Senate Budget and Fiscal Review—Holly J. Mitchell, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard D. Roth, Chair
Senator Steven M. Glazer
Senator Scott Wilk

Thursday, March 23, 2017
9:30 a.m. or upon adjournment of Session
State Capitol – Rose Ann Vuich Hearing Room (2040)

PART A

Consultant: Mark Ibele

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ISSUES PROPOSED FOR VOTE ONLY

0509 GOVERNOR'S OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

Issue 1: Sustainable Freight Project Manager (BCP)

Governor's Proposal. The Governor's Office of Business and Economic Development (GO-Biz) is requesting funding for an exempt position and ongoing budget authority of $227,000 (special funds), to allow GO-Biz to meet the requirements regarding the sustainable freight action plan. The position will allow GO-Biz to develop the project schedule, including a scope of work, projected costs and ongoing work elements. The position will also be responsible for establishing and staffing a steering group of experts to evaluate and pursue potential strategies.

Background. California's transportation system is a significant source of greenhouse gas and pollutant emissions. In July 2015, the Governor signed an executive order mandating that GO-Biz (along with other agencies) develop the sustainable freight action plan (SFAP) by July 2016. The plan is to establish targets for freight efficiency, transition to zero-emissions technologies, and increase economic competitiveness of the system. GO-Biz is responsible for coordinating and staffing the work with agencies, departments, private freight industry partners, local economic development agencies, the workforce development agency, and the general public in creating targets and developing measurement metrics.

Staff Comment. Staff has no concern with the proposal.

Staff Recommendation. Approve as budgeted.

Vote:

0840 STATE CONTROLLER'S OFFICE

Issue 1: Information Security Workload (BCP)

Governor's Proposal. The State Controller's Office (SCO) requests $966,000 ($549,000 General Fund) in 2017-18 and $928,000 ($529,000 General Fund) in 2018-19 to support eight positions, and $258,000 ($148,000 General Fund) in 2019-20 and ongoing, to support two permanent positions for strengthening the SCO's security measures. The proposed resources would be deployed to validate SCO compliance with state security standards and verify the proper functioning of security precautions. The initial two years of the proposal would include costs associated with temporary help for security activities. The two permanent positions would consist of an information asset security analyst and an information asset custodian. There would also be six temporary positions acting as program area information asset liaisons, one each for SCO's six divisions.

Background. The state and the SCO have adopted the National Institute of Standards and Technology (NIST) guidelines as minimum information security control requirements. The SCO owns and maintains numerous systems with confidential or sensitive data that serve statewide functions. Upon additional review of the NIST standards and in compliance with these standards, the SCO indicates it found two areas – risk assessment and continuous monitoring – that required additional resources. Risk assessment will entail accounting for threats, vulnerabilities and organizational impacts to business operations. Continuous monitoring includes ongoing assessment of information technology infrastructure and evaluating information system security effectiveness. The workload tasks include establishing and maintaining inventories of all information assets, completing annual risk assessments, implementing a continuous monitoring program, and conducting trend analyses on security threats.

Staff Comment. Staff has no concerns with the proposal. The investment in additional security is relatively minor commitment for the continued protection of SCO data bases and systems.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 2: State Government Reporting (BCP)

Governor's Proposal. The budget includes a request from the SCO for resources and positions related to continuing workload for the Budgetary Legal Basis Annual Report (BLBAR) and the Comprehensive Annual Financial Report (CAFR), and to address the new and ongoing workload related to continuing implementation of accounting and reporting standards set by the Governmental Accounting Standards Board (GASB). The request is for eight permanent accounting positions and $1.1 million ($617,000 General Fund).

Background. The activities engaged in by the existing accounting administrators and accounting analysts are crucial for the accurate maintenance of the state's financial transaction records and the representation of these in a standardized acceptable format. In addition, the workload will consist of implementing additional reporting requirements of 11 newly implemented GASB rules, largely related to pensions and pension plans. The responsibilities associated with the BLBAR and the CAFR are currently being addressed using personal service savings, used to hire five permanent staff within the temporary help blanket and to pay for two retired annuitants. As a consequence of this staffing issue, the number of authorized positions for this area is 28.6 and the actual number of filled positions is 34.6. SCO indicates that it is unable to fund such activities on a continuing basis from salary savings and thus seeks resources to provide for the existing seven staff, plus one additional position to address the added GASB workload.

Staff Comment. Staff has no concern with the proposal.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 3: Proposition 47 Agency and Grant Audits (BCP)

Governor's Proposal. The budget includes a request from the SCO for three permanent positions and $389,000 in 2017-18, and $383,000 in 2018-19 and ongoing, from the Safe Neighborhoods and Schools Fund (SNSF). The resources will be used for audits regarding grant awards made by the California Department of Education, California Victims Compensation Board, and the Board of State and Community Corrections, pursuant to the passage of Proposition 47 in 2014.

Background. Proposition 47, passed by the voters in November 2014, reduced penalties for certain offenders convicted for non-serious and nonviolent property and drug crimes. Estimated savings from the measure are $39.4 million in 2016-17 and $62.6 million in 2017-18 and annually, thereafter. Resources equivalent to the savings are to be transferred to the SNSF to be used in support of truancy reduction and drop-out prevention programs, increase victim services grants, and support substance abuse programs and mental health treatment services. The measure requires the SCO to perform an audit of the SNSF every two years, beginning in 2018, to ensure the funds are disbursed and expended solely according to program requirements. The SCO estimates that approximately 125 grants will be ready for audit once the resources are received. Activities of the effort will include auditing of state agencies grant programs, developing a risk assessment for future grantees, and actual audits of grantees.

Staff Comment. Staff has no concerns with the proposal.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 4: Electronic Claims Processing (BCP)

Governor's Proposal. The budget proposes $343,000 (reimbursements) in 2017-18, and $337,000 (reimbursements) in 2018-19 and ongoing, for three permanent positions to address increased workload associated with processing electronic claims, implementing new electronic claims, conducting system conversions, and performing post-payment surveys in conjunction with electronic claims processing. The additional positions will audit electronic claims prior to payment and guard against errors and fraud.

Background. Electronic data processing (EDP) audits fulfills the mandate given to the SCO to determine the legality, propriety and accuracy of claims against the state. EDP audit activities include readiness testing of the system, control evaluations, prepayment audits, post-payment field surveys, and annual tests. Through 2010-11, the department had 17 positions devoted to EDP audits, which was increased in the 2011-12 budget to 21 positions on a two-year, limited-term basis. The department now has 17 positions, with an additional three positions loaned to the audit activity from other divisions. The workload, as documented by the department, has continued to increase. Audited electronic claims have increased from 35.1 million in 2011-12 to

41.7 million in 2016-17 (18.6 percent), and processed electronic claims schedules have increased from 11,303 to 16,160 (42.9 percent) during the same period.

