP yield a 39-page settlement agreement to resolve most differences and continue project with significantly higher state costs.

March 2012 – SCO requests an additional $179 million, pushing the project's cost to **$373 million.** Completion date pushed back another year, to **September 2013.**

June 11, 2012 – Pilot1 goes live with SCO's 1,300 employees, but numerous payroll check errors are noted by SCO.

Aug. 9, 2012 – Pilot 2, incorporating another 15,000 state employees and scheduled to start September 1, is postponed indefinitely because of recurring errors in Pilot 1.

Oct. 25, 2012 – SCO sends "cure notice" to SAP, initiating contract termination, and indicating "SAP's breaches span the entire breadth of the contract from the project planning and project implementation, to the execution of the plans, and finally to the results."

Nov. 30, 2012 – SAP response to cure notice states it "…has not breached the contract in any material respect and cannot be terminated for default."

Feb. 5, 2013 – SAP issues demand for mediation to resolve project disputes.

Feb. 8, 2013 – SCO terminates the contract with SAP Public Services. At the same time, CTA suspends the project.

21st Century Project Action Summary

Action	Date of Approval by CTA	Amount Requested (millions)	Change from original request (millions)	Expected Implementation Date	Phase (Primary Vendor)	Background
FSR	May 14, 2004	$132	n/a	2009	BearingPoint	Project to replace the legacy system used to pay 294,000 state employees.
SPR 1	April 11, 2004	$138	$6	6/2009		SPR adjusts project costs to reflect the procurement of BearingPoint as system integrator and SAP as software.
SPR 2	May 12, 2008	$179	$41	6/2010		SPR 2 extends project timeline due to data conversion issues discovered during early phases of project. Resolution between SCO, DGS and Bearing reached.
SPR 3	May 27, 2009	$126	$(-53)	6/2010	n/a	SPR 3 addressed project restart, which was necessary after terminating BearingPoint contract. Project scope changed – CSU employees removed.
SPR 4	December 16, 2009	$305	$179	9/2012	SAP	SPR 4 reflects SAP as the system integrator. Project costs increased reflecting change in project methodology and use of additional tools.
SPR 5	March 9, 2012	$371	$66	9/2013		SPR 5 required after encountering significant issues with data conversion. Data migration vendor brought onto project.

Crash Course:
Failure to heed early warnings, troubles of the past contributed to payroll system collapse

A report prepared for Senate Budget and Fiscal Review Subcommittee No. 4, Senator Richard Roth, Chair

August 12, 2013

Prepared by Jim Sweeney and Dorothy Korber

California Senate Office of Oversight and Outcomes

John Adkisson
John Hill
Saskia Kim
Dorothy Korber
Jim Sweeney

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Executive Summary

When state Controller John Chiang terminated the contract for a new state payroll system on Feb. 8, 2013, California was left with little to show for a project that burned through more than a quarter of a billion dollars over 10 years.

Unlike other big state computer failures, the 21st Century Project collapsed not once, but twice, despite multiple layers of oversight designed to spot trouble early and keep the complex and massive undertaking on track.

A review of hundreds of pages of documents and interviews with many of those involved show the project suffered from lapses in due diligence, a failure to resolve core issues raised early and often, chronic turnover in leadership and what may have been unrealistic expectations.

At the same time, the Senate Office of Oversight and Outcomes found a lack of candor at times with the Legislature about the project's difficulties. At some of its darkest moments, the State Controller's Office (SCO) delivered upbeat reports to legislators that only hinted of the turmoil churning within the project.

System Error:

It will be difficult to determine, if anyone ever does, exactly what doomed the project, the largest payroll modernization in the nation. The system was designed to take over human resources and payroll responsibilities for 240,000 state employees. At the end, the project had nearly tripled in cost, to $373 million, and was years behind schedule.

The expensive misadventure has once again left many wondering why – in a state that has given the world Google, Apple, Facebook and Twitter – California consistently struggles to modernize its own public computer systems.

It will be difficult to determine, if anyone ever does, exactly what doomed the project, the largest payroll modernization in the nation. The new system was designed to take over human resources and payroll responsibilities for 240,000 state employees. By the time the last contract was cancelled, the project had nearly tripled in cost, to $373 million, and was years behind schedule.

Yet the software provider and prime contractor, SAP Public Services, Inc., argues that it is unfair to call the project's demise a failure. The global information technology company was pushing at the end to plow ahead – despite persistent errors with an initial live pilot – with a second, larger roll-out.

The Controller's Office and SAP blame each other for the project's collapse, with the dispute expected to be settled in court. As much as $190 million may hang in the balance – up to $135 million the state hopes to recover and $55 million that SAP believes it is owed, according to the Legislative Analyst's Office.

The expensive misadventure has once again left many wondering why – in a state that has given the world Google, Apple, Facebook and Twitter – California consistently struggles to modernize its own public computer systems.

The Senate Office of Oversight and Outcomes was asked to examine not the technical details, but where the planning and management process may have failed. As such, this report compiles information gathered for an oversight hearing by Senate Budget and Fiscal Review Subcommittee 4, chaired by Sen. Richard Roth, D-Riverside.

While the state has had a number of high-profile IT failures, the 21st Century Project stands out because it has now skidded off the rails twice. Moreover, unlike some other failed projects, such as the digital consolidation of court records, overhauling the state's human resources and payroll computers is not optional. The existing, Vietnam War-era system is maintained and operated by a dwindling number of retirement-age specialists who still understand the outdated computer language. The original feasibility study warned the existing system needed to be replaced as soon as possible. That was more than 10 years ago.

The Controller's Office issues $1.2 billion in payroll checks every month. Should the existing system crash, the Controller's staff said all of the necessary data is stored in a backup system that could reproduce the state's payroll. That has never happened, so it is unknown how disruptive it might be.

"I think everyone knows that at some point, that payroll system is going to blow up for good," warned Vince Brown, who was involved in the early stages of the project as chief operating officer under former state Controller Steve Westly.

Conceived in the late 1990s, the 21st Century Project was launched in July 2003 with a feasibility study for a new payroll system for 294,000 state employees, which included the California State University workforce. The system, named MyCalPAYS, was expected to modernize and improve management of payroll and benefits administration while offering self-service access, much like the state's MyCalPERS system.

In April 2005, the Controller's Office signed a contract with SAP for off-the-shelf software that would be customized to meet the state's needs. A year later, the SCO hired BearingPoint Inc. to serve as the system integrator, the prime contractor. The $132 million project was to be finished by June 2009.

Before work began, however, there were troubling reports about another SAP payroll system newly installed at the Los Angeles Community College District. In July 2005, just three months after the state purchased its SAP software, LACCD officials were publicly describing their transition to an SAP payroll system as "horrific."

Eighteen months later, in January 2007, the Los Angeles Unified School District experienced similar results when it transitioned to a new SAP payroll system. The fiasco paralyzed Los Angeles Unified for nearly a year as administrators scrambled to correct thousands of paychecks and stabilize the payroll.

At the time, the Controller's staff issued public assurances that they were aware of what had happened at the nation's largest community college district and second largest K-12 district, and would make sure the state's new payroll system would not suffer a similar fate. The SCO said it dispatched a team to review what happened in Los Angeles, but it's unclear how thorough that review was. When the Senate Oversight Office asked for documentation, the SCO could find no report or memo detailing the team's findings or recommendations.

While SAP enjoys a reputation as a global leader in payroll and human resources systems, IT specialists told the Senate Oversight Office that its off-the-shelf software was designed largely for private sector clients, whose payroll and HR systems are much different and much simpler than the state's, which has 160 departments and 21 different labor or bargaining units.