Staff Comment. The department has adequately demonstrated the need for additional resources for the identified activities in its workload data, and has documented the backfilling for additional activities through the use of loaned personnel.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 5: Local Government Oversight Initiative (BCP)

Governor's Proposal. The budget calls for $1.1 million ($108,000 General Fund) for the SCO to provide permanent funding for nine positions (eight continuing and one new) to allow for continued oversight of local government entities. The activities involve the enforcement of the financial transactions reporting requirements of local governments, analyzing and monitoring the financial data for potentially distressed entities, and conducting audits of local government entities. The resources for the existing efforts are largely paid (90 percent) by reimbursements from local governments themselves.

Background. In 2012-13, the SCO was provided limited-term funding for performing local government oversight, with an implementation date of January 2012. These resources were temporarily redirected to significant workloads associated with the dissolution of redevelopment agencies, and as a consequence implementation of local government oversight was delayed to 2013-14. In 2014-15, the budget included three-year, limited-term funding for nine positions with an implementation date of July 2014, in order to provide increased oversight of local governments. The resources received were used to 1) increase compliance with annual financial transaction report requirements by all local government agencies (non-filers) through increased outreach and data collection by the SCO; and 2) develop a method to identify factors that could be used to support a decision to conduct investigations and to conduct such investigations.

Staff Comment. The SCO makes a reasonable case for the continuation of the existing positions, given that statutory requirements do not appear to be sufficient to guarantee local government compliance and guard against waste, fraud, and abusive practices. Numerous findings related to recent SCO audits of the cities of Bell, Montebello, Hercules, Stockton, Cudahy, Atwater, West Covina, the Association of Bay Area Governments, and the review of the County of Modoc demonstrate there have been significant failures in local government financial management and controls. These failures can result in financial mismanagement of state and federal funds, jeopardize bond credit ratings or negatively affect the security of outstanding debt obligations, and result in pressure for state financial assistance.

Staff Recommendation. Approve as budgeted.

Vote.

1701 DEPARTMENT OF BUSINESS OVERSIGHT

Issue 1: Program Consolidation

Governor's Proposal. The budget calls for consolidation of several programs within the Department of Business Oversight (DBO). The proposal would combine the supervision of California Business and Industrial Development Corporations (BIDCO), Industrial Banks, and Savings and Loan programs, and put them all under the licensing and supervision of Banks and Trust Companies program. No additional funding is requested.

Background. The mission of the DBO is to regulate state-licensed financial institutions, products and professionals in order to provide accessibility to a fair and secure financial services marketplace. The department enforces the state's financial services laws and provides resources to Californians to make informed financial decisions. DBO's examinations focus on reviewing capital, assets, management, earnings, liquidity, market sensitivity and operations of licensees in each area. The examinations also include a review of the licensee's compliance with state and federal laws and regulations. Examinations are the essential foundation of the Banking Program's oversight and supervision of licensees, and are intended to promote safe and sound licensees. Although there are four programs regulating financial entities, all examinations, licensing, and regulatory oversight are performed by the Banking Program examiners, under the direction of the Deputy Commissioner of Banking.

Staff Comment. The Banking Program has over one hundred positions that perform work for the Banking, BIDCO, Industrial Banks, and Savings and Loan programs. All examinations, monitoring, enforcement and licensing is performed by Banking Program staff; no staff are solely designated to the BIDCO, Industrial Banks, and Savings and Loan programs. This request is to consolidate the budgetary display of the BIDCO, Industrial Banks, and Savings and Loan programs under the Banking Program. Approval of this request will not change DBO's responsibilities, programs, reporting requirements, budgeted appropriation amounts or fund source, but will ensure the department has the flexibility in expenditure authority to continue support of each program. Specifically, this change will ensure that the department's budget display supports its responsibility to expend staff resources to interchangeably administer and manage the four programs' licensing, examination and regulatory oversight functions. Consolidating the BIDCO, Savings and Loans, Industrial Bank programs under the Banking Program will enable it to more effectively and efficiently administer these programs it already manages.

Staff Recommendation. Approve as budgeted.

Vote:

ISSUES FOR DISCUSSION AND VOTE

0840 STATE CONTROLLER'S OFFICE

Presenter: Betty Yee, California State Controller

Department Overview. The State Controller's Office (SCO) is principally responsible for transparency and accountability of the state's financial resources and ensures the appropriate disbursement and tracking of taxpayer dollars. The controller serves on various boards, commissions, and committees with duties that include administrative oversight of public pension funds, protection of state lands and coastlines, and modernization and financing of state infrastructure. The SCO offers fiscal guidance to local governments and has independent auditing authority over government agencies that spend state funds. The controller's primary objectives are to: account for and control disbursement of all state funds; issue warrants in payment of the state's bills; determine legality and accuracy of financial claims against the state; audit state and local government programs; safeguard various assets until claimed by the rightful owners in accordance with the Unclaimed Property Law; inform the public of the state's financial condition and financial transactions of city, county, and other local governments; administer the Uniform State Payroll System; and, audit and process all personnel and payroll transactions for state civil service, state exempt employees, state university employees, and college system employees.

Budget Overview. The department receives about 30 percent of its annual budget from reimbursements, 29 percent from the General Fund, 19 percent from the Unclaimed Property Fund, about 15 percent from the Central Service Cost Recovery Fund, and the remainder from various special funds. The funding structure is based on the SCO's statewide responsibilities that cut across all funds and programs.

State Controller's Office
Program Expenditure
(dollars in thousands)

Program	Actual 2015-16	Estimated 2016-17	Proposed 2017-18
Accounting and Reporting	$42,037	$42,824	$46,155
Audits	45,961	50,659	50,885
Personnel and Payroll	50,290	42,343	45,121
Unclaimed Property	40,073	35,594	36,784
Disbursements	23,573	25,710	25,904
Net Administration	-41	279	279
Total Expenditures	**$201,893**	**$197,409**	**$205,128**

State Controller's Office
Position Authority
(actual positions)

Program	Actual 2015-16	Estimated 2016-17	Proposed 2017-18
Accounting and Reporting	276.5	253.7	258.5
Audits	300.5	297.3	299.3
Personnel and Payroll	202.3	205.0	205.0
Unclaimed Property	245.6	255.4	256.0
Disbursements	82.6	95.8	95.8
Administration	281.4	276.8	277.3
Total Positions	**1,388.9**	**1,384.0**	**1,391.9**

Issue 1: Implementation of Financial Information System for California – Oversight

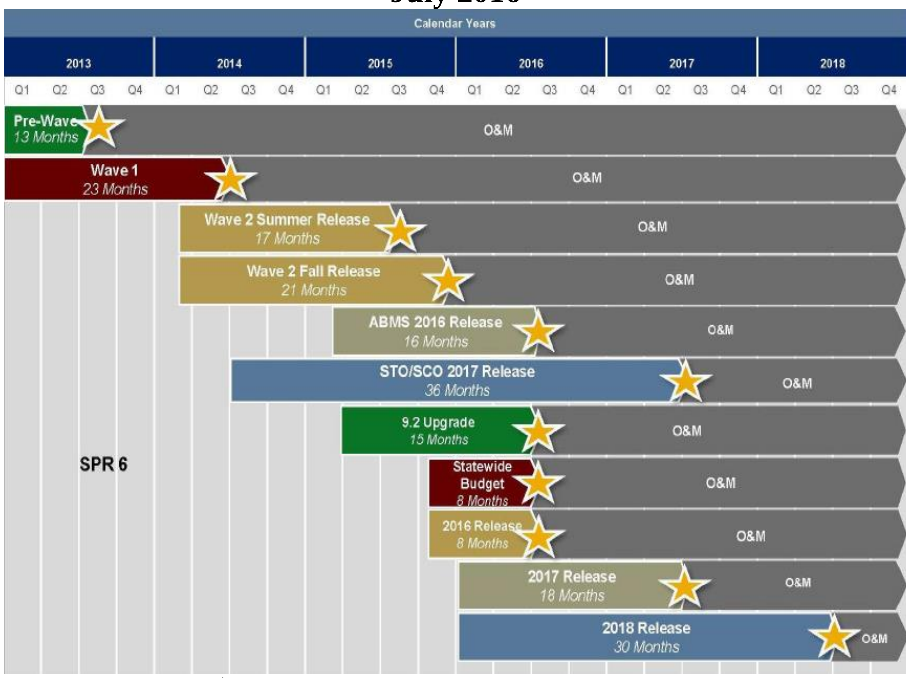
Budget Issue. In February, the Senate Committee on Budget and Fiscal Review held a hearing regarding the implementation of the Financial Information System for California (FI$Cal). At this hearing, issues were raised regarding departmental implementation of the FI$Cal program and its functionalities, as well as the SCO's role in this process.

FI$Cal Background. FI$Cal is one of the most important information technology (IT) projects for the state, and is being undertaken to integrate and re-engineer the statewide business processes related to budgeting, accounting, procurement and cash management. The goal of the project is to provide a unified and consistent financial system the will be used by virtually all state entities. Last year, the Legislature approved a permanent administrative structure for FI$Cal, establishing it as a stand-alone department.

FI$Cal is an ambitious and complex project, and in reflection of this, the project has undergone numerous changes in scope, schedule and cost. These various changes have been incorporated and documented in special project reports (SPRs) with the project currently working under the rubric of SPR 6, approved last year. Under the previous SPR 5, a series of waves were scheduled to roll in, with each wave consisting of additional departments and system functionality. The Legislative Analyst's Office (LAO) notes that there were some 'early successes' in this process, but later some difficulties and delays occurred. Overall, the LAO notes that project changes to date have led to schedule extensions and cost increases, but have also led to modifications that have mitigated project risk and made project objectives potentially more attainable.

Under the changes in SPR 6, the project transitioned from implementing 'waves' to more independent 'releases', allowing departments that are not prepared to implement on the scheduled date to come on line at a later time. The amended approach established new programs to assist departments in transitioning to the project, revised the implementation schedule for remaining releases, and allowed more time for knowledge transfer to the state. These changes resulted in increased costs for the project and a two-year delay in the overall timeline for the project. The two-year time extension pushed out project completion from July 2017 to July 2019. The costs also expanded significantly to $910 million, representing an increase of $237 million from those in SPR 5, dated January 2014. The currently timeline is shown in the department's graphic below.

FI$Cal
Project Schedule
July 2016



Source: Department of FI$Cal

State Auditor's and LAO Concerns. The State Auditor's most recent letter report of January 2017, indicates that the project continues to experience some delays, despite the two year time extension provided in SPR 6. For example, according to Department of Technology, which is the providing independent project oversight (IPO), a key component of the project – testing of the activity based management system (ABMS) – was taking 10 weeks longer than planned as of October 2016. In addition, the IPO indicated that implementation of functionality for both the SCO and the State Treasurer's Office were delayed, along with a five week delay in the release for other departments.

While the delays represent a continuing concern, it is unclear whether these are the responsibility of FI$Cal or the participating departments, or both. We should note that many of the delays are apparently due to failures on the part of departments to adequately staff the conversion to the new system. Specifically, the most recent letter report from the auditor identifies as a significant driver of the most recent SPR, the unanticipated need to provide continuing support from FI$Cal to departments in year-end reconciliation and budget close-out. More recently, in some cases, it appears that delays or time extensions have been necessitated by departments unwilling or unable to make a decision on how to proceed at a certain decision point. The auditor's letter notes that if delays continue and compound, the project may need to extend the schedule again, which could increase the costs by an additional $100 million. Alternatively, not extending the schedule could jeopardize the functionality and quality of the final product. The auditor 'remains concerned' regarding the number and size of the departments that have yet to implement FI$Cal, as well as the compressed time frame proposed for implementation. Given the challenges that were presented with smaller, fewer and less complex departments, the auditor notes potential issues with the project's ability to implement the next releases (scheduled for July 2017 and July 2018), which consist of major state departments.

Last year in conjunction with FI$Cal budget proposals, the LAO weighed in on the overall status of the project. At that time, it expressed the view that the Governor's budget proposal to implement the changes proposed in SPR 6 was a reasonable plan to implement the remaining functions and departments in FI$Cal, and recommended approval of this component of the Governor's budget proposal. However, LAO also noted that the FI$Cal Project involves the development of an extremely ambitious and complex IT system and significant work remains before the system is fully implemented. Given the scope of the remaining work and signals from oversight entities that some project activities continue to track behind schedule, LAO thinks a future SPR is likely that would further extend the project schedule and increase costs.

Staff Comment. Of particular concern to the subcommittee is the status regarding SCO's role in the FI$Cal project and the ability of departments to provide data and information to the SCO in order to meet the current timelines. SCO indicates that it has reservations regarding the timeline, but is continuing to work towards the implementation based on the current schedule. However, as an example of the difficulties encountered, it notes that only 14 of the 58 FI$Cal agencies have closed their books and reconciled through January 2017. In addition, only three of the 52 FI$Cal state agencies filed their year-end reports by the established deadlines.

Concern regarding the FI$Cal timetable, and particularly the integration of various departments, has been raised by both the LAO and the BSA. The project took the cautious approach last year and extended the timeframe for the project and requested additional resources. Staff's view is that this cautious approach continues to be the appropriate one, rather than adhere to a faster implementation schedule if such a schedule is unrealistic and unrealizable. The SCO should update the subcommittee regarding the status of its internal efforts to implement different components of FI$Cal and comment on the status and ability of other departments to complete their own FI$Cal-related reporting components in a timely fashion.

Staff Recommendation: Information and oversight item.

Issue 2: FI$Cal Implementation of Control Functions (BCP)

Governor's Proposal. The budget includes a request from the SCO for $1.5 million (General Fund) and 13 positions to transition the state's Accounting Book of Record (ABR) from the SCO legacy system to the Financial Information System for California (FI$Cal) system and provide support to the FI$Cal departments.