The Controller's project team noted that the state used a different system integrator – BearingPoint – than the Los Angeles Community College District and Los Angeles Unified. As the prime contractor, the system integrator does the hardest work, customizing the software as necessary to build the new system.

In October 2007, as Los Angeles Unified continued to grapple with its payroll, the Controller's Office served notice that its project also was in serious trouble. State attorneys sent a "cure notice" and breach of contract warning to BearingPoint. After an attempt to regroup and restart the project, BearingPoint was fired and the project was suspended in January 2009. BearingPoint later filed for bankruptcy.

The project was restarted in February 2010 with the SAP software and SAP under contract as the new system integrator. The estimated cost had more than doubled to $305 million and the completion date was extended more than three years, to September 2012. The CSU system also had been dropped from the project, reducing the payroll by 18 percent, from 294,000 to 240,000 employees.

Eighteen months later, in August 2011, the Controller's Office issued another cure notice, this time to SAP, threatening to cancel the contract unless a number of issues were resolved. The biggest problem was a failure to complete data conversion, a process to enable the transfer of employee data from the legacy computers to the new system. Data conversion difficulties had dogged the project from the beginning.

In a telling response, SAP agreed to address the SCO's concerns, but noted: "As you are well aware, there is a disagreement between SAP and SCO as to the contractual responsibility for data conversion." Thus, more than eight years into the project, the state and its vendor were haggling over a core responsibility that should have been clearly assigned in the contract. The dispute was resolved during two months of confidential negotiations, after which the state agreed to pay an additional $15 million to bring in a data conversion specialist.

Less than a year later, in October 2012, the SCO issued a second cure notice to SAP and both sides began bracing for a legal fight over who would pay for a project on the brink of collapse. When SAP issued a demand for mediation on Feb. 5, 2013, the SCO terminated the contract three days later.

The October 2012 cure notice revealed what looks to be another significant lapse in due diligence. Nine years into the project, the letter questions whether SAP has the ability and experience to deliver such a large payroll conversion.

The sudden collapse of the project caught legislators, as well as some budget and policy analysts, by surprise. Some have since questioned whether the SCO was completely candid with the Legislature about the project's status.

The Senate Oversight Office found that in August 2011, SCO representatives told the Little Hoover Commission that the project was proceeding as planned and was in the midst of rigorous testing. What the project's leadership didn't tell the commission – which includes two legislators – was that the Controller's Office six days earlier had issued a cure notice threatening to cancel the project. Similarly, in its quarterly report to the Legislature a month later, the Controller's Office did not mention the August cure notice.

When the second cure notice was issued in October 2012, legislative analysts said they did not find out about the startling development until days or weeks later. One said he first learned of the cure notice "through the rumor mill."

A review of independent oversight reports that tracked the project also shows that key issues – such as the state's payroll complexity, the need to prepare existing staff for the new system, project staff vacancies and data conversion difficulties – shadowed the project from the outset. Many of those same issues continued to be cited in oversight reports during the summer and fall of 2012 as the project foundered.

The failure to resolve major issues identified early on may reflect a lack of ownership and frequent turnover at the top of the project team. Controller John Chiang inherited the 21st Century Project from former Controller Steve Westly in 2007. Westly had inherited it from former Controller Kathleen Connell. If it is resurrected, it will likely be under a fourth controller. Term limits will force Chiang from the office after next year.

In addition, documents show that over the past decade the SCO's team had at least five different project directors and four different project managers. Over the final 18 months alone, it had three project directors and two project managers. The IT vendors, SAP and BearingPoint, also changed their project team leaders, although that is more difficult to track.

As a result of the many changes at the top, the independent overseers who raised concerns about payroll complexity, staff training, chronic vacancies, data conversion and other risks often were taking up those issues with an ever-changing audience – a new project director, or a new project manager, either of whom might be working for a new controller.

Finally, the independent oversight reports issued repeated warnings that the state was asking for more customization than perhaps it should from software sold as a an “off-the-shelf” product not designed to undergo extensive modification. One veteran state IT specialist said it’s not uncommon for IT vendors to promise more than they might be able to deliver in such modifications. But the Senate Oversight Office found broad agreement that the more a client attempts to modify commercial off-the-shelf software, the greater the degree of difficulty and likelihood of failure.

In the end, the project’s leadership also failed to heed repeated warnings throughout the final year about the adequacy of testing designed to identify and fix mistakes before the first payroll was issued on July 1, 2012.

“Lack of quality in testing may result in MyCalPAYS errors and … in employees not receiving correct pay,” a March 2012 oversight report declared. The warning proved prescient.

(This report focuses on just one project and should not be construed to infer that any of the problems cited are similar or dissimilar to those experienced by other projects. In addition, the report refers frequently to the California Technology Agency, which existed until June 30, 2013, when it was reconfigured as the Department of Technology. Similarly, CTA officials interviewed or referenced for work done while employed by the former agency are identified by their CTA positions.)

Missteps and Lessons Not Learned

On Feb. 8, 2013, when state Controller John Chiang cancelled a contract to build a new computer system to take over the state's 240,000-employee payroll, he suspended a $373 million project that has been in the works for more than a decade.

The State Controller's Office (SCO) had been planning the project since at least 1999, when it concluded the state's aging computer system needed to be replaced as soon as possible. Introduced in the early 1970s, the legacy system is based on dated computer language understood by a dwindling number of aging computer technicians.

At the end of a long planning process, the SCO signed a contract in April 2005 with SAP Public Services, Inc. for off-the-shelf software that would be customized to accommodate the state's needs. At the same time, the SCO began the search for a system integrator to modify and deploy the software.

SAP is a global leader in providing payroll and human resources software. But many of its clients are private sector firms with payroll systems that are simpler than those of government agencies. Few payrolls – public or private – are believed to be as complicated as California's, which maintains historic data for roughly 300,000 employees in 160 departments with 21 different labor or bargaining units.

The Controller's Office and SAP said several states – Maryland, North Carolina, Pennsylvania and South Carolina – have successfully converted to SAP systems. But the SCO's project team said recently that it was unsure whether any of those states have payrolls as complex as California's.

About the time the Controller was shopping for payroll software, several other public employers were experiencing major problems with new SAP systems. Three months after the state purchased SAP software, the Los Angeles Community College District – the nation's largest community college district – was sounding an alarm over its new SAP payroll system.

The district's July 2005 changeover to an SAP system was "horrific," according to the district's payroll manager.

Three months later, on Oct. 4, 2005, Los Angeles Unified School District signed a $95 million contract for SAP payroll, financial management and procurement software to be modified and integrated by Deloitte Consulting.

On Oct. 6, 2005 – just two days after LA Unified signed its SAP-Deloitte contract – the Irish Health Service gave up on two SAP systems, one of which was to handle payroll and related systems for 120,000 employees, half the size of the state's payroll. The Irish Health Service's SAP payroll system had been expected to take three years and $10.7 million to complete. It was scrapped 10 years and $180 million later.

LA Unified, the nation's second largest school district with nearly 100,000 employees at the time, began using SAP software for payroll in January 2007. The results were disastrous, with thousands of employees receiving incorrect paychecks. It would take more than a year to stabilize Los Angeles Unified's payroll in what became an ongoing public spectacle that was not lost on the Controller's Office.

In February 2007, when asked about the pending conversion of the state's payroll to the same brand of software involved in the spectacular failures at LA Unified and the community colleges, state officials said they had dispatched a "lessons learned" team to Los Angeles to make sure they did not repeat mistakes made there.

"The State Controller's Office has definitely been paying attention to what's going on and is on top of this," an SCO spokesman said at the time.