Background. The activities associated with establishing and maintaining the ABR are of significant importance to the state and deeply integrated with departments. The conversion to FI$Cal from the legacy system will allow the SCO and departments to operate on the same basis

– modified accrual basis of accounting – as opposed to the different systems used at the current time. As part of this process, the SCO will have access to encumbrances and accrual and other non-cash ‘obligations.’ The process will facilitate and streamline the documentation necessary for the production of the Budgetary Legal Basis Annual Report (BLBAR) and the Comprehensive Annual Financial Report (CAFR).

The responsibilities associated with this component of the FI$Cal project are essential elements of implementing and maintaining financial management and control functions in the new system. The functions associated with this effort include mapping business processes to FI$Cal, training staff in FI$Cal processes, cash management, journal transaction posting, budget and appropriation control, bond management recording, loan recording, statewide financial reporting for annual BLBAR and CAFR reports, and producing the monthly statement of receipts and disbursements.

Staff Comment. Staff has no significant concerns with the proposal; however, the overall timeline associated with the SCO implementation of FI$Cal remains a concern. If the project timeline is extended, approval of the positions could well be premature. The department should comment in relation to the overall status of FI$Cal implementation.

Staff Recommendation. Hold open.

Vote:

Issue 3: Vendor Management Workload (BCP)

Governor’s Proposal. The budget includes an SCO request for $1.2 million ($674,000 General Fund) in 2017-18, $1.1 million ($655, 000 General Fund) in 2018-19, and $488,000 ($278,000 General Fund) in 2019-20 and ongoing. The resources will support 12 positions, seven limited term for the initial two years, and five permanent. The resources and positions will be used to implement the Vendor Management File (VMF), a component of FI$Cal.

Background. Prior to FI$Cal, state agencies, boards, commissions and other state entities independently maintained their own vendor files. The implementation of the VMF began in July 2014, with the first FI$Cal ‘wave’ (now termed release). Releases will continue through 2018, based on the current schedule. The VMF is an important part of FI$Cal, and used by departments for procurement of state assets and resources, by the SCO for mandated reporting contractor payments, as well as for a variety of other activities. While the SCO has managed the VMF using existing resources of five positions, it expects the future workload to exceed existing capabilities, especially as additional waves of departments come on line. Total departments will expand from the current 63 to 151. In terms of expected workload, this is expected to grow over the next couple of years due to development, implementation and maintenance of new functionality for vendors and departments. In terms of VMF requests, these are expected to total 23,043 in 2016-17, 26,131 in 2017-18, and 31,044 in 2018-19, before dropping to a stable 14,600 in 2019-20 and beyond. The limited-term funding will be sufficient to provide resources during the initial phase, with five positions for ongoing workload.

Staff Comment: Staff has no significant concerns with the proposal; however, the timeline associated with the SCO implementation of FI$Cal remains a concern. If the project timeline is extended, approval of the positions could well be premature. In addition, even if the current timeline remains unaltered, there is uncertainty regarding the future workload, and it would seem prudent to approve 12 positions on a temporary basis, and then revisit once the permanent workload becomes clearer. The necessary positions could be converted to permanent as a future budget change. The department should comment in relation to the overall status of FI$Cal implementation.

Staff Recommendation. Hold open.

Vote:

Issue 4: California State Payroll System (BCP)

Governor's Proposal. The Governor's proposal regarding this item includes a SCO budget request of $3 million in one-year, limited-term funding ($1.7 million General Fund) to support 11 positions in 2017-18 to perform business process analysis for human resources management and payroll processing practices, document solution requirements, and continue work on the alternatives analysis. The request includes $1.8 million for consulting services related to establishing a new payroll system for the state, the California State Payroll System (CSPS). The position authority includes two positions for the Division of Accounting and Reporting, eight positions for Personnel Payroll Service Division, and two positions for the Information System Division.

Background. The failure of the 21st Century Project has been amply documented. The most recent developments include the settlement of the lawsuit with the vendor (SAP) in June 2016, and the subsequent payment by the vendor to the state of $59 million. The department submitted a Post-Implementation Evaluation Report (PIER) to the Department of Technology (CDT) in November 2016, which compared the project objectives to actual outcomes, documented the failures and success experienced on the project, and described the corrective actions the SCO will take to improve the chances of future success. The submission of the PIER represents the official end of the 21st Century Project.

The SCO received funding of $2.4 million in 2016-17 and $2.8 million in 2017-18 to support eight positions to complete the project assessments, convey the results of the project management assessment in a post implementation evaluation report, perform business process re-engineering of human resource management and payroll processing practices to refine the scope of the future payroll project and complete CDT project approval. The Legislature also adopted Supplemental Reporting Language (SRL) directing the department to provide detail on future assessment activities; the department has complied with this requirement in the context of the current budget request.

The additional resources requested in this proposal will augment the existing positions and continue the extensive effort of examining these business practices and working with SCO divisions, Department of Human Resources (CalHR), FI$Cal, Department of Finance, and departmental human resources offices to determine where the state can conform to industry standards for payroll processing. The current project team is just completed close-out activities, and is refocusing its efforts on working with internal groups to identify potential areas of policy change to reflect best practices for initial business process re-engineering opportunities. This will assist in refining the scope of the future CSPS project. The SCO anticipates the that it will complete the new information technology approval process – known as the Project Approval Lifecycle (PAL) – in December of 2019, and anticipates initiating project work in 2020-21.

Legislative Analyst's Office Comment. The Legislative Analyst's Office (LAO) notes that it has no concerns with the Governor's budget proposal, but indicates that the project will ultimately be expensive and carry a great deal of risk and many challenges. Given this, it points out that the project alternatives (noted in the LAO report and the SRL submitted by the department) should be given careful consideration. It also recommends that since the completion of the PAL process does not exactly coincide with the budget timelines, the department report to the Legislature on its preferred project solution (PAL Stage 2) pursuant to the PAL process, before any additional funding is approved. According to the current schedule, this should occur in August 2018, when the project moves from PAL Stage 2 to PAL Stage 3.

Staff Comment. Staff has no concerns with the funding of the beginning phases of the renewed attempt to design a statewide payroll system. The renewed approach is being undertaken pursuit to the state's revised IT procurement and implementation process. The PAL process focuses on a more rigorous approach to planning in order to minimize risk and cost exposure. Given the complexity of the payroll system effort, the approach embodied in PAL is appropriate, although it likely extends the timeframe for implementation and may require more upfront budget resources. The PAL process will be examined more fully at a later hearing in connection with the Department of Technology.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 5: California Automated Travel Expense Reimbursement System (BCP)

Governor's Proposal: The budget includes an SCO request for $1.3 million ($642,000 General Fund) and $642,000 ($390,000 General Fund) in 2018-19 and 2019-20 The resources will provide support for three positions for fiscal year 2017-18 to continue the required analysis and documentation for replacing the California Automated Travel Expense Reimbursement System (CalATERS) vendor and reimbursement system, maintain the current system without disruption to service through 2019-20, and obtain final approval for the replacement program. Expenses not associated with personnel are for external consulting and professional services.

Background. The SCO's personnel and payroll services division is responsible for the operation and maintenance of the CalATERS, which allows state employees to electronically submit claims, and for those claims to follow an automated review, approval, and payment process. The

SCO has been utilizing CalATERS, which was designed by International Business Machines (IBM), for claims processing since 2000. Currently, there are 98 agencies, with 107,488 individual customers, that utilize the CalATERS platform. In May 2014, IBM notified the SCO that it will discontinue support for the CalATERS platform, effective March 31, 2016, which coincides with the completion of the current contract. IBM informed SCO that they could provide the state with continued support, but at an additional cost. The state has contracted with IBM for these services through 2020, when the new system is expected to be completed. The new system qualifies as an IT project, requiring the SCO to proceed according to the PAL process. Stage 1-Business Analysis, has been completed. Stage 2-Alternative Analysis, is in progress. State 3-Solution Development, is expected to be completed in early 2017, followed by Stage 4-Project Readiness and Approval.

Staff Comment. Given the limited alternatives that are currently available it would be appropriate to approve the requested resources in order for the SCO to a replacement system. Stage 2 of the PAL was expected to be completed in February of 2017, but has been slightly delayed according to the SCO, and should commence in the next month. SCO should describe the next steps, and what the implications are should it begin to run behind in the scheduling. The SCO should describe its contingency plans for the project.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 6: Unclaimed Property Securities Accounting (BCP)

Governor's Proposal. The SCO requests $2.9 million (Unclaimed Property Fund) in 2017-18, and ongoing, and 23.1 permanent (continuing) positions to manage and maintain the security portfolio, pay security claims, and sell securities within the allotted timeframe. The resources will be used for managing the stock and mutual fund corporate action workload; ensure compliance with the UPL by selling securities in a timely fashion; reconcile and post dividends, interest, proceeds and any other income; process security claims in a timely manner to reduce litigation; manage and maintain the securities portfolio; and, reconcile the portfolio and integrate internal controls. Most of the positions (15) will be assigned to securities issue analysis, reconciliation, and research and property recordation. The remaining positions are for accounting and support activities.

Background. The California UPL was enacted to assure that property is returned to its rightful owners or their heirs. This law gives the state an opportunity to return the property and provides California citizens with a single source, the SCO, to check for unclaimed property that may be reported by holders from around the nation. By law, holders of unclaimed property (such as banks) must report and remit unclaimed property to the SCO after a specified period of time.

Under the program, holders are required to proceed through a series of steps before remitting property to the SCO. A holder notice report submitted by the holder is used by the SCO to send out pre-escheat notices to rightful owners or their heirs, advising owners to contact holders directly to retrieve the reported property, giving the owners the opportunity to reestablish contact with the holders, or have their property sent directly to them. After filing a holder notice report, holders are required to provide the SCO with a holder remit report containing the information on any remaining properties that were not reclaimed by the rightful owners or their heirs. At the time the holder remit report is filed, holders are required to remit the property to the SCO.

The current proposal converts the temporary positions continued in the 2014-15 budget into permanent ones, with a focus on working down the existing backlog of property, addressing current workload, and providing managerial oversight. The division also received an augmentation in 2016-17 for the purposes of streamlining procedures, increasing outreach and detecting and preventing fraud.

Legislative Analyst's Office Comment. The LAO notes that without a change in the program, additional workload will continue and require additional funds. LAO indicates that the workload of managing securities prior to sale is substantial, and notes that the process could be accelerated (reducing the workload) if state law were changed to allow property to be sold and converted to cash more quickly. Currently, the SCO must wait at least 18 months after receiving the report from the holder before converting any property into cash.

Staff Comment. The continued commitment of resources makes sense given the continued level of activity associated with unclaimed property. The vacancy rate of 23 percent is somewhat high, and could be reduced by converting the limited-term positions (where most of the vacancies are) to permanent. However, the division has expanded rapidly over the last few years, from 15.1 authorized positions in 2011-12 to 35.5 positions in 2015-16 (mostly limited-term). This has resulted in security sales proceeds increasing from $64.6 million to $85.9 million, but other portfolio measures have expanded significantly as well, indicating an increasing workload. Given these factors, the division should be prepared to discuss the overall plan for its activities and what the overall level of staffing should be to address a steady workload growth. Staff views the 18 month waiting period before selling securities is a reasonable policy, given the gravity of the escheat process. Nevertheless, LAO comments regarding increasing workload are well-founded and the department should explore other means of achieving efficiencies.

Staff Recommendation: Hold open.

Vote:

STATE BUILDING PROJECT

Issue 1: State Office Infrastructure Plan (TBL)

Governor's Proposal. The budget includes a proposal to eliminate the $300 million deposit to the State Building Infrastructure Fund (SPIF) that was planned for 2017-18, through trailer bill language. The funding was to be used to partially fund new state buildings, consisting of the O Street Building, Resources Building and Capitol Annex. As a result of the reduction and other factors, the Administration has also notified the Joint Legislative Budget Committee (JLBC) regarding the building projects, which could have an impact on the financing plans.

Background. The 2016-17 budget established the SPIF and provided $1.3 billion from the General Fund to the SPIF over two years. The $1.3 billion is intended to provide pay-as-you-go funding to replace three state buildings the Food and Agriculture Annex (O Street Building), Natural Resources Building, and State Capitol Annex. The fund is continuously appropriated for the renovation and construction of state buildings. The statutory language governing the fund allows the Administration to establish and move forward with projects funded by the SPIF without having to receive legislative approval through the traditional state budget process, as is typically required for capital outlay projects. Instead, the language requires the Administration to provide certain notifications and quarterly reports to the Legislature related to SPIF-funded projects. Since the passage of the 2016-17 budget, the Administration has been moving forward with the O Street Building and the new Natural Resources Building, including providing a notification of its intent to spend a total of $14.9 million from the fund on the development of the cost, scope, and delivery method for these buildings in a notice to the JLBC in February 2017.

Legislative Analyst's Office Comment. The Legislative Analyst's Office (LAO) notes that it is highly unlikely that the $1 billion provided in 2016-17 will be sufficient to fund all three projects that were initially proposed. While the Administration has yet to officially establish the cost of the three initial projects, its preliminary estimates place their cost at about $1.4 billion ($225 million for the O Street Building, $600 million for the new Resources Building, and $580 million for the State Capitol Annex). The Administration has not yet indicated how it plans to fully fund these projects, but should have additional information this month. LAO has expressed concern regarding the square footage costs of the buildings, especially compared to other comparable structures In addition, LAO has raised questions about the zero net energy component of the project, with respect to both the additional cost and its cost-effectiveness.

LAO indicates that the Administration has significant discretion to determine how to allocate funds among projects; it could choose to proceed with a less ambitious version of its original plan in order to stay within the remaining $1 billion in the SPIF. In this case, the Administration would likely not need to return to the Legislature for additional approvals. Instead, it would report to the Legislature about these changes through the JLBC (for the O Street Building and Resources Building) and Joint Committee on Rules (for the Capitol Annex). Alternatively, the Administration could return to the Legislature to seek additional funding to complete all three initial projects as originally envisioned. At this point, the Administration's plan for proceeding is unclear.