Asked recently about the lessons learned from the Los Angeles experiences, Collin Wong-Martinusen, the controller's chief of staff, told the Senate Oversight Office that the SCO made two significant changes. It established a steering committee as a new layer of oversight and decided to phase in the SAP software, rather than deploying it in a single "big bang" introduction as Los Angeles Unified did.

But the Controller's Office could find no memos or reports that were prepared by its "lessons learned" team, either from its interaction with the community college district or Los Angeles Unified.

Two years after the SAP rollout at LA Unified, a civil grand jury had to resort to legal arm-twisting to persuade the district to give up pertinent documents and other information about the fiasco. “Following several failed attempts over a five-month period and the threat of a subpoena, LAUSD produced the documents the (grand jury) determined to be useful and relevant,” the grand jury’s report said.

The grand jury report disclosed that the botched conversion to SAP software resulted in an overpayment of $60 million to some 35,000 LA Unified employees. In late 2009, nearly three years after the conversion, approximately $9 million of that overpayment still had not been collected from 2,400 employees, the grand jury found.

In its report, akin to a “lessons learned” analysis, the grand jury said that – despite assertions to the contrary – simulated parallel payroll runs could have been executed and compared to existing payroll. This might have been a lesson that could have averted the epic problems of the state’s first live payroll run.

A thorough review of the LA Unified experience also would have revealed that, despite the district spending an extra $40 million to address and correct all of the payroll problems, a third and final phase of the SAP conversion was postponed indefinitely in May 2009. It was not completed until last month (July 2013). As a result, the district continued to bear the expense of operating and maintaining its legacy system for procurement activities, according to a December 2009 report prepared by the district’s inspector general.

Two months after the release of that inspector general’s report, the SCO signed a new contract with SAP to serve as the system integrator of its software for the state. The project’s original system integrator, BearingPoint, had been fired a year earlier.

Wong-Martinusen, the controller’s chief of staff, said that although SAP software was the common denominator in the troubled new systems at the community college district, LA Unified and the state, those projects used different system integrators, which served as the prime contractors.

When the state fired BearingPoint, the state did not have any problems with the software, Wong-Martinusen said. Regardless, he said, difficult transitions and failures are not uncommon in the IT industry.

“For any major IT vendor, you could easily find a dozen public or private failures,” he said.

As part of a pending assessment of the 21st Century Project, the state plans to reassess the software, to review why it was selected initially, whether it can be modified to accommodate the state's complex payroll and whether it has been successfully customized for other states with similarly complex payroll systems.

Was the SCO's due diligence adequate?

Other excerpts gleaned from hundreds of pages of documents reviewed by the Senate Office of Oversight and Outcomes raise additional questions about how well the Controller's Office reviewed vendor proposals when it first embarked on the 21st Century Project in 2003, and again in 2009-10, when it sought to salvage the project after firing the first system integrator, BearingPoint.

When the SCO dismissed BearingPoint in January 2009, one of the key factors the state noted was the company's failure to develop accurate, reliable data conversion programs, scripts and computer instructions that would allow the new system to incorporate and use the historical data stored in the SCO's legacy computers.

"Data conversion is one of the most crucial aspects of a successful project," the Department of General Services wrote in a Dec. 3, 2008, letter that served as a notice of intent to terminate the BearingPoint contract.

Yet, three years later – eight years into the 10-year project – data conversion remained a major stumbling block and the new system integrator, SAP, was disputing who was responsible for it.

"As you are well aware, there is a disagreement between SAP and SCO as to contractual responsibility for data conversion," an SAP executive wrote in an Aug. 21, 2011 response to another cure notice, the second issued on the project.

The statement raises the question: Why, on a project of such magnitude and complexity, would a critical core task such as data conversion not be clearly assigned in the contract?

SAP and the SCO ultimately agreed to bring in a third party, BackOffice Associates, to do the data conversion. The state agreed to pick up the added $15 million cost, although the payment is among those the state withheld when it cancelled the SAP contract.

Finally, in a third "cure notice," dated Oct. 25, 2012, the SCO raised questions about SAP's ability to deliver and the company's experience with such a large payroll conversion – approximately 240,000 state employees. In May 2012, the cure notice reveals, the SCO asked the company "to identify an SAP client where 191,000 employees are successfully processed in a single payroll area using SAP software."

Leadership turnover a problem from the outset

State Controller John Chiang inherited the 21st Century Project from a previous controller, Steve Westly, who also inherited it from a previous controller, Kathleen Connell. In all likelihood, Chiang – who is termed out next year – will hand off the remains of the project to his successor.

The SCO's original project director and manager left shortly after the project was launched. Early oversight reports starting in 2006 also warned repeatedly about prolonged vacancies in top positions.

In addition, documents show the SCO had at least five different project directors and four different project managers over the course of the 10-year project. During the final 18 months alone, it had three different project directors and two project managers. The last project director took over on March 13, 2012, just three months before the June 11 "go-live" date. The vendors, SAP and BearingPoint, also changed leaders on their teams, although that is more difficult to track.

The independent project oversight consultant (IPOC) position, a key observer embedded with the project, turned over three times in the last, tumultuous year of the project. In addition, the SCO, the IPOCs and an independent verification and validation (IV&V) consultant all cited turnover at the top of the vendor's team as a serious problem.

The constantly changing cast of leaders left few, if any, with real ownership or start-to-finish responsibility for the project. Most likely knew they would be gone before the project was finished or any other point where they could be held accountable.

Procurement process critical to successful project

As the Controller's top staff reflected on the demise of the 21st Century Project, Chief Administrative Officer Jim Lombard suggested the new payroll system may have been doomed from the start.

"It comes back to procurement – not bringing the right vendor on board to do the job," Lombard said.

The Controller's Office never had many vendor choices at any stage of the project. Just two companies bid on the software contact in 2004. Only one bid to be the first system integrator in 2005 and only three bid on the second system integrator contract in 2009.

Wong-Martinusen, Chiang's chief of staff, said the project has persuaded the Controller's Office that "we need to treat IT procurement differently than we treat procurement for other goods and services."

The existing system is "driven by a risk-adverse mentality" designed to protect the state from costly, time-consuming protests from bidders, Wong-Martinusen said. The rigid process was developed to insure that all bidders are treated equally. But it can also prevent the state from pressing a bidder for added information in critical areas, such as proposed plans and experience, Wong-Martinusen said.

After the initial system integrator failed, the state paid SAP and a second bidder, Accenture, \$500,000 each to demonstrate in a "bakeoff" how they would design a new system to take over the state's payroll. During that process, one of the Controller's consultants warned that SAP's data migration tool – a critical component in the modernization of a payroll system as large and complex as California's – appeared to be inadequate for the daunting project. But the state's procurement rules prevented the Controller's team from questioning SAP about the data migration tool, said Tony Davidson, the SCO's current project director.

When the Controller's Office issued its first "cure notice" to SAP in August 2011, threatening to cancel the contract, the step was taken because of the company's "inability to migrate data," according to an SCO document.

After the BearingPoint failure, the Controller's Office asked if it could try the successful strategy Caltrans has used on some projects – bonuses for early completion and financial penalties for delays. Attorneys at the Department of General Services concluded state law did not allow that for IT projects, SCO officials said. The state also has taken steps, including the repeal of a performance bond requirement, to foster increased interest and bidding on IT projects.

In response to a number of recent IT failures, the state last month transferred the responsibility for IT procurement, along with a small team of specialists, from General Services to the new Department of Technology.

Dirty data, few records to decipher original coding

The Controller issues paychecks for employees of 160 state departments. Most, if not all, of those departments have or have had the ability to enter their own employee data into the legacy system. This has resulted in an unusual amount of unreliable or "dirty" data, such as employee start and exit dates from different departments. (None of those interviewed for this report said faulty data contributed to paycheck errors. But a payroll comparison done for the project did discover that the legacy system was deducting too much from some employees' paychecks for state disability insurance. An extra $14 million had been collected from 100,000 employees dating back to 2005. The Controller's Office has started refunding that money.)