Staff Comment. The Administration state project plans continue to be somewhat in flux. In particular, a major issue is the Administration's priorities in the using the existing funds in the SPIF, or alternative means of financing should these resources prove insufficient. Given that planning is moving forward for the O Street and Natural resources buildings, the question arises where each of the buildings stand in the list of priorities. Given the uncertainty that remains regarding project plans, no action should be taken on the Administration's proposal at this time. DOF and the Department of General Services (DGS) should report at the hearing regarding its plans for proceeding.

Staff Recommendation. Hold open.

Vote:

1701 DEPARTMENT OF BUSINESS OVERSIGHT

Department Overview. The Department of Business Oversight (DBO) is housed under the Business, Consumer Services and Housing Agency, and is responsible for overseeing financial service providers, prompting appropriate business practices, enhancing consumer awareness, and protecting consumers by preventing marketplace risks, fraud and abuse. The DBO supervises the operations of state-licensed financial institutions, including banks, credit unions and money transmitters. Additionally, the DBO licenses and regulates a variety of financial service providers, including securities brokers and dealers, investment advisers, payday lenders and other consumer finance lenders.

Budget Overview. The department receives all of its resources through special funds. Revenue to the special funds is generated by fees imposed on the regulated entities. The most significant of these funds are the State Corporation Fund (56 percent of total) and the Financial Institutions Fund (32 percent of total). The department received a significant increase in resources and staffing last year, distributed across several programs. Program expenditures and position history are displayed in the tables below.

Department of Business Oversight
Program Expenditure
(dollars in thousands)

Program	Actual 2015-16	Estimated 2016-17	Proposed 2017-18
Investment Program	$24,572	$26,933	$28,623
Lender-Fiduciary Program	21,429	22,757	22,685
Bank and Trust Supervision and Licensing	23,161	23,909	25,973
Money Transmission	3,577	4,010	4,012
Business and Industrial Development Supervision	26	31	0
Savings and Loan	0	80	0
Industrial Banks	661	689	0
Local Agency Security Administration	404	516	517
Credit Unions	8,287	10,096	10,097
Net Administration	0	0	0
Total Expenditures	**$82,117**	**$89,021**	**$91,907**

Department of Business Oversight
Position Authority
(actual positions)

Program	Actual 2015-16	Estimated 2016-17	Proposed 2017-18
Investment Program	130.1	134.6	173.0
Lender-Fiduciary Program	113.3	115.2	138.5
Bank and Trust Supervision and Licensing	131.6	134.9	170.4
Money Transmission	26.6	28.0	32.1
Business and Industrial Development Supervision	0	0	0
Savings and Loan	0	0	0
Industrial Banks	0	7.4	0
Local Agency Security Administration	1.1	1.3	1.8
Credit Unions	50.3	59.5	69.7
Net Administration	90.3	90.6	0
Total Positions	**543.3**	**571.5**	**585.5**

Issue 1: Broker-Dealer and Investment Advisor Program Examinations (BCP)

Governor's Proposal. The Governor proposes $1.7 million (special funds) and 11 permanent positions in 2017-18 and $3 million and 20 permanent positions in 2018-19 and ongoing, to enable the department's broker-dealer and investment advisor activities to expand the examination cycle administered by the DBO. The resources will allow the department to extend its current examinations to greater number of licensed entities and enforce regulatory requirements. The positions requested upon full implementation in 2018-19 are for 15 corporation examiners, three associate governmental program analysts and two administrative staff.

Background. The Broker-Dealer and Investment Adviser (BDIA) program's primary functions are to license and regulate broker-dealers, broker-dealer agents, investment advisers, and investment adviser representatives, pursuant to the Corporate Securities Law of 1968. Regulatory oversight is designed to ensure the investors are protected from unethical and fraudulent activities and California's financial market is secure, fair, and transparent. Regulatory oversight is achieved by performing detailed licensing reviews and regulatory examinations of the licensee population.

In enacting SB 538 (Hill), Chapter 335, Statutes of 2013, the Legislature found that the department lacked adequate resources for a comprehensive regulatory program. The program had a 28-year examination cycle for a routine regulatory examination, compared to four-year cycle is used in approximately 60 percent of all states and by the Financial Industry Regulatory Authority (FINRA). SB 538 authorized new fees to be raised with the intention that the department use the revenue to perform regular, periodic examinations of broker-dealer agency and investment adviser representatives at least once every four years.

In response to the global financial crisis, as well as numerous events involving financial fraud and moral turpitude, Congress passed, and the President signed, the 2010 Financial Regulatory Reform Act, commonly referred to as "Dodd-Frank," which was designed promote financial stability in the United States by improving accountability and transparency in the financial system, protect taxpayers by ending bailouts, and protect consumers from improper financial service practices. Prior to the passage of Dodd-Frank, the department was responsible for regulatory oversight of investment advisory firms with less than $25 million in assets under management. The passage of Dodd-Frank expanded the department's responsibility to include regulatory oversight over investment advisory firms with assets under management up to $100 million. While Dodd-Frank only requires regulatory oversight of investment adviser firms, the department's licensees include investment adviser representatives, broker-dealer firms, and their broker-dealer agents, all of which are subject to regulatory examinations.

In response to the new requirements of Dodd-Frank and SB 538, the department has received regular increases in resources over recent years. The increases have not been sufficient to reduce the examination cycle to four years, but rather, in order to gradually work towards that goal. In the short-term, it is not feasible for the department to absorb and manage (and fiscally support) the necessary personnel to reach the four cycle, but it is likely that future budget requests will continue at a modest and manageable rate of about 16 percent per year. The positions requested will support increased examinations, increase protection to investors, and discourage illegal and fraudulent activity. Additional activities to ensure adequate regulation will occur through both routine (based on a regular examination cycle) and non-routine (based on referrals or investor complaints) examinations and necessary enforcement activities.

Staff Comment. The department will need the resources requested in this proposal, as well as resources in the future, in order to significantly work toward the goal of a four year examination cycle. The increment increase approach to staffing for these activities seems prudent at this time. The department estimates that eventually it will require approximately 300 examiners to reach the cycle goal; with the approval of this proposal it would reach 62. The additional required resources in the future would depend on changes in examinations standards, reporting technologies and any achievable efficiencies. The department dramatically increased its examinations between 2014-15 and 2015-16, from 72 to 269; however, it still is examining only about one percent of licensees. The subcommittee may be concerned about the implementation over the long term of the preferred four-year examination cycle, and whether more efficient examination procedures can be instituted.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 2: Student Loan Servicing Act (BCP)

Governor's Proposal. The DBO requests $1.2 million (special funds) and three permanent positions in 2017-18, and $819,000 (special funds) and five permanent positions in 2018-19 and ongoing to develop and start-up the Student Loan Servicing Office required by Assembly Bill AB 2251, This request will be funded by the Financial Institutions Fund, and beginning 2018-19, costs will be funded by fees and assessments on licensees. The positions include in 2017-18 one attorney, one financial institutions manager and one senior programmer analysts. Two senior financial institutions examiners would be added in 2018-19.

Background. AB 2251 (Stone), Chapter 824, Statutes of 2016 added the "Student Loan Servicing Act," to the California Financial Code, which requires the department to create a new Student Loan Servicing Office to license and regulate student loan servicers and to enforce any violation of the Student Loan Servicing Act. The department is also required to examine the affairs of each licensee at least once every 36 months for compliance with the Student Loan Servicing Act, and if deemed necessary, conduct such examinations frequently.

Under the legislation, the new Student Loan Servicing Office (SLSO) will become operative on July 1, 2018, but actions may be taken on and after January 1, 2017, to prepare for the July 1, 2018 operative date. The measure is intended to provide state standards to ensure consistent, fair, quality student loan servicing, and expands the duties and authority to include licensure, regulation, supervision and enforcement of student loan servicers. AB 2251 authorizes SLSO to enforce the law through administrative orders, suspension or revocation of licenses and civil money penalties, and requires servicers to adhere to specified borrower protections when servicing student loans.

The bill prohibits a person from acting as a student loan servicer without a license, unless exempt student loan servicers are commonly different than the original lender or loan holder. Lenders contract with servicing companies to manage student loans. Servicers manage borrowers' accounts, process monthly payments, and communicate directly with borrowers. Borrowers must contact student loan servicers to enroll in alternative repayment plans, obtain deferments or forbearances, or process loan forgiveness benefits for which the borrower has qualified. A borrower typically has no control over which company services his or her loan. Servicers must comply with applicable consumer financial laws and US Department of Education contractual requirements.

Staff Comment. Despite the volume of student loan debt and servicing, there are no consistent, market-wide federal standards for student loan servicing. AB 2251 requires the department to license and regulate student loan servicers and to enforce any violation of the Student Loan Servicing Act. The department is also required to examine the affairs of each licensee at least once every 36 months for compliance with the Student Loan Servicing Act. If and when SLSO deems necessary and appropriate, examinations may occur more frequently.

Although some of the activities identified in the BCP are similar to existing activities of the department, there are also some new activities that fall outside the parameters of the department's existing workload. Given the start-up nature of the SLSO and the new activities, staff is favorably disposed to a slow and steady ramp-up of activities. To a certain extent, this has been proposed with the three positions increasing to five after one year. However, staff recommends somewhat more time and deliberation be afforded and recommends that the expansion in year two be resubmitted next year and evaluated at that time.

Staff Recommendation. Approve funding and permanent positions requested for 2017-18. Do not approve proposal for additional positions in 2018-19.

Vote:

0509 GOVERNOR'S OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

Department Overview. The Governor's Office of Business and Economic Development (GO-Biz) provides a single point of contact for economic development, business assistance and job creation efforts. GO-Biz works with companies and organizations across the nation to market the benefits of doing business in California, recruit new businesses, retain businesses, and support private sector job growth. GO-Biz serves as the Governor's lead entity for economic strategy and the marketing of California on issues relating to business development, private sector investment, economic growth, export promotion, permit assistance, innovation and entrepreneurship. GO-Biz consists of the following programs:

- **GO-Biz** serves as the Governor's lead entity for economic strategy and the marketing of California on issues relating to business development, private sector investment, and economic growth, and export promotion. This program makes recommendations to the Governor and the Legislature regarding policies, programs, and actions for statewide economic goals.

- **California Business Investment Services** serves employers, corporate executives, business owners, and site location consultants which are considering California for business investment and expansion. This program works with local, state, and federal partners in an effort to attract, retain, and expand businesses. The Innovation Hub (iHub) initiative is an effort to improve the state's national and global competitiveness by stimulating partnerships, economic development, and job creation around specific research clusters.

- **Office of the Small Business Advocate (OSBA)** serves as the principal advocate in the state on behalf of small businesses, including regarding legislation and administrative regulations that affect small business. The OSBA is responsible for disseminating information about programs and services provided by the state that benefit small businesses, and how small businesses can participate in these programs and services. The OSBA responds to issues from small businesses concerning the actions of state agencies, state laws and regulations adversely affecting those businesses. The OSBA maintains and distributes an annual list of persons serving as small business ombudsmen throughout state government.

- **California Film Commission (CFC)** provides significant financial assistance through its publically-funded tax credit program. The purpose of the CFC is to retain and increase motion picture production in the state. The CFC supports productions by issuing film permits for all state properties, administering the film and TV tax credit program, maintaining a location library, and offering production assistance on a wide variety of issues. CFC also works with cities and counties with the goal of creating 'film friendly" policies that are consistent state wide.

- **California Tourism Market Act** provides for the marketing of California through an assessment of businesses that benefit from travel and tourism. The objective of the Tourism Assessment Program is to identify potentially assessable businesses, assist companies with determining the appropriate amount of their self-assessment, and collect the fee.

- **California Infrastructure and Economic Development Bank (IBank)** was created to finance public infrastructure and private development that promotes economic growth. IBank has a broad authority to issue tax-exempt and taxable revenue bonds, provide financing to public agencies, provide credit enhancements, acquire or lease facilities, and leverage state and federal funds. IBank's current programs include the infrastructure state revolving fund, 501(c)(3) tax-exempt and taxable revenue bond program, industrial development revenue bond program, exempt facility revenue bond program, governmental bond program and the Clean Energy Finance Center (CEFC) and the Statewide Energy Efficiency Program under the CEFC.

- **Small Business Loan Guarantee Program (SBLGP)** promotes local economic development by providing guarantees for loans issued to small businesses from financial institutions, typically banks, which otherwise would not approve such term loans or lines of credit. The loan guarantee serves as a credit enhancement and an incentive for financial institutions to make loans to small businesses that otherwise would not be eligible for such financing.

- **California Welcome Centers** are visitor information centers that are accessible to and recognizable by tourists, and are designed to encourage tourism in California and provide benefits to the state economy. The objective of the California Welcome Center Program is to determine the locality of underserved travelers, designate a welcome center, and establish operating standards across the network.

Budget Overview. The department has expanded modestly over the recent past, due both to program expansions (such as the California Competes program discussed below) and through the inclusion of other existing program (such as the IBank). The department’s budgets (and positions) for the prior, current and budget years are shown in the tables below.