The legacy system also contains applications, or code, that was developed as needed over the years with little record of how the code was written or what it says. That compounded the difficulty of converting the massive amount of historic data into a form that could be used by the new system.

"Everyone knew the data in the Controller's system was bad … fraught with errors fed in from all of the different departments," said Vince Brown, CEO of the Alameda County Employees' Retirement Association. Brown worked on the project as chief operating officer under former Controller Steve Westly.

Adequacy of testing

As early as December 2010, an independent oversight consultant embedded in the project began warning that testing had fallen behind schedule. A year later, both of the project's independent oversight consultants (IPOC and IV&V) were raising concerns about delays and shortcuts taken in testing.

"We were concerned about not having enough test scripts to vet, because we knew our payroll is complex. ... We were concerned the test plan didn't appear thorough enough," said Mary Winkley, an assistant secretary with the California Technology Agency (CTA), which employed the oversight team.

The testing concerns raised in January 2012 were repeated every month for the balance of the year as the project team pushed toward the first live test on June 11. Because testing typically occurs near the end of a project, it is often something that gets condensed and shortchanged, Winkley and others said.

The independent oversight reports sounded increasingly urgent alarms about the state of testing as the project approached the June 11 "go-live" date. Three months out, an oversight report cautioned that a "lack of quality in testing may result in MyCalPAYS errors and … in employees not receiving the correct pay." A month out, an oversight report warned ominously: "The project has had quality challenges in documenting testing results, which makes it difficult to ascertain if testing actually occurred and the results of testing."

In its October 2012 cure notice, the SCO flagged testing lapses as a key factor in the payroll errors experienced in Pilot 1.

"SAP failed to develop, plan and, critically, execute a comprehensive test program," the SCO alleged. Among the testing lapses, the SCO cited a "failure to execute a complete payroll test" which led to "undetected configuration errors and contributed to paycheck errors." The SCO's letter stated that it had "informed SAP multiple times that its testing was inadequate."

In its response, SAP maintained that Pilot 1 was a success, that most of the mistakes resulted from user errors by poorly prepared and overwhelmed SCO employees rather than system defects for which SAP was responsible.

As with data conversion, the Controller's Office and SAP disagreed sharply about who was responsible for testing.

Did the state seek too much customization of the software?

The SCO's project team has maintained that contracts for the 21st Century Project always required the new system to accommodate the state's complex payroll practices. But the two system integrators both complained that the state was trying to replicate its legacy system with excessive customization of the SAP software.

The SCO's project team said it worked with the state Department of Human Resources to simplify state practices when possible, but could not change many other practices, some of which are required by law or labor agreements. At the outset, and again when the project was restarted in 2010, SCO officials said, SAP assured the state that its software could handle or be customized to accommodate all of the state's businesses practices.

In the final design of the new system, the Controller's Office said SAP agreed that 283 customizations would be required. At project termination, 251 of those customizations were in operation, said Tony Davidson, the SCO's current project director.

In written responses to questions from the Senate Oversight Office, SAP said the Controller's customization of the base software "was extraordinarily high compared to other large SAP payroll systems." During the course of the project, SAP said the Controller's Office requested 359 changes, including 126 after the June 11 go-live date, to the base software or the original design.

"The 21st Century Project should have been an opportunity to correct the errors that had accumulated over decades of separately built, separately maintained 'legacy' payroll systems operated as a patchwork to serve hundreds of state agencies and departments," SAP said in its responses to the Senate Oversight Office.

The independent oversight reports warned repeatedly that the state was asking for more customization than perhaps it should from the software. The Senate Oversight Office found broad agreement that the more a client attempts to modify commercial off-the-shelf software, the greater the degree of difficulty and likelihood of failure.

Institutional resistance

Big IT projects often run into serious trouble when existing payroll and human resources staff get involved, several veteran IT specialists told the Senate Oversight Office. Employees often do not want to change long-established practices and will insist they cannot do their work in the new way. In addition, the state often doesn't have enough time or resources to properly train staff.

As an added disincentive to the rank and file, new IT systems often are expected to produce efficiencies, meaning fewer jobs. The 21st Century Project was no exception, promising staff reductions through attrition.

"If you can't overcome that problem, if people don't want to go to the new software, you can get into some very difficult situations," said Teri Takai, chief information officer at the Department of Defense and the state's CIO from 2007 to 2010. "That's generally a big part of failures … in industry or government."

SAP's response to the Controller's cure notice alleged that state human resources personnel often refused to actively participate in SAP training sessions. As evidence, SAP quoted an email from Lisa Dean, the Controller's workforce transition leader.

"General feel in the class is one of negativity and hostility … One participant slept quite a bit … One participant very frustrated, not willing to try and learn … I'm at a loss for the lack of respect being shown in class," Dean's May 2012 email said.

No parallel payroll test

The SCO's team said it relied on assurances from SAP that three payroll comparison tests all but guaranteed that, "after accounting for known differences," the payroll would run within $1 of the legacy system for most employees.

"We did expect problems, but nothing of the magnitude experienced when we turned it on," said Jim Lombard, the SCO's chief administrative officer.

It is expensive and labor intensive to run an actual parallel payroll test, which requires all of the staff time to do an actual payroll, the SCO team explained. But a parallel payroll test would have allowed the SCO and SAP to analyze mistakes and work to correct them in a calmer, clinical setting, without hundreds of angry SCO employees clamoring for immediate corrections.

A Decade of Challenges

Monthly reports prepared by independent oversight consultants show the 21st Century Project suffered from delays and challenges from the start, new problems that emerged immediately after it was resurrected in January 2010 and other serious issues that, in some cases, dragged on for months.

The independent project oversight consultants, or IPOCs, were employed by the California Technology Agency (and its predecessors). They were embedded in the project – with onsite work space and access to meetings and documents – and filed reports with the agency and the project team. It is important to note that issues cited in the reports were those that remained unresolved after informal discussions between the oversight consultants and the project team. The reports were known as IPORs, for Independent Project Oversight Reports.

The oversight consultants worked with a second, similar overseer known as the independent verification and validation (IV&V) consultant. The latter, employed by a private company under contract with the state, focused on technical issues, while the IPOCs largely reviewed management of the project.

The following summaries and excerpts from key IPOC reports show the 21st Century Project was plagued by known challenges identified at the outset and that continued, in some cases, for a decade. These basic, core problems included the state's payroll complexity, data conversion, staff vacancies, organizational change management (the process of teaching and selling the new system to existing staff), the absence of a quality assurance team, and an inability to stay on schedule:

- **July 2004.** Project's first independent project oversight report (IPOR) questions whether the state will be able to continue its semi-monthly pay schedule in the new system. The payroll schedule and complexity will remain an issue throughout the project.

(Eight years later, as the project is overwhelmed by errors in its first live pilot, an IPOR concludes "the payroll calendar complexity may create an unsustainable operations model.")

- **August 2004.** Project's second IPOR warns, in a telling prediction, that "failing to gain timely union agreement and acceptance of new payroll system changes could increase the scope of the project, require more time and extend the implementation schedule (and cost)."

- **October 2004.** Five months in, the project is already "several months" behind schedule.

- **July 2005**. New independent oversight consultant sounds an early warning about potential high risk the project faces in "organizational change," the teaching and selling of the new system to often-resistant existing staff.

  "A fully implemented 21st Century Project potentially impacts the business processes of every state entity, and the methods used by every state employee to record time and manage leave. Continuous communications with all project stakeholders will be crucial to project success," IPOR says.

  (Seven years later, as the project careens toward failure, an IPOR concludes the level of organizational change management and training had been "insufficient to prepare users for the new system.")

- **December 2005**. Selection of a system integrator, to be the project's prime contractor, has fallen up to nine months behind schedule. IPOR also notes "high risks" that:

  - The state may not be able to recruit required staff for the project.

  - "The state team may not be able to make timely decisions on project design due to a lack of knowledge or authority."

- **August 2006** IPOR identifies a number of developing problems:

  - Unfilled State Controller's Office (SCO) positions for the project "are of great concern." Project business manager and technical manager positions are vacant.

        - "With key decision makers not available, delays in the approval process are inevitable," the report states. "Additionally, the project could venture down the wrong path for some time before it is noticed and course corrections are made."

        - "Without the appropriate expertise available to review product deliverables, quality assurance will suffer."

    - Project delays are causing work to be rescheduled resulting in unknown long-term impacts.

- **November 2006** IPOR repeats many of the same warnings with added emphasis in some cases:

    - "Specific positions unfilled are of great concern … both the SCO project business manager and technical manager positions remain vacant. The 21st Century Project will be at risk until these key positions are filled."

    - Oversight team "remains very concerned with schedule management."

    - "Poor quality assurance practices could result in delivery of a solution that does not satisfy all project requirements."

      "As with the project schedule, we have reported on these concerns repeatedly."

      (Seven years later, when the state cancels a second contract for the project, oversight reports were still warning "there is no quality assurance team.")

- **March 2007** IPOR suggests project is in serious trouble:

    - Project is behind schedule and much of the work "continues to be completed later than planned."

    - In an ominous forecast, report states that "because only a limited number of departments participated in blueprint workshops, critical requirements may not have been captured … Missed requirements could result in incorrect data in the SAP system *which has the potential to prevent employees from being paid correctly* (emphasis added)."

Project "rebaselined" with increased budget, extended completion date

- **May 2008**. With the project far behind schedule, all involved agree to "rebaseline" it, increasing the cost to $179 million and extending the completion date by a year, to June 2010.
- Seven months later, in **January 2009**, the state terminates the system integrator's contract. Failure to develop accurate, reliable data conversion programs and scripts are a key factor. Data conversion problems would continue to haunt the project.

Second attempt to build 21st Century Project encounters immediate problems

- **February 2010**. The project restarts with SAP as the new system integrator. Scope has been narrowed by dropping the California State University's 54,000 employees. Cost increases to $305 million and completion date is pushed back another two years, to September 2012.
- **February 2010.** Oversight report for the first month since the restart warns the project already is experiencing challenges:
  - Three deliverables have been rejected and three others, including the project schedule and deployment strategy, have been delayed.
  - SAP submits change requests to address the late deliverables. In an early sign of conflict, the SCO rejects the change requests.
  - SAP prepares an informal "project recovery plan" to outline late deliverables and establish new due dates.
  - SAP has only 18 of 24 planned staff on site. "This staffing shortage is having an impact on completion of major deliverables," report states.
- **March 2010** IPOR notes that, two months into the restarted project:
  - There still is no project schedule. The SCO submitted 505 comments outlining deficiencies in schedule submitted by SAP.

  - SCO and SAP staff cannot move into the project work space until Aug. 1, six months after the project restart.

- **June 2010** IPOR delivers blunt warnings about delays, shortcuts and "critical" vacancies:

  - Report flags a major flaw in the "Requirements Traceability Management Plan" (RTMP), a key document that "describes the process that will deliver the agreed upon scope" to meet project requirements. The RTMP "discusses tracking *project* requirements, not *business* requirements (emphasis added).

    "Project requirements are at a higher level … Business requirements are the lowest level of functionality that is required to be built.

    "It is common and accepted best practice to separately identify and track each business requirement through development, unit and integration testing and back. That is not being done here (emphasis added)."

- **September and October 2010** IPORs flag SCO vacancies in three "critical" project positions.

- **December 2010** IPOR finds:

  - Project director has split project management between two people, blurring responsibility for some critical tasks, such as organizational change management (OCM), the teaching and selling of the new system to existing staff. The OCM process is essential to a smooth transition. Twice, the IPOR warns, the divided project leadership "may be a challenge for SCO to manage."

  - SCO still has three "critical" vacancies.

- **January 2011** IPOR discloses the SCO has requested significant changes to the system, "the total number and complexity" of which "is not known." Report warns the late changes – to be detailed in a pending Change Request 34 – will delay the project and increase costs. Among the consequences, a completed test deliverable must be reopened and a new testing cycle developed.

- **February 2011** IPOR outlines several major new concerns:
  - For the first time since the project was restarted a year earlier with SAP as the system integrator, the oversight consultant sounds an alarm over the state of data conversion.

    "Legacy data conversion has experienced significant delays and technical difficulties. … Further delay will result in significant impact to testing cycles."
  - The project has moved into unchartable territory, with "no objective measurement" to gauge impacts that changes sought in Change Order 34, and the added testing required, will have on the project's "critical path," a sequence of activities that must be completed on time for the project to finish on schedule.
  - Major departments – CalFire, the State Water Resources Control Board, Caltrans and, surprisingly, the California Technology Agency – are behind schedule and at "serious risk" of missing deadlines to develop interfaces to interact with the new system.
  - The SCO still has three vacancies in "critical positions," four years after Chiang took over the project.
- **March 2011** IPOR reveals a significant shortcut taken as a result of the data conversion troubles:
  - To prepare for a payroll comparison test, the project attempted to convert legacy payroll data for 22,000 records chosen to reflect populations of the Pilot 1 and Pilot 2 departments, as well as a representative sample of the remaining state employee population.

    "This legacy data extraction, performed by the SCO, had limited success. … As a result, the extraction resulted in about 5,800 records (26 percent of the planned 22,000 sample) being converted." The SCO determined it was a "good enough" sample to proceed with Payroll Comparison Test 1.

    "However," the report warned, "it is anticipated that, of the 5,800 records, a significant number may drop out as the data conversion progresses."

- **April 2011** IPOR reveals the project has been brought to its knees by data conversion challenges:
    - A data conversion deadline, already missed, is pushed back another two months.
    - For the first time, oversight consultant warns the project may be unable to meet planned Sept. 1, 2011 go-live date.
    - Eclipse Solutions, which analyzed the data conversion problems at the request of the California Technology Agency, issues a jarring assessment that cites "critical discrepancies":
        - "These include, but are not limited to, inaccurate mappings, incomplete conversion cycles … a lack of focus and priority … lack of formal review and signoff for critical artifacts, lack of clear communications, a lack of collaboration, overloaded resources (project staff), and a lack of adequate management involvement."
    - Project team starts developing another "project recovery plan."
    - SCO still has not filled all of the "critical" project vacancies, with one remaining.

Controller suspends second attempt to complete the 21st Century Project

On Aug. 19, 2011, the SCO issued a "cure notice" to SAP, threatening to terminate the contract largely because of the inability to resolve the data conversion problems. SAP responded with a letter that declared: "As you are well aware, there is a disagreement between SAP and the SCO as to the contractual responsibility for data conversion."

Two months of confidential negotiations produced a Nov. 17 settlement agreement to resolve most differences and continue the project with significantly higher state costs and a one-year schedule extension. Added expense included $15 million for a specialized vendor to take over data conversion.

- **December 2011** IPOR, completed just one month after the mid-November restart, immediately sounds new concerns, including "significant" new test quality issues uncovered.

- **February 2012** IPOR repeats the warning about testing and raises two more major issues:
    - It is unclear whether Payroll Comparison Test 2, to compare legacy payroll results to those produced by the new system, fully covers essential factors such as wage types and benefits. With fewer SCO employees than planned, "substantially less records (were) manually validated by expert end-users than planned."
    - The project has stopped monitoring progress in "knowledge transfer," the comprehensive preparation and training necessary to enable state workers to take over operation of the new system after launch.

- **March 2012** IPOR, covering the three months since the November restart, notes the project continues to have difficulties "documenting testing results," and further warns: "The project lacks quality assurance staff, which has had an adverse impact on ensuring quality in testing, coding and configuration."

  In a prescient admonition, the reports states: "Lack of quality in testing may result in MyCalPAYS errors and … in employees not receiving correct pay."

  (From the outset, oversight consultants warned that the project had no formal quality assurance practices or quality assurance team.)

- **April 2012** IPOR amplifies warnings about test quality and shortcuts, knowledge transfer and SCO staff vacancies, and adds a number of other "key concerns," including:
    - Continued overlap of multiple test cycles is stretching project staff.

- **Second April 2012** IPOR, prepared by a new independent oversight consultant, issues frank warnings about testing and training of SCO staff for the transition:
    - One phase of critical performance testing was unsuccessful and another could not even be attempted because of system limitations. "Given that the full performance testing had not been completed, the (oversight consultant) could not confirm that the current sizing of the system was sufficient for full deployment."

(In other words, a little more than a month before the June 11 launch of Pilot 1, the oversight team couldn't say for sure that the system ultimately could handle the state's full payroll.)

  - An employee survey "clearly shows most of the functional team members have not attended SAP training courses" on how to operate the new system. In addition, SCO project vacancies include the organizational change manager, a key position to guide often-resistant existing staff in the transition to the new system.

- **May 2012** IPOR, prepared less than two weeks before the June 11 launch of Pilot 1, adds several new "key concerns" to those that had been repeated and left unresolved, in some cases, for months:

  - "The project team has made program-level decisions with regard to how many pay cycles may be run and whether they need to be closed out before the next is initiated. These business decisions mimic existing legacy functionality and allow flexibility … but are not aligned to the way SAP is designed to operate and will create complexity and extra workload for operations *that could prove unsustainable (emphasis added)*."

  - "The project has had some quality challenges in documenting testing results, *which makes it difficult to ascertain if testing actually occurred and the results of the testing (emphasis added)*."

  - "It is unclear what the need and plan is for after-hours support during the first cycles of production runs."

  - "The Pilot 1 back-out plan is incomplete and not well communicated. While the probability of the plan being executed is low, the impact of failure to restore is high."

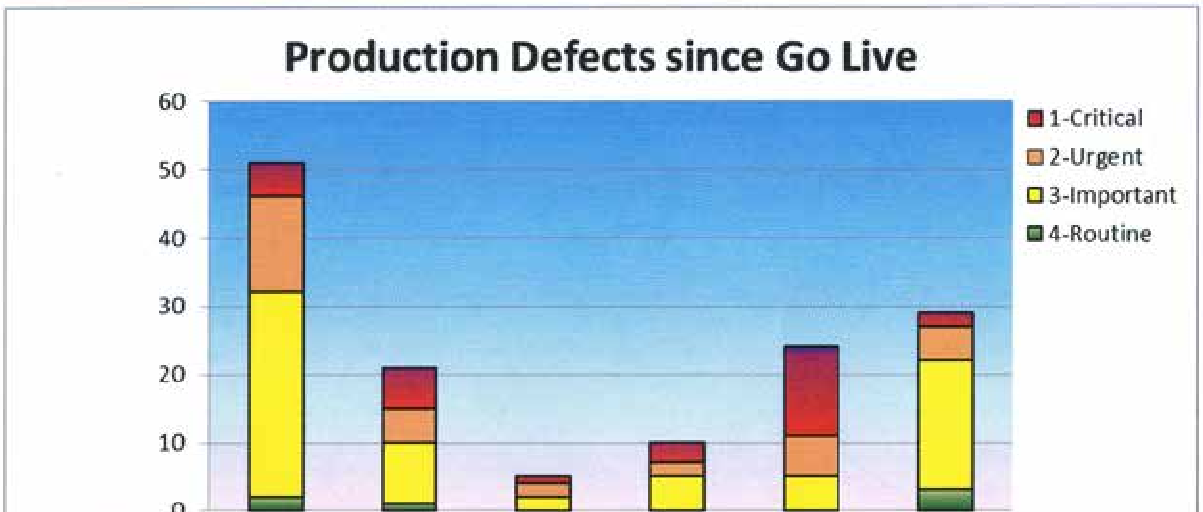
Pilot 1 errors doom project

A few weeks later, the Pilot 1 payroll to some 1,300 SCO employees – less than 1 percent of the workforce for which the system was designed – contained hundreds of errors in pay and deductions. The errors caused an internal uproar and proved so difficult to correct over eight months that the SCO suspended the live test and, on Feb. 8, terminated the contract with SAP. The termination came three days after the state received a demand from SAP to mediate differences over the causes and responsibility for the errors.

Immediately after the Pilot 1 launch, the independent oversight consultant raised issues that essentially repeated and confirmed warnings that had shadowed the project from the outset.

- **June 2012** IPOR notes confusion between the SCO's human resources staff and HR staff at other state departments over the management of miscellaneous deductions.

  Report warns bluntly: "If the payroll calendar and legacy operations are not simplified, the level of complexity may overwhelm MyCalPAYS and legacy operations staff."



Severity	8/2012	9/2012	10/2012	11/2012	12/2012	1/2013	Grand Total
4-Routine	2	1				3	6
3-Important	30	9	2	5	5	19	70
2-Urgent	14	5	2	2	6	5	34
1-Critical	5	6	1	3	13	2	30
Grand Total	51	21	5	10	24	29	140

Source: State Controller's Office, which noted that a defect may impact a single employee or all employees. The Controller's Office said the chart reflects a conservative view of system defects SAP was required to correct. SAP contends that most of the Pilot 1 problems resulted from user errors, committed by state employees.

- **July 2012** IPOR restates testing concerns with the most revealing and pointed warning yet: "Decisions were made during the testing phase that (it) was impractical to test every possible paycheck scenario, so test scripts were not run for every possible scenario. It is unclear whether that decision may have missed detecting defects and/or missing functionality."

- **August 2012** IPOR portrays a project on life support and reveals previously unreported problems:

    - Pilot 2 postponed, and project team to re-examine *problems in most of the basic development areas* – organizational change management, schedule, testing, payroll/operations and user training (emphasis added).

    - "Organizational change management and training is insufficient to prepare users for the new system."

    - "Payroll calendar complexity may create an unsustainable operations model as more waves are rolled out."

    - "A relatively large number of new issues were added to the (issue) log this month. This is because a number of existing issues were being tracked outside of the issue log and not necessarily reflective of how many issues were actually opened this month."

      (The August IPOR was prepared by a new oversight consultant who had assumed the assignment in May, just before the Pilot 1 launch.)

Reports to Legislature Sugar-coated, Ignored Problems

After the payroll system's first collapse, Sen. Denise Ducheny – then chairwoman of the Joint Legislative Budget Committee – asked the Controller to give the Legislature regular updates on the 21st Century Project. In response, Controller John Chiang committed in a February 2010 letter to provide written quarterly reports, as well as "briefings to legislative staff at major project milestones and ad-hoc briefings at the request of the Legislature." The first of those quarterly reports was submitted to the joint budget committee in April 2010.

Lawmakers wanted to more closely monitor the beleaguered project, which was overdue and over budget. But a review by the Senate Oversight Office found that the quarterly reports often lacked candor, sugar-coating some problems and ignoring others. This failure to be transparent compromised legislative oversight and stymied accountability.

That finding is based on a comparison of the legislative reports with documents prepared by others monitoring the project. Every month, the California Technology Agency issued a detailed Independent Project Oversight Report (IPOR) which ticked off performance measurements and potential problems in the 21st Century Project. These were paired with more technical memos from an Independent Verification and Validation (IV&V) team. Those monthly reports – along with others that documented problems – provide the basis for comparison.

Collin Wong-Martinusen, the Controller's chief of staff, also noted that project managers briefed staff from the Legislative Analyst's Office – 19 times in 2011 and 22 times in 2012. Many of these "touch points" were telephone conversations. It is impossible for the Senate Oversight Office to review these oral communications. The quarterly reports were the Controller's official updates to the Legislature and, as written documents, can be scrutinized.

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Software giant SAP Public Services, Inc. took over as integrator of the 21st Century Project on Feb. 2, 2010. By January 2011, the California Technology Agency's independent overseer was expressing serious concerns about data conversion, calling it the project's top priority. This was not conveyed in the Controller's quarterly report to the Legislature, however. In the February 2011 report, Chiang wrote that the project has made "significant progress." The words data conversion were not mentioned in the 15 Vital Signs or the 5 Risk Profiles, two matrixes used to mark progress.

In the Controller's April 2011 report to the Legislature, data conversion is listed as a high priority issue, but it is characterized as largely contained: "SAP retained data management consulting firm, Utopia, to help expedite the process." The situation was described very differently by Robert Eich, the technology agency's independent oversight consultant, in his April report. Eich said a corrective action plan was being developed to allow the project to move forward in light of significant delays caused by data conversion. Meanwhile, he rated seven areas as facing high risk and said numerous contract deliverables were behind schedule.

Things were to worsen later that summer. On August 19, 2011, the State Controller's Office (SCO) sent a strongly worded "cure notice" to SAP, initiating termination for default procedures against the contractor. The main issue, again, was data conversion. The Controller accused SAP of breach of contract and lack of good faith. According to the notice, SAP leaders had failed to show up at high-level meetings to deal with the problems. The project was running far behind schedule – 24 deliverables were overdue. And, contrary to the April quarterly report to the Legislature, SAP had still not secured the services of a qualified data conversion vendor by June 1, 2011.

John Hiber, the Controller's project director, wrote this in the August cure notice: "While the SCO continues to work in good faith under the terms of the contract, to date SAP has not responded to the SCO's requests to resolve issues of SAP's failure to perform, and little progress has been made toward achieving the goals agreed upon during the June 27, 2011, meeting."

The slow pace of the negotiations was also a major concern for Eich, the oversight consultant. "The extensive timeline to finish the negotiations brings additional risk to the project," Eich wrote in his August 2011 report. He listed those risks: Significant additional costs. Staff retention. Loss of momentum. Damage to staff morale.

In the midst of all this, however, SCO staffers conveyed a rosy picture during a fact-finding hearing before the Little Hoover Commission, which includes members of the Legislature.

On August 25, 2011 – just six days after the cure notice was issued – the commission held a public hearing on information technology governance. A portion of the hearing focused on the progress of the 21st Century Project. Project Manager Laurye Gage testified for the Controller's Office.

In written materials presented to the commission, Gage acknowledged that data conversion was more complex and labor intensive than originally anticipated. But she also wrote: "The Project has consistently been fully staffed on both the State and SAP teams." This statement is contradicted by Eich's and other oversight reports, which repeatedly identified staff vacancies as a serious and ongoing risk.

Nothing was reported to the commission about the cure notice or the rancorous relationship with vendor SAP. In fact, according to Gage, the relationship between the SCO and SAP was a positive: "Co-locating the state and contractor team, with counterparts jointly reporting status, combined with leadership example, has helped to forge a positive, results-oriented team culture."

In a similar vein, the Controller's quarterly report to the Legislature in September 2011 was positive overall. It did cite data conversion as a significant problem that would delay the project six to 12 months. But nothing was said about the cure notice or a lack of good faith on the part of the contractor. Instead, the report cites substantial progress.

Over the next six months, the SCO's reports to the Legislature continued the upbeat theme. The April 2012 report, for example, said data conversion was working well and the project was on track for the first pilot: creating actual paychecks for 1,300 SCO employees beginning that June.

Each legislative report includes a scorecard of 15 Vital Signs, with a green, yellow or red box indicating the relative status of each. The colors are like traffic signals: go, caution, stop. In April 2012, this matrix showed no red boxes and just one yellow (Unresolved Issues, which was rated "late with no impact"). Other Vital Signs – like Team Effectiveness, Strategy Alignment, Vendor Viability and Technology Viability – glowed green, green, green. (See 3/31/12 Project Scorecard on pages 34 and 35, which was part of the April 2012 report to the Legislature)

The technology agency's independent observers were not so optimistic. On March 6, 2012, the agency's oversight report noted that the technology team was unable to verify some test results. It said the impact of inadequate tests could be profound: "Lack of quality in testing may result in MyCalPAYS errors and … in employees not receiving the correct pay," wrote oversight consultant Eich.

A month later, in the April 30 report – the same date as the legislative report with all those green lights – oversight consultant Chi Emodi fired another warning shot. This time the issue was training: "The latest employee survey clearly shows that most of the functional team members have not attended the SAP Training courses. It is still not clear how and when the SCO payroll functional resources will receive knowledge transfer."

On June 11, 2012, the 21st Century Project hit its Waterloo. That was the start of Pilot 1, when the new payroll system was tested on SCO employees. When the actual paychecks rolled out on July 1, top SCO officials said in an interview, the number of mistakes left them "shocked and dismayed." Wong-Martinusen, the Controller's chief of staff, said, "We flipped it on and the number of errors were unsettling. SAP was as flabbergasted and surprised as we were."

The payroll was riddled with mistakes, despite years of work and hundreds of pages of risk identifiers, key concerns, top issues, project scorecards – and all those optimistic reports to the Legislature. Here's how the Legislative Analyst's Office described the problems:

"Incorrect paycheck deductions were made, payroll and pension wages were erroneously calculated, and medical benefits were denied for some employees and their dependents. In one case, employees that took vacation time during the first payroll cycle received compensation in addition to their base salary. Attempts to correct these errors created further problems in the following payroll cycle."

On Oct. 25, 2012, the Controller sent another cure notice to SAP – this one 37 pages long and bristling with accusations of breach of contract.

Some are specific: "SAP also failed to notify SCO that it was a best practice to enter employee time on a regular basis rather than once a month."

Some are broad: "SAP's breaches span the entire breadth of the Contract from the project planning and project implementation, to the execution of the plans, and finally to the result or output of the execution."

One might ask what happened to that positive, results-oriented team culture.

The October 2012 quarterly report to the Legislature mentioned the cure notice. It did not include a copy of it, however. And now all the risks are listed as "high" and the Vital Signs scorecard is dotted with red boxes. But "Team Effectiveness" still gets a green: highly effective.

The quarterly report's cover letter, signed by Jim Lombard, SCO's chief administrative officer, states that SAP has 30 days to correct the deficiencies. Lombard manages to find a positive note: "Notwithstanding the significant design and operational issues cited in the [cure] letter, the SCO still believes that the SAP software is the platform for payroll and personnel administration for the future." He concludes: "SCO is working with SAP to resolve the issues and will keep the [Joint Legislative Budget Committee] informed of the outcome."

On Feb. 8, 2013, the Controller's Office announced that it was terminating the contract with SAP – a project that cost taxpayers more than a quarter of a billion dollars. On Feb. 12, Carlos Ramos, the head of the California Technology Agency, notified the Legislature that he was suspending the 21st Century Project.

After the contract was terminated, the tone of the SCO's quarterly reports to the Legislature struck a different note. Instead of scorecards of Vital Signs, the May 2013 legislative report offers a post mortem titled "Contract Termination – Problems."

Lombard also wrote the cover letter for the May report. "The SCO worked with SAP in good faith to go through the errors and ensure that SAP was addressing them," Lombard said. "However, eight months of payroll runs have yet to produce any pay cycle without material errors and have instead exposed a system riddled with grave weaknesses."

* * *

In its report on IT governance, the Little Hoover Commission made one comment that seems particularly instructive for the Legislature. The commission counseled the California Technology Agency to be wary of self-assessment by departments. The reason was simple: "Such self-rating is vulnerable to bias toward making projects appear more successful than they might be."

Project Scorecard, as of 3/31/12

Vital Sign	Variance	Value	Your Score	Score Justification
1. Customer Buy-In	High Degree of Buy-In	0	0	
	Medium Degree of Buy-In	1		
	Low Degree of Buy-In	2		
2. Technology Viability	Strong Viability	0	0	
	Medium Viability	1		
	Weak Viability	2		
3. Status of the Critical Path (delay)	<5%	0	0	
	5% to 10%	2		
	>10%	4		
4. Cost-to-Date vs. Estimated Cost-to-Date (higher)	<5%	0	0	
	5% to 10%	2		
	>10%	4		
5. High-Probability, High-Impact Risks	0 to 3	0	0	046 Department Readiness
	4 to 6	1		
	>6	2		
6. Unresolved Issues (on time resolution)	On time	0	2	2012-016 A comprehensive reporting strategy has not been developed 2012-023 Operational Readiness Test expectations and planning 2012-040 Interface Test 3 late finish 2012-044 CalPERS Interface Readiness
	Late with no impact	2		
	Late impacting the critical path	3		
7. Sponsorship Commitment	Fully engaged	0	0	
	Partially engaged	2		
	Inadequate engagement	4		
8. Strategy Alignment	Strong alignment	0	0	
	Partial alignment	1		
	Weak or no alignment	2		

(From the Controller's April 30, 2012 Quarterly Report to the Legislature. Project Scorecard of Vital Signs showed 14 of 15 categories rated green, the highest possible. On June 11, 2012, the project would go live with its first payroll).

Project Scorecard, continued

Vital Sign	Variance	Value	Your Score	Score Justification
9. Value-to-Business	Strong	0	0	
	Medium	1		
	Weak	2		
10. Vendor Viability (provide rationale for the rating in the field following the scorecard)	Strong	0	0	
	Medium	1		
	Weak	2		
11. Milestone Hit Rate (rate of achievement as planned)	>90% on time	0	0	
	80-90% on time	1		
	<80% on time	2		
12. Deliverable Hit Rate (rate of production as planned)	>90% on time	0	0	
	80-90% on time	1		
	<80% on time	2		
13. Actual vs. Planned Resources	>90% assigned and available	0	0	State and SAP are adequately staffed on the project. The project is currently working to fill 2 critical State vacancies.
	80-90% assigned and available	2		
	<80% assigned and available	4		
14. Overtime Utilization (% of effort that is overtime)	<15%	0	0	
	15-25%	1		
	>25%	2		
15. Team Effectiveness	Highly Effective	0	0	
	Moderately Effective	1		
	Ineffective	2		
		Total	2	

Green = 0 - 8
Yellow = 9 - 19
Red = 20+

Source: March 2012 Report to Technology Agency

Project Timeline

July 2003 – State chief information officer approves feasibility study for nation's largest payroll/human resources modernization.

May 2004 – Department of Finance approves feasibility study. Project begins with initial cost estimate of **$132 million** and **mid-2009** completion date.

April 26, 2005 – Project contracts with SAP Public Services, Inc. for software, begins search for "integration vendor" to design, develop and deploy the software.

July 2005 – Los Angeles Community College District starts using new SAP payroll system. District officials describe transition as "horrific."

June 2006 – Controller contracts with BearingPoint to serve as system integrator.

January 2007 – John Chiang sworn in as new state controller. Replaces Steve Westly.

January 2007 – Los Angeles Unified School District launches SAP payroll system. Thousands of paychecks are incorrect. Mistakes continue for months.

February 2007 – Amid firestorm of criticism over LA Unified's SAP rollout, Controller's Office vows state will not make similar mistakes.

Oct. 19, 2007 – State issues "cure notice" to BearingPoint, declaring the system integrator in breach of contract and threatening termination.

Oct. 26, 2007 – BearingPoint responds with letter blaming the Controller's Office for the project's troubles.

May 2008 – Controller, Department of General Services and BearingPoint agree to "rebaseline" the project, which is months behind schedule. Cost increases to **$179 million**, completion date pushed back a year, to **June 2010**.

January 2009 – State terminates BearingPoint contract.

February 2010 – Project restarts with SAP as system integrator. California State University's 54,000 employees removed from project. Cost increases to **$305 million,** completion date pushed back two more years, to **September 2012**.

Spring 2011 – Data conversion difficulties and other serious implementation issues emerge.

May 18, 2011 – Controller initiates "problem escalation process" for SAP's alleged failure to resolve "contractually material issues."

Aug. 19, 2011 – Controller sends "cure notice" to SAP. Primary problem is stalled data conversion.

Aug. 21, 2011 – SAP cure notice response notes "disagreement between SAP and the SCO as to the contractual responsibility for data conversion."

Aug. 25, 2011 – Little Hoover Commission oversight hearing includes progress report on 21st Century Project. No mention of Aug. 19 cure notice.

Sept. 1, 2011 – "Go live" date can't be met and is pushed back to March 2012.

Sept. 7, 2011 – SCO and SAP enter into confidential negotiations to resolve differences outlined in the August cure notice and SAP's response.

Nov. 17, 2011 – Confidential negotiations between SCO and SAP yield a 39-page settlement agreement to resolve most differences and continue project with significantly higher state costs.

March 2012 – SCO requests an additional $179 million, raising the project's cost to **$373 million.** Completion date pushed back another year, to **September 2013.**

June 11, 2012 – First pilot goes live with Controller's 1,300 employees. Payroll checks contain numerous errors.

Aug. 9, 2012 – Pilot 2, to incorporate another 15,000 state employees starting Sept. 1, is postponed indefinitely because of recurring errors in Pilot 1.

Oct. 25, 2012 – Controller sends "cure notice" to SAP, initiating contract termination. Notice states: "SAP's breaches span the entire breadth of the contract from the project planning and project implementation, to the execution of the plans, and finally to the results."

Nov. 30, 2012 – SAP response to cure notice states it "has not breached the contract in any material respect and cannot be terminated for default."

Feb. 5, 2013 – SAP issues demand for mediation to resolve project disputes.

Feb. 8, 2013 – Controller terminates the contract with SAP. At the same time, CTA suspends the project.

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Senate Office of Oversight and Outcomes

1020 N Street, Suite 560

Sacramento, CA 95814

Telephone: (916) 651-1518

Facsimile: (916) 324-5927

http://www.sen.ca.gov/oversight

Special Counsel John Adkisson • john.adkisson@sen.ca.gov

Office Manager Monique Graham • monique.graham@sen.ca.gov

Principal Consultant John Hill • john.hill@sen.ca.gov

Principal Consultant Saskia Kim • saskia.kim@sen.ca.gov

Principal Consultant Dorothy Korber• dorothy.korber@sen.ca.gov

Principal Consultant Jim Sweeney• jim.sweeney@sen.ca.gov

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