Governor’s Office of Business and Economic Development
Program Expenditures
(dollars in thousands)

Program	**Actual 2015-16**	**Estimated 2016-17**	**Proposed 2017-18**
Go-Biz	$4,626	$4,991	$6,478
California Business Investment Services	1,831	1,852	1,752
Office of the Small Business Advocate	2,480	1,792	292
Infrastructure, Finance and Economic Development	17,013	18,234	18,017
Total Expenditures	**$25,950**	**$26,869**	**$26,539**

Governor's Office of Business and Economic Development
Position Authority
(actual positions)

Program	Actual 2015-16	Estimated 2016-17	Proposed 2017-18
Go-Biz	25.7	22.0	33.6
California Business Investment Services	11.7	9.0	9.0
Office of the Small Business Advocate	2.8	6.0	6.0
Infrastructure, Finance and Economic Development	42.9	45.4	45.4
Total Positions	**83.1**	**82.4**	**94.0**

Issue 1: California Competes Tax Credit Program – Oversight

Presenters: **Governor's Office of Business and Economic Development**
Legislative Analyst's Office

Background. The California Competes Tax Credit (CCTC) is a targeted tax credit program administered by GO-Biz and the Franchise Tax Board (FTB). In its administration of the CCTC, GO-Biz is responsible for a relatively new program that involves a sizeable commitment of state funds, in the form of revenues foregone, over several years. The funds 'flow' is based on negotiated contracts with private companies. The purpose of the CCTC is to attract, expand, and retain businesses in California. Business entities that apply for the credit are evaluated on the basis of number of employees; jobs created or retained; location of the company in the state; and magnitude of new investment. The tax credit packages are negotiated between the business and the Administration (GO-Biz) and then voted on by the GO-Biz committee, consisting of the director of GO-Biz, the director of the Department of Finance, the State Treasurer, and one appointee each from the Senate and the Assembly.

Taxpayers may receive a maximum of 20 percent of the total amount of credits available for a particular year. In addition, 25 percent of the available credits must be provided to small businesses (companies with gross receipts of $2 million or less). The amount of credits that is allocated is up to $30 million in 2013-14, $150 million in 2014-15 and $200 million for years 2015-16 through 2017-18. These amounts may be reduced in order to ensure the total amount of tax reductions resulting from the program and two other tax preference programs (sales and use tax exemption for certain capital investments and new hiring tax credit) is no greater than $750 million in a fiscal year.

The implementation of the program is defined based on the application process, evaluation process, negotiation process and committee process, as described below:

- **Application Process.** During this stage of the program, CCTC staff engages in in one-on-one contact with applicants and their designated representatives by providing assistance with computing and entering the required information. CCTC staff also confirms eligibility, explains regulations, recommends other resources and provides information about deadlines.

- **Evaluation Process.** The evaluation process is two-phased. The initial phase calculates the cost-benefit ratio from the state's perspective, based on the credit request, aggregate employee compensation, and aggregate investment. The most completive proposals move to the second evaluative phase. The second phase involves looking at specific selection criteria, including number of jobs, amount of investment, extent of unemployment and poverty in the project area, and opportunity for additional growth.[1]

- **Negotiation Process.** Contract negotiations require a significant amount of analysis and discussion between CCTC staff and the applicant. The intent is to reach specific agreements that create definitive milestones, explain agreement provisions, and tailor language specific to the project.

- **Committee Process.** At this stage, CCTC staff briefs committee members and presents the negotiated agreements for approval at a public hearing. It also informs the FTB of the approved items and conditions of the agreements and posts information on the awards to the website.

Staff Comment. While programs similar to the CCTC are used in other states with varying degrees of success, this approach to business development and assistance is not one that California has used in the past. Given this new approach to awarding tax credits, it is important that the Legislature be vigilant in its oversight of the program, to ensure that it is implemented in as effective a manner possible. The committee may wish to have the GO-Biz provide an update on the development and implementation of the program.

One of the underlying problems associated with traditional open-ended tax incentives is that the majority of the tax benefit goes to businesses that would have engaged in the desired behavior irrespective of the incentive program. Put another way, only businesses operating 'on the margin' would engage in the desired behavior ***because*** of the incentive. The result is a significant loss in revenue with little or no associated impact on economic activity. The GO-Biz CCTC program attempts to eliminate or minimize this loss by targeting its incentives at companies on the margin; its ability to do this, however, is open to question (as it would be for any outside entity attempting to measure internal business investment decisions).

As staff indicated last year, one way to measure success in this regard would be to examine companies that met the cost-benefit threshold (initial evaluation phase) and were among the finalists in selected criteria (second evaluation phase), but for one reason or another, were not

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[1] The specific criteria are: a) the number of jobs created or retained in the state; b) the compensation paid to employees, including wages and fringe benefits; c) the amount of investment in the state; d) the extent of employment or poverty where the business is located; e) the incentives available to the business in the state; f) the incentives available to the business in other states; g) the duration of the business's proposed project and the duration the business commits to remain in this state; h) the overall economic impact; i) the strategic importance to the state, region or locality; the opportunity for growth and expansion; the extent to which the anticipated benefit to the state exceeds the projected benefit to the business from the tax credit.

selected as credit recipient. Unfortunately, there are sizeable information and data gaps that would have to be overcome in order to use this method. Other alternative approaches to measuring effectiveness – including econometric studies – could be used, as well. The Legislative Analyst's Office offer comments regarding the effectiveness of this type of program.

While a rigorous examination of the effectiveness of the program has not been conducted, GO-Biz has compiled a comprehensive panel of descriptive statistics on the 574 awards it has granted, including data regarding: business size, business activity type, and location of awardees. Go-Biz should present this data to the subcommittee. The committee may want to consider the following issues with respect to CCTC, and pose relevant questions to GO-Biz and LAO:

- The need for additional legislative oversight of the CCTC activities with respect to the location of activities and the types of industries approved for support, through a regular institutionalized process.

- The degree to which GO-Biz has been able to channel investment into economically-challenged areas of the state and into activities that provide opportunities to regional residents.

- The extent to which Go-Biz is capable of assessing whether jobs and investment would either not be retained or not created absent the existence of the credit, or whether an independent study should be required.

- The benefits of a comprehensive analysis – by LAO or other independent entity – of the effectiveness of the program to assess what the state has realized in exchange for its investments, prior to any extension of the program.

Staff Recommendation. Information and oversight item.

Issue 2: California Competes Tax Credit Program Staffing (BCP)

Presenters: **Governor's Office of Business and Economic Development**
Legislative Analyst's Office

Governor's Proposal. The CCTC unit of GO-Biz is seeking $1.2 million (General Fund) annually for three years for permanent funding for 10 positions to administer the program. The positions are in the final year of their three-year temporary funding. The staff resources are used for evaluating the applications for tax credits, negotiating an agreement with the business, structuring a written agreement between GO-Biz and the taxpayer, monitoring the achievement of milestones embodied in the agreement, as well as other activities designed to ensure the adherence to the program's goals.

Background. Tax credits awarded by the CCTC are available through 2017-18. CCTC indicates that the program may be extended, although that remains unknown at this point. In addition, monitoring the credit recipients will continue beyond the 2017-18 fiscal year. In this regard, GO-

Biz the credits span a five year term and credit milestones are to be maintained for three years after the end of a contract.

Staff Comment. Given the uncertain nature of the continued staffing requirements beyond 2017-18, staff does not recommend permanent funding at this time; however, the activities required by the program do call for continued temporary funding for the budget year. A continued program might warrant permanent funding of all positions; if the program is terminated, fewer resources would be required. In next year's budget, GO-Biz will have additional information regarding its resource needs, whether the program is continued or not.

Staff Recommendation. Approve one-time funding for existing unfunded positions for 2017-18.

Vote